

Investigating the role of representation theory and Signaling theory on dividend Policy

Mehrdad Ghanbari^{1*}, Khadijeh Fathollahi², Maryam Ghorbanzadeh², Saber Zamani²

¹Department of Accounting , Kermanshah Branch, Islamic Azad University , Kermanshah, Iran, ² Department of Accounting , Ilam Branch , Islamic Azad University , Ilam, Iran.

Correspondence: Mehrdad Ghanbari, Department of Accounting, Kermanshah Branch, Islamic Azad University, Kermanshah, Iran.

ABSTRACT

The most important way of equipping and optimal allocation of capital in the country is in the stock exchange, and recognizing the market and its elements and relationships existing in it is regarded as one of the important factors in the development of capital market. One of the important elements of this market is investors. Investors have various goals in investing in companies' stocks. The different interests and incentives of investors about the distribution and maintenance of company profits lead to their different expectation about the dividend policy. The purpose of this article is to investigate the role of representation theory and signaling theory in dividend policy in companies accepted in the Tehran Stock Exchange from the years 2014 to 2016. This research is a practical in respect of goal, and in respect of researcher, it is among the descriptive-survey researches which is correlation type in respect of relationship between variables. Data analysis was done through Eviews software. The research results showed that there is a positive and significant relationship between representation theory and dividend ratio, and also showed that there is a significant relationship between signaling theory and dividend ratio.

Keywords: Representation theory, Signaling theory, dividend Policy.

Introduction

Cash dividend, due to its objectivity and tangibility, has special position for the company's stakeholders. This issue is also important for companies' managers, so a part of the power and attention of companies' managers focuses on a category that is referred to as the dividend policy. Because investors in the stock exchange have targeted gaining profits from company dividend and stock increase, and they are speculating in the hope of rising returns and wealth. In this regard, the adoption of appropriate divisional policies is one of the issues that can be effective on the interests and motivations of investors and directing market resources. The dividend policies are different in various

countries.

The lack of adequate theories that can explain the impact of dividend policy on the company's value have been emphasized by scientists such as Black (1976) and Berry and Myers (2003). These scholars believe that the dividend topic is one of the unresolved financial riddles, which requires a lot of researches. On the other hand, Di Angelo (2006) criticizes Black's opinion and states that the topic of dividend is not a riddle, but it is also rooted in Miller and Modigliani's incorrect belief (1961) and their unrelated dividend theory. Other scholars have also confirmed the theory of Black, and Berry and Myers and emphasized the mystery of dividend.

There are many viewpoints about dividend and its theories. This issue is of great importance for the managers and investors as well. Hence, a part of the ability and attention of corporate managers is focusing on what is referred to as dividend policies or procedure. It can be said that the change in the dividend policy of the company gives this message to the shareholders and investors that how the company's financial condition is. In this regard, this research has investigated the impact of representation theory and signaling theory on dividend policies.

Access this article online

Website: www.japer.in

E-ISSN: 2249-3379

How to cite this article: Mehrdad Ghanbari, Khadijeh Fathollahi, Maryam Ghorbanzadeh, Saber Zamani. Investigating the role of representation theory and Signaling theory on dividend Policy. J Adv Pharm Edu Res 2018;8(S2):156-159.

Source of Support: Nil, Conflict of Interest: None declared.

This is an open access journal, and articles are distributed under the terms of the Creative Commons Attribution-Non Commercial-ShareAlike 4.0 License, which allows others to remix, tweak, and build upon the work non-commercially, as long as appropriate credit is given and the new creations are licensed under the identical terms.

Hypothesis

1. There is a relationship between the representation theory and the dividend ratio.
2. There is a relationship between the signaling theory and the dividend ratio.

Research History

Chahkhoenejad (2014) in a research investigated the impact of representation theory and signaling theory on growth opportunities and dividend policies among banks and insurance companies accepted in the Tehran Stock Exchange. The overall research results show that there is a significant relationship between representation theory and signaling theory concerning the growth opportunities and dividend policies among banks and insurance companies accepted in the Tehran Stock Exchange ^[1].

Golestani et al. (2014) in a research investigated the relationship between effective tax rate and dividend policy and stock returns in companies accepted in the Tehran Stock Exchange. The findings showed that there is a positive and significant relationship between the effective tax rate and future stock returns. In other words, with the increase in the tax rate, the annual stock return will also increase ^[2].

Kharazmi et al. (2013) in a research investigated the impact of minority shareholders, representation costs, and the information asymmetry on the dividend policy of companies accepted in the Tehran Stock Exchange ^[3]. The results of this research show that there is a reverse and significant relationship between the ownership percentage of minority shareholders and dividend policy. Indeed, with the increase in the ownership ratio of minority shareholders, dividend of companies is reduced. Also, there is a reverse and significant relationship between representation costs and dividend policy. In fact, with the increase in representation costs, dividend ratio of companies has declined. Other findings of this research show that there is a reverse and significant relationship between information asymmetry and dividend policies.

