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The Effect of Company's Life Cycle on Dividend Policy of Listed Companies on the Tehran Stock Exchange

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Abstract

Based on the life cycle theory, firms have various characteristics in various stages of their life cycle.Since the issue of dividend policy always was discussed as one of the most controversial topics of finance science for more than five recent decades. This present essay is mainly aimed at analyzing the effects of company's life cycle on dividend policy of companies listed on the Tehran Stock Exchange. In order to do so, 105 companies listed in the Tehran Stock Exchange (Iran) during 2006 - 2012(735 firm-years) examined. To test the hypotheses we used panel data analysis and GLS (Generalized Least Square) method. The results of the study indicated that dividend policy is influenced by firm's life cycle stages. In other words, the dividend policy at each stages of the life cycle is significantly different from each other.

*Keywords :*Company's Life Cycle ,Dividend Policy, Dividend Payout Ratio, Tehran Stock Exchange.

1. Introduction

Financial reports are the most important output of an accounting system. The purpose of financial reporting is to provide the information which can be useful for business decisions (FASB 1980). The most significant accounting item prepared and presented in financial reports is the earnings. It is considered as a key factor in determining the dividend policy.

One of the main variables of shareholders investment decision-making is dividend. Some investors make all their investment strategies on the basis of dividends and invest on companies that pay more dividend than the market average. Even if an investor does not make all his strategies based on dividends, he gives more importance to companies which pay more dividends. The reputation that a company gets through the payment of dividends, causes an investor to ask what will be the market response when the dividend policy changes. Many of previous studies about dividend payment have reached the conclusion that markets show a positive response to payments and a negative response to dividend removement (Stacescu, 2006).

Dividend policy is one of the topical issues in financial management because the dividend shows the main cash pays of companies and it is considered as one of the most important alternatives and decision which managers confront. The manager should decide how much of the profit of the company should be distributed and how much of it should be invested in the form of accumulated profit in the company. Although paying the dividend directly affects the stockholders, it affects the ability of the firm in accumulation profit in order to use the growth opportunities (Baker& Powell, 2005). The dividend policy is discussible matters concerning firms' financial affairs. In fact, the dividend policy has become a complicated problem for the researchers (Sava, 2006) and it seems like a puzzle which pieces can't match well (Black, 1976) therefore it was the subject of many studies for many years from past to present.

On the other hand, the life cycle theory is based on this assumption that economic enterprises like all other living creatures have life cycle too. These living systems in each stage of their life cycle show specific behavioral patterns of themselves in order to dominate periodical problems confronting with or to transfer them into the next cycles.

Theories of economics and management divide firm life cycles into some stages. Based on the stages of their life cycles, firms and institutions follow certain policies which are reflected in some form in accounting information (Bixia, 2007).Adizes attributes five stages for the life cycle (birth or introduction, growth, maturity, stagnation and bankruptcy). In this article three stages of them including birth, growth, and maturity are studied. A number of researchers have examined the effects of life cycle on accounting information .Therefore in the following research; the effects of the company's life cycle on dividend policy in accepted corporations in Tehran Stock Exchange are being tested.

2. Literature review

2.1. Theoretical bases of Corporate Life Cycle

Life cycle theory suggests that a firm possesses different risk characteristics and different economic attributes across life cycle stages (Bixia, 2007). Economic theory divides a corporate life cycle into four stages: start-up, growth, maturity and decline or stagnation stage. These stages are discerned by corporate-specific attributes such as the degree of uncertainty that faces the corporate, its assets in place and its investment opportunities (Mueller, 1972, 1975; Myers, 1977). Growing and aging stages show business units based on the ability to control and flexibility. In young (growing period), business unit is very flexible, but in most cases they are non-controllable. By increasing business unit's life ages, Relationships changed control increases and flexibility decreases. Finally, aging (the decline period) the ability to control will be decreased. When business unit has the ability to control and is flexible, indicate that has young and aging benefits simultaneously, this situation is known as evolved stage (maturity)

(Adizes, 1989). Researchers have introduced the following 4 main phases as the firm's life cycle: (Rezvani et al., 2013)

2.1.1. Stage one: existence

Known as the entrepreneurial (Quinn and Cameron, 1983) or birth stage (Lippitt and Schmidt, 1967), Existence (Churchill and Lewis, 1983) marks the beginning of organizational development. The focus is on viability, or simply identifying a sufficient number of customers to support the existence of the organization. Decision-making and ownership are in the hands of one, or a few, and the organizational structure is very simple. Organizations in this stage tend to enact or create (Bedeian, 1990) their own environments(Rezvani et al., 2013).