Theoretical Bases

Representation Theory

A branch of dividend theories has investigated this issue from the point of view of the relationship of representation that has been created as a result of the separation of the interests of management and ownership in companies, and analyzes the conflict of interest existing between the parties of the relationship of representation, which the issue is so called "Representation". The fundamental assumption of this theory is the practice of individuals to maximize their personal interests, and since the utility function of individuals does not always necessarily coincide with each other, managers do not always necessarily seek the maximum benefits for the owners. In this connection, Jensen and Meckling (1976) stated that managers, through the control they have, can allocate company resources

to the activities that are solely in the direction of their own personal interests and do not necessarily result in the maximum benefits of owners ^[4]. According to the representation theory, owners having the awareness of this conflict of interest and the likelihood of the emergence of opportunistic behaviors from management, by using a series of corporate governance mechanisms seek to reduce the problems of representation and aligning the interests of managers and owners.

Jensen (1986) noted that managers to some extent have too much optimal motivation for the growth of company under their control, because increasing the size of company would increase the resources under their control and, along with the considerations of reputation, would increase their maneuverability too ^[5]. Therefore, it is expected that managers resist against the reduction of their controlled resources by using their authorities. The question now is whether the dividend can help solving the representation problems or not. According to the representation theory, one of the mechanisms for reducing the problems of representation between managers and owners is dividend.

Signaling Theory

This theory is the source of creating information asymmetry, and the existence of hidden information at the management's disposal, in a way that management, compared with external investors, has more information about growth opportunities, profitability, cash flows, and generally the company's future expected status, because managers spend most of their time on evaluating and analyzing company's products, market, strategies and opportunities to invest and have more timely information about current performance and therefore are able to predict the company's future status better.

The basis of the hypothesis of signaling is the existence of dividend information content and the reduction of information asymmetry through the underlying information in the unexpected changes in the cash profit, so that dividend, and especially its unexpected changes, is regarded as a sign that new news is sent to the market, that has not been made available to the market through other reliable sources of information.

Considering the great importance that market has given to the dividend and its changes, and regarding the strong reaction of market to reducing (or disconnecting) the cash flow (as bad news about the company's expected future), the companies by announcing the increase of dividend, express practically their confidence about the company's future profitability and future cash flows effectively.

Otakary (1979) claimed that managers transmit information about future expected profitability and cash flows to the market by dividend, in a way that the more the protection ability of existing projects from cash payments is, this will be signaled through distributing more profit as a good news to the market. Bravo et al. (2005) believe that one of the reasons that companies avoid to reduce (or disconnect) their dividend, can be signaling issue. They found out that companies even in the conditions of occurring liquidity problems, and if they are not permanent ones, are ready to perform measures such as

borrowing, disposing appropriate projects, or even selling assets, but they do not tolerate to reduce their cash profit, because they believe that a reduction in cash flow would be a sign of emerging long-term problems for the company and would result in a strong reaction of the market.

Research Method

This research is an applied study. Like most performed researches in the field of social sciences, including accounting, in this research, a semi-experimental research project has been used. To test the research hypothesis, the regression model and Excel and Eviews software have been used.

Statistical Population and Statistical Sample

The statistical population of research hypotheses test includes all companies accepted in the Tehran Stock Exchange. The time period of this section is from the year 2014 to 2016. With regard to the following criteria, the statistical sample of companies, 112 companies, were finally selected: the information required by the companies from 2014 to 2016 should be available; the end of the fiscal year of the companies should be March; they should not have fiscal year change during research time period, they should not be in the group of investment, financial intermediaries, banks and holding companies; the shares of companies should be traded during each one of the years of the research period.

Research Findings

Descriptive Statistics of Research Variables

Table 1: Descriptive Statistics Results

Research Variables	Number	Mean	Median	Minimum	Maximum	Standard Deviation
Representation Theory	112	0.010	0.032	-2.46	2.56	0.992
Signaling Theory	112	-0.038	-0.109	-3.31	2.222	0.971
Dividend	112	0.0005	0.044	2.55	4.41	1.04

As it is observed in table (1), descriptive statistics include mean, median, minimum, maximum, and standard deviation.

In this research, a multiple regression model has been used to test the hypotheses. The Chow test (F Limer) has been used to determine the type of estimation method (combined or panel) that results obtained from the above test are shown in table 2.

Table 2: Results of Chow and Hausman Tests

Test	Statistic	Significance Level	Result
F Limer test	2.4	0.000	Panel Data
Hausman test	21.10	0.000	Fixed Effects

As the results show, the significance level of the F Limer statistics is less than 5%; therefore, the desired method to estimate the model is a panel. Since the significance level of Hausman statistic is less than 5%, the desired model is of a fixed effect type.

First Hypothesis

The obtained results from investigating research hypotheses model are as follows:

H₀: There is a relationship between the representation theory and the dividend ratio.

H₁: There is no relationship between the representation theory and the dividend ratio.

Table 3: Estimation Results of First Hypothesis Model

Variable	Coefficient	Standard Deviation	t Statistic	Significance Level
rt	0.321	0.0011	13.001	0.003
st	-0.235	0.0054	-2.805	0.000
ps	-0.516	0.0081	4.328	0.000
1.975	Durbin-Watson statistic	0.214	Adjusted R ²	
1.72	F statistic	0.65	Determinant coefficient (R ²)	
0.000	Significance level of F statistic			

The results of investigating the Durbin-Watson test shows the number 1.975 that can be found out that in the presented model, there is no self-correlation of the first type and the errors are independent of each other. The estimated determinant coefficient value for regression models is 0.65, which this value indicates that about 65 percent of the behavior of the dependent variable is explained by the independent variable, which indicates the appropriate relationship between the independent variable and the dependent variable.

Second Hypothesis

The obtained results from investigating second hypothesis model are as follows:

H₀: There is a relationship between the signaling theory and the dividend ratio.

H₁: There is no relationship between signaling theory and dividend ratio.

Table 4: Estimation Results of Second Hypothesis Model

Variable	Coefficient	Standard Deviation	T Statistic	Significance Level
rt	-0.66	0.0013	-0.66	0.001
st	0.88	0.0073	-3.56	0.000
ps	-2.01	0.0041	7.32	0.000
1.321	Durbin-Watson statistic	0.31	Adjusted R ²	

25.74	F statistic	0.62	Determinant coefficient (R ²)
0.000	Significance level of F statistic		

The obtained results of investigating the Durbin-Watson test shows the number 1.321 that can be found out that in the presented model, there is no self-correlation of the first type and the errors are independent of each other. The estimated determinant coefficient value for regression models is 0.62, which this value indicates that about 62 percent of the behavior of the dependent variable is explained by the independent variable, which indicates the appropriate relationship between the independent variable and the dependent variable.

Discussion and Conclusion

Investors in the stock exchange, hoping to increase returns and wealth, speculate, targeting to gain benefits from dividend of companies and increasing stock price. Among the issues that can affect investors' incentives and interests and guiding market resources are theories that affect the policies and procedures of dividend; in this respect the representation issue is related to the incentive to distribute profits from the perspective of the profits owners. In public corporations, managers, owners and creditors of the company are considered differently from the point of view of the position of decision-making and measurement motivations. In such a case, the conflict of interests is manifested and the problem of representation emerges.

And the hypothesis of cash profit signaling is based on the fact that management sends message with the increase of dividends about future profitability of the company. The results of research showed that there is a positive and significant

relationship between representation theory and dividend ratio and also showed that there is a significant relationship between signaling theory and dividend ratio.

References

1. Chahkhoienejad Rafsanjan, Nahid, (2014), "Investigating the Impact of Representation Theory and Signaling Theory on Growth Opportunities and Dividend Policies among Banks and Insurance Institutions Accepted in the Tehran Stock Exchange", International Conference on Economics, Accounting, Management and Social Sciences, Poland.
2. Golestani, Shahram Deldar, Mostafa Seyedi, Seyed Jalal and Seyed Habib Ja'fari Shourchek (2014), "Investigating the Relationship between Effective Tax Rate and Dividend Policy and Stock Return in the Companies Accepted in the Tehran Stock Exchange". Quarterly of Economic Researches and Policies, Year 22, No. 70, pp. 181-204.
3. Kharazmi, Mohammad; Mohammad Hossein Vadie Noghabi and Mohammadreza Shorvarzi, (2013), "The Effect of Minority Shareholders, Representation Costs and Informational Asymmetry on the Dividend Policy of Companies Accepted in the Tehran Stock Exchange", The 11th National Accounting Conference of Iran, Mashhad, Ferdowsi University of Mashhad.
4. Jensen, G., Solberg, D. and Zorn, T. (1992). Simultaneous Determination of Insider Ownership, Debt, and Dividend Policies. *Journal of Financial and Quantitative Analysis*, 27: 247–263.
5. Jensen, M. C. (1986). Agency Costs of Free Cash Flow, Corporate Finance and Takeovers. *AEA Papers and Proceedings*, 76 (2): 323–329.