2.1.2. Stage two: survival

As firms move into the Survival stage they as firms move into the Survival stage they seek to grow (Adizes, 1989; Downs, 1967), develop some formalization of structure (Quinn and Cameron, 1983), and establish their own distinctive competencies (Miller and Friesen, 1984). Goals are formulated routinely in this stage, with the primary goal being the generation of enough revenue to continue operations and finance sufficient growth to stay competitive (Churchill and Lewis, 1983). TheSurvival stage provides several interesting alternatives: Some organizations grow large andprosper well enough to enter the next stage, some "hit and miss," earning marginal returns in some fiscalcycles, and others fail to generate sufficient revenue to survive. Most organizations in this stage are structured in a functional manner, and decision makingis more decentralized than the Existencestage(Rezvani et al., 2013).

2.1.3. Stage three: success

Commonly called maturity (Adizes, 1989), the Success stage represents an organizational form where formalization and control through bureaucracy are the norm (Quinn and Cameron, 1983). A common problem in this stage is what many businesses have long referred to as "red tape" (Miller and Friesen, 1984), a condition of wading through layers of organizational structure to get anything accomplished. Job descriptions, policies and procedures, and hierarchical reporting relationships have become much more formal. Such organizations have passed the survival test, growing to a point that, at times, they may seek to protect what they have gained instead of targeting new territory. The top management team focuses on planning and strategy, leaving daily operations to middle managers. Organizational structure is varied, but many firms tend to be organized by product or geographic divisions due to the need to serve wide markets(Rezvani et al., 2013).

2.1.4. Stage four: decline

Although firms may exit the life cycle at any stage, the Decline stage can trigger the demise. The Decline stage is characterized by politics and power (Mintzberg, 1984), as organizational members become more concerned with personal goals than they are with organizational goals. Control and decision-making tend to return to a handful of people, as the desire for power and influence in earlier stages has eroded the viability of the organization(Rezvani et al., 2013).

2.2. Theoretical bases of dividend policy

Firm's dividend policy is the most important financial decision and responsibility of management. Dividend policy is the decision of how much portion of earning should be transferred to the shareholders in the form of dividends. It reflects the distribution of profits between dividends to stockholders and reinvestment in the firms, this is an arguable issue for financial managers for more than 50 years. Ever since Miller and Modigliani (1961) published their pioneering article on dividend policy, numerous theoretic and empirical studies have examined this important issue. Empirical evidence suggests that a firm's dividend policy may depend on the stage of the firm's life cycle. For example, younger firms with higher growth opportunities but lower profitability may distribute less cash dividends. In contrast, mature firms with higher profitability but lower growth opportunities may distribute more cash dividends. The

past two decades have witnessed drastic changes in dividend policy among industrial firms. Fama and French (2001) report a significant decline in the proportion of United States industrial firms that pay cash dividends in the period 1978-99. They note that such changes in dividend policy are related to changing characteristics of these publicly traded firms. DeAngelo et al. (2006) propose that changes in dividend policy of publicly traded industrial firms in the United States are consistent with the prediction of the life cycle hypothesis (Wang et al., 2011).Dividend has long been an important issue for financial researchers and it has remained as one of the most controversial issues in the field of financial management (Grullon et al., 2002).

The basic objective of dividend policy is to maximize the wealth of owners (shareholders). It is devised not only to raise the share price in the short run, but the long term objective is to maximize the owner's wealth (Brigham &Gapenski, 2002). Some investors make all their investment strategies on the basis of dividends and invest on companies that pay more dividend than the market average. Even if an investor does not make all his strategies based on dividends, he gives more importance to companies which pay more dividends. The reputation that a company gets through the payment of dividends, causes an investor to ask what will be the market response when the dividend policy changes. Many of previous studies about dividend payment have reached the conclusion that markets show a positive response to payments and a negative response to dividend removement (Stacescu, 2006).

Although the firms follow different purposes from dividend policies say as, to absorb their special clients, communicate the information to the market or, only pay back of the cash surplus to the shareholders. Why no dividend theory has been individually better than the other one that is probably because of different motives to pay the dividend (Feldstein and Green, 1983).

 Dividend payouts ratio is dependent on lots of elements such as: investing opportunities profitability, income tax, laws obligation and liquidity. It means because of extra amount of cash flow and low need to liquidity, investing opportunities profitability decrease, so company increase the dividend payouts and because of low amount of cash in comparison to investing opportunities, decrease the amount of dividend payouts(Ferdinand & Gull,1999) .

2.3.   An overview of previous studies

Despite numerous studies on dividend policy in developed and developing countries, the discussion on this issue is still continuing. As yet researchers do not have an acceptable explanation about the factors influencing the behavior of firm with regard to its dividend policy (Ahmad, 2009).

French and Fama in 2001 conducted a leading study in the U.S. firms between 1926 and 1999. They observed that the proportion of firms paying dividend declines dramatically after 1978. They found that the reason was new listed firms in the U.S. stock market so they argue that firm`s life cycle affect on the dividend policy. After them DeAngelo, DeAngelo and Stulz (2006) in an important study observe that a highly significant relation between the decision to pay dividends and the earned/contributed capital mix, controlling for profitability, growth, firm size, total equity, cash balances, and dividend history. They show that the mix of earned/ contributed capital has a quantitatively greater impact than measures of profitability and growth opportunities. These results also are supported by Al-Malkawi (2007) who find that size, age, and profitability of the firm seem to be determinant factors of corporate dividend policy in Jordan. Their contribution to the scope of financial management was introduction of mix of earned/ contributed capital as a basic measure for firm's life cycle measurement. After this point most of studies have used mix of earned/ contributed capital as a basic measure for firm's life cycle measurement (Chay and Suh, 2009; Thanatawee, 2011; Wang et al., 2011).

One of the first studies on dividend policy was done by John Lintner in 1956; His primary goal was seeking a model for explaining the dividend. After careful review of academic literature, he developed a model based on a survey of U.S. managers. Ultimately, he listed about 15 factors that he found has significant effect on dividend payout by the firms.His research method based on interviews with company executives and technique is OLS. Lintner research results can be summarized as: Company set their

dividend levels to avoid having to reverse dividend increases, and gradually increase dividends toward a target payout ratio when earnings increase. Mature companies that have stable profitability, usually paid a significant part of their profits; and payout of the companies that are in growth stage are less (Lintner, 1956).

According to Miller and Modigliani (1961) hypothesis a negative relation between dividend payouts ratio and future earnings growth is expected. This was because as a firm pays out a lower proportion of its retained earnings as dividend, retained earnings ratio will increase which help company face with profitable investment opportunities that leads to a higher growth rate of earnings.

Angelo et al., (2006) in a study as the title of "Dividend payments Policy and the accumulated benefit in the Capital Structure" concluded that the life cycle, profitability and investment opportunities are effective factors on the dividend.

Denis &Osobov (2008) conducted a comparative study to examine the dividend behavior of firms in six countries which includes UK, US, Germany, France, Japan and Canada. The result shows that large and profitable firms tend to pay dividend. Further, results indicate that almost in every country, the dividend policy is affected by, profitability, growth opportunities, firm size and the earned/contributed equity mix. Results are consistent with life cycle theory of dividend .The firm pays less dividend in the initial stage of growth. As a firm matures propensity to pay dividend also raises. Further they report that the proportion of dividend payers decreases between 1998 and 2002 in all six countries except Japan and Germany, because of increase in listing of small firms with high growth opportunities but with low profitability.

Chay and Suh (2009) conducted a research by employing Logit regression in order to investigate the factors influencing dividend. They mostly emphasized on cash flow uncertainty and introduced it as the most factors influencing on dividend policy. They asserted that the effect of cash flow uncertainty on dividends was generally stronger than the effect of other potential determinants of payout policy such as the earned/contributed capital mix, agency conflicts and investment opportunities. They reported that cash flow uncertainty, life cycle, investment opportunity and agency conflicts had a direct relationship with dividends. This result was also supported with DeAngelo et al., (2006) who found that life cycle and investment opportunities were the two factors influencing on dividend policy.

Wang et al., (2011) examined the dividend policy for firms listed on the Taiwan Stock Exchange and tested the life cycle hypothesis .The results stated that dividend payers were associated with higher profitability, higher asset growth rate, and higher market-to-book ratio than non-payers (none dividends). These results were consistent with the life cycle hypothesis of dividend payment because younger firms with higher growth potential but lower profitability would be more likely to distribute more stock dividends than cash dividends.

Stepanyan (2011) investigated how to distribution of cash between the shareholders (dividends, redemption of shares or a combination of both) during the life cycle of companies. He came to the conclusion that the payments during the companies' life cycle (birth, growth and maturity) are different.

Malik et al., (2013) examined the determinants of dividend policy of firms and found that liquidity, leverage, earning per share, and size were positively associated with dividend, whereas growth and profitability were reported to be insignificant determinant of dividend policy. The results revealed that earning per share, company profitability, and size increase the probability of companies to pay dividend, whereas growth opportunities could decrease the probability of paying dividends.

3. Purposes and hypotheses of the study

A review of literature related to financial accounting shows that the life cycle of the company, an important determinant for a large number of decisions of the company including accounting method, politics, profits, contracts, compensation and capital structure and financial decisions. In addition, it has been found that the life cycle of a company on the impact of accounting information (Black, 1998).

Therefore, in this study it is argued that the connections between the life cycle of the company and dividend policy. Thus, in this study, the following hypotheses have been proposed.
The main purpose of the study is:

➢ Research on the effect of company's life cycle on dividend policy in accepted corporations in Tehran Stock Exchange (TSE).

The below hypotheses have suggested to arriving to this purpose:

➢ The main hypothesis : dividend payout ratio is significantly different throughout the firm's life cycle.

• Sub-hypothesis 1: there is a significant difference in company's dividend payout ratio during growth and maturity periods.

• Sub-hypothesis 2: there is a significant difference in company's dividend payout ratio during growth and decline periods.

• Sub-hypothesis 3: there is a significant difference in company's dividend payout ratio during maturity and decline periods.

4. Research methodology and variable measurement

4.1. Corporate Life Cycle Analysis Methodology

The independent variable in this research is the company's life Cycle. Previous experimental studies concerning accounting have shown that the firm's financial qualities are not the same in different terms of their life cycle and have relation with each term. Anthony's and Ramesh's findings (1992) show that there is a significant relation between the shares price and accounting data (Such as profit growth percent, cost of capital percent and cash profit division percent) during the life cycle. Here the firms are divided into growth, maturing and decline terms by the four variables; according to Park and Chen's (2006) methodology as follows:
1. Primarily the sale growth, cost of capital, divisible profit proportion and age of the firms are calculated for each company.
2. Firm years are divided into five categories on the basis of each variable of the four ones and according to the statistical category from one to five by virtue of the following table.
3. Then a composite score is gained for each company year and classified by virtue of following conditions in one of the terms (Growth, maturing or decline):
a. If total score is between 16–20 ; it is in growth phase.
b. If total score is between 9–15 ; it is in mature phase.
c. If total score is between 4–8 ; it is in decline phase.

Table1. Life cycle model (Score Assignment)

Categories	AGE	Sale growth (SG)	Cost of capital (CE)	Divisible profit (DPR)
First	5	1	1	5
Second	4	2	2	4
Third	3	3	3	3
Fourth	2	4	4	2
Fifth	1	5	5	1

Where:
$SG_{it} = [1- (Sale_{it} / Sale_{it-1})] \times 100$,
$DPR_{it} = (DPS_{it} / EPS_{it}) \times 100$,

CEit = (increase (decrease) in fixed assets during the period / firm market value) ×100,

AGE = the difference of 't' year and the year when the firm was established.

Here the life cycle was defined in three forms of growth, maturing and decline (The appearance term was ignored) because the transaction (Purchase and sale) was inactive or the new firms did not participated in the Tehran stock exchange

4-2-*Measurement of dividend policy*

The dependent variable in this research is the company's Dividend policy. The relationship between dividend and earnings per share shows the company's Dividend policy (Cooper &Ijiri, 1983; Mancinelli & Ozkan, 2006). Furthermore, the most common criterion is selected from among all present policies of profit distribution, the Dividend per share ratio on the earning per share they are used in researches done by Rozeff (1982) and Gul & Kealey (1999),Mancinelli & Ozkan(2006).So we have used of DPS/EPS ratio to study about the effect of dividend policy that shows the percent of distributed dividend. In the other word, it shows that the firm distributed how percent of gained profit to investors.

5. Methods of data analysis and hypothesis testing

5.1. Sample selection

The sample is drawn from the population manufacturing companies listed in Tehran Stock exchange (TSE) during 2006-2012. In this research census method has been used. In order to choose our statistical units, those firms having the following characteristics have been chosen as our statistical units.

1. These companies are listed in Tehran Stock Exchange before the year 2006.
2. Their financial period has not changed during the studied period.
3. Their information such as financial statements and notes are available.
4. The companies should be profitable

According to the above conditions, 105 company (735 years - companies) during 2006and 2012 were selected and in those 82, 577 and 76 years - companies were in growing, mature and decline stages respectively. The data needed for analysis are gathered from audited financial statements and decisions taken in annual general meetings. Necessary information was extracted by referring to financial reports, general meeting reports, and the stock exchange database. Independent and dependent variables and primary processing of data were carried out by Excel .Finally, SPSS and R softwaresare used to perform statistical analysis and panel data analysis are used to investigate the objectives also the significance level for testing the hypothesis is 95 percent.

5.2. Descriptive statistics

Table 2 shows descriptive statistics and the variables classified as corporate life cycle stages of the growing, maturity and decline separately.

Table 2. Descriptive statistics of testing variables

mature phase				growth phase				
Std. Deviation	*Median*	*Mean*	*N*	*Std. Deviation*	*Median*	*Mean*	*N*	*Variables*
47.32	80.25	75.32	577	26.84	54.08	53.40	82	*dpr*
34.38	15.37	19.43	577	115.68	35.06	48.93	82	*SG*
16.26	1.04	3.08	577	33.31	7.80	16.36	82	*CEV*
12.38	35	33.80	577	11.14	22	25.22	82	*AGE*
0.47	0.803	0.75	577	0.27	0.54	0.53	82	*DP*

Total				decline phase				
45.53	79.88	75.24	735	35.52	95.85	98.19	76	*dpr*
50.73	15.49	20.51	735	15.77	-0.31	-1.99	76	*SG*
19.42	1.10	3.73	735	14.45	-1.86	-4.92	76	*CEV*
12.78	35.00	33.90	735	10.07	47	43.97	76	*AGE*
0.46	0.80	0.75	735	0.36	0.96	0.98	76	*DP*

As you will see in table2, the results of descriptive statistics for each variable have been given separately for each of life cycle stages. The main central indicator is mean, which shows the balance point and gravity center of distribution and it is a good indicator for showing the centrality of data. For example, the mean of dpr , SG , CEV, AGE , DP in growth phase are 53.40 , 48.93 ,16.36 , 25.22 ,0.53.The mean of dpr ,SG ,CEV, AGE , DP in maturity phase are 75.32 , 19.43 ,3.08,33.80,0.75 and the mean of dpr ,SG,CEV,AGE,DP in decline phase are98.19,-1.99,-4.92,43.97,0.98. Companies in growth stage have the highest sales growth and CEV and companies in the decline stage have the lowest sales growth and CEV. Companies in growth stage have the lowest AGE and companies in the decline stage have the highest AGE. Median is another central indicator which shows social condition. As is evident in table 2 median of AGE variable in growth phase is 22 which shows that half of data is less than quantity and other half of data is more than this quantity. Dispersion parameters is a criterion for determining the dispersion of each other or their dispersion proportion to mean standard deviance is one of the most important dispersion parameters the quantity of this parameter for SG variable in maturity phase equals 34.38.

5.3. Test hypotheses

5.3.1. Identify the appropriate method for testing the hypotheses

As can be seen from the results of Table 3, To determine the appropriate method for estimating the model, first F-Limer test is performed to select one of the common effects and fixed effects methods and, if necessary Hausman test (to select one of the fixed effects and random effects methods) andother methods are performed to select the appropriate method. According to the results presented,appropriate method for testing hypothesesis GLS method.

Table 3. Determine an appropriate method for hypothesestesting

F Limer test for individual effects	$df_1 = 104$ $df_2 = 628$	F = 2.2524	p-value = 1.103e-09
F Limer test for individual effects(with year factor)	$df_1 = 98$ $df_2 = 628$	F = 2.306	p-value = 8.154e-10
Hausman Test	df = 2	chisq = 0.7634	p-value = 0.6827
Lagrange Multiplier Test - (Breusch-Pagan)	df = 1	chisq =48.9504	p-value = 2.625e-12
Lagrange Multiplier Test - time effects (Breusch-Pagan)	df = 1	chisq = 0	p-value = 0.9978
Lagrange Multiplier Test - two-ways effects (Breusch-Pagan)	df = 2	chisq =48.9504	p-value = 2.347e-11
studentizedBreusch-Pagan test	df = 8	BP = 5.6355	p-value = 0.688
Durbin-Watson test		DW = 1.6804	p-value = 8.752e-06

5.3.2. The results of hypothesis testing

The results of hypothesis testing, as follows:

Table4. The results of hypothesis testing

Generalized least squares fit by REML				
Model: dv ~ factor (life.code) + factor(year)				
Coefficients:				
	Value	Std.Error	t-value	p-value
(Intercept)	0.4606658	0.06002125	7.675045	0.0000
factor(*maturity phase*)	0.2073627	0.05288485	3.921022	0.0001
factor(*decline phase*)	0.4397852	0.07182136	6.123320	0.0000
factor(year)85	0.1016159	0.06135644	1.656157	0.0981
factor(year)86	0.1449557	0.06148282	2.357661	0.0187
factor(year)87	0.0814442	0.06139361	1.326590	0.1851
factor(year)88	0.0504409	0.06184052	0.815660	0.4150
factor(year)89	0.0912609	0.06193813	1.473421	0.1411
factor(year)90	0.1156493	0.06158601	1.877851	0.0608

According to the test results, P-value for maturity stage relative to growth stage and decline stage relative to growth stage is less than 0.05. Therefore, the first, second and third sub-hypothesis are approved with a confidence of 95%. This means that dividend policy is significantly different throughout the firm's life cycle .This means that companies in every stage of their lifecycle will follow different dividend policy.

6.Discussion and Conclusion

Dividend policy is one of controversial financial issues. Dividend is an influential factor in future investment decisions. Dividend policy is quite important in the valuation process of companies. It decreases internal resources and increases the need to external resources. In the other hand, many stockholders prefer pay dividend to retain it. As a result, it is necessary to balance between investments opportunities and stockholders prefers. Therefore, dividend policies are sensitive and important (Mehrani&Talaneh, 1998).A review of literature related to financial accounting shows that the life cycle of the company, an important determinant for a large number of decisions of the company including accounting method, politics, profits, contracts, compensation and capital structure and financial decisions. In addition, it has been found that the life cycle of a company on the impact of accounting information (Black, 1998). The firms in their different stages of life cycles are tended to follow different policies on accounting disclosure considering their financial conditions and motivations. Therefore, the main objective of this study is to investigate the effect of company's life cycle on dividend policy in accepted corporations in Tehran Stock Exchange (TSE). For this purpose, a sample of 105 companies during the years 2006-2012 is used.The results of the study indicate that the dividend policy in Tehran Stock Exchangeis significantly different throughout the firm's life cycle and companies at every stage of their life cycle proportional to the stage and to overcome problems associated with that stage ,have adopted a different dividend policy. The obtained results of the study are in accordance with the DeAngelo et al, (2006), Coulton and Ruddock(2011).

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