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Examination of The Relationship Between Institutional Ownership And Dividend Policy

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ABSTRACT

The purpose of this study is to investigate the relationship between institutional ownership and dividend policy of the companies listed in Tehran Stock Exchange. The importance of this study is that it demonstrates the relationship between Dividends and institutional ownership to managers, investors, and other decision makers; based on these conclusions, they can make better decisions. Investors can also considerinstitutional ownership of the company and promote the rights of shareholders and stakeholders and the Stock Exchange can develop properregulations to implementfor organizations and its management, according to the obtained results.Scope of the present investigation is a six-year period between 2007 and 2012. Providing the results of the study of the impact of institutional investors on dividend policy helps investors, actual and potential creditors, and also organization's managersmake correct and reasonable financial decisions.

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INTRODUCTION

Dividend policy has been the subject of attention in financial literaturein recent years and several studies have explained the reasons and manner of distributing profits among shareholders and the attention of investors to the dividend and this issue is still the crux of dividends in financial literature [1].

Creditors and shareholders can affect the method of dividend and financing the economic unit through funding requirements. Also, capital structure and dividend decisions are likely to affect the motivation of managers, enhance their performance and generally, capital structure and dividend policy of the Company will be effective on the firm value.Research results suggest that the relationship between firm value and financial decisions, are seriously the issue and subject matter of financial markets and investors, but in most of these studies, the effect of ownership structure is not considered. This factor is especially important in Iran, because it can increase the conflict of interest between the major shareholders (Company controllers) and the minority shareholders in the economic unit; thisconflict of interestis one of the most influential factors in determination of the dividend policy and the regulation of financial leverage.

High proportion of dividend in Iran, less attention to corporate financial structure, and exaggerationin corporate profits in recent years have caused less growth in corporate investment and development and it seems that in some cases not only dividend didn't exist, but also we were witness of capital share. According to the presentation, different policies regarding dividend has been raised. The difference between these policies was the stability or instability of the interest paid to shareholders during several yearsand each of them will have certain risks.

Capital Structure:

In the decisions about capital structures and the selection of an optimal financing, the method of using debt against the use of equity has been analyzed and evaluated and finally the procedure and methodwill be selected that will reduce agency costs to a minimum [28]. Agency costs are defined as the cost of excessive use of fringe benefits of managers (large office, company cars, etc.) that shareholders incur due to reduction in the price of shares. Since the supply of additional shares in the market and increase in the number of shareholdersreduces the effective cost of management use for each stockholders; therefore, it can be concluded that for more

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magnitude and distribution of the stockholders, agency costs reduce and eventually the attractiveness of equity, as a method of cheap financing, will increase.

Williams (1987) evaluates the concepts of risk and fringe benefits. According to him, managers of companies with concentrated structure tend to invest proceeds from loans and debts in high risk projects. According to him, if the managers themselves are stockholders, then in order to maximize the market value, they tend to choose high risk projects and at the same time, try to use fringe benefits less.

On the other hand, the conflict of interests between management and shareholders is evident in assessment of economic projects.Although the net present value and internal rate of return methods are considered a better method for maximizing shareholder wealth, than a method like Capital recovery period, however, the latter method is widely used.Perhaps that is why managers are expecting to receive bonuses for their short-term performance or stay in the company for a short time, prefer the CapitalPayback period method, because return of investment in short term increases liquidity and fundingunder management control(rather than increasing shareholder wealth).

Ownership structure:

In conceptual literature, the concept of ownership structure has been used in the two meanings of concentrationand composition of the property [37]. Primarily in countries with a high focus on equity, the ownership structure is considered as an important internal control mechanism which influences the value and performance of the companies. Concentration of ownership and existence of ownership control as opposed todispersed ownership and their probable relationship between each of them with the performance and value of economic units and on the other hand the combination of an economic units, includingstate ownership, corporate and institutional ownership, foreign ownership or individual ownership and the effect each can have on companies' performance and value, are of the important issues discussed in the past two weeks.

Management Ownership:

Jenson and Mackenling (1976) in their article titled "The theory of economic units: Management behavior, agency costs and ownership structure"state on the role and importance of management ownership that keeping the shares by the institution management is beneficial to the alignment of interests between managers and shareholders. Unity of interestamong directors and shareholders will cause deletions of conflict between the two.In such a situation, managers tend to deviate less from the objectives and plans of the company in order to strengthen their personal interests.

In contrast,Hilmberg, Hoyard, and Palia (1999), studied the influence of management ownership on companies' performance, using panel data models with fixed effects on the study. They discovered that management ownership to sales to capital ratio is negatively correlatedbut it is positively correlated with advertising expenses to sales ratio and also the ratio of operating profit to sales. After controlling the effects of above variables and fixed effects of the firm, they discovered that changes in managementownership are free of any significant effect on firm performance.

Public and private ownership:

Some of the studies done in the areas of different kinds of ownership demonstrate performance improvement in theinstitutes that have tended to change their type of ownership or implementedprivatization operation. Privatization is the transfer of ownership from the public sector to a private investor, investors who put more emphasis on profitability and efficiency[14].

Differences in managerial incentives and regulatory, political objectives and social obligations of the state units mainly cause the expectation that the mentioned units, to have a lower performance comparing to similar institutions. Some of the owners, such as institutional and corporateownersmay have better performance due to stronger motivation to gain more profit and information. In contrast, some of the other owners, such as the public section may prefer achieving specific political goals, creating job opportunities, and focusing on strategic industries to gaining profit. In the government-affiliated institutions, the main objective is to achieve political goals, a goal that is not necessarily consistent with the purpose of making profit [5].

There is a big chance thatconcentratedprivate ownership is successful in countries where investors have a weaker support system. Large shareholders, i.e. shareholders whose wealth largely depend on the performance of the companies, have more motivation to monitor, manage, andensure that theirresources are not diverted from its original path. Moreover, when privatization is directed towards dispersed ownership, in this case, even if the cost of political control is reduced, agency costs associated with the control of managementmay continue to increase [14].

The identities of the owners are likely to affect performance of newly privatized firms. For example, foreign investors require higher standards of disclosure andto maintain their reputation; they apply hard controls on the operations of the manager.Alsoinstitutional investorsimpose high degrees of monitoring onmanagement activities, to ensure high efficiency[16].

Institutional and corporate ownership:

Institutional and corporate ownership include ownership of pension funds, insurance companies, investment funds and financial and credit institutions ad banks and private companies on the stock of the companies. In USA and UK, institutional investors play an important role in capital markets. In the United States, more than 44% and in UK over 60% of the shares of the companiesoperating in the stock market are held by institutional investors.

But what is noteworthy here, is the gathering of the two scattered ownership and institutional investors in the capital market.This means that in these countries on one hand, there is no focus on stock ownership and on the other;institutional investors hold a high proportion of shares in companies.The presence of these two phenomena together indicates the high number of institutional investors and yet the existence of a low percentage of shares owned by them.In other words, in these countries, institutional investors own companies' stocks in the form of small ownerships.

Schifler and Vischli(1986) argued that existence of biginstitutional investors in the sense of more effective monitoringhas the positive effect on the value of the institute market. Such monitoring reduces the possibility of making non-optimal decisions. On the other hand, many empirical studies conducted in the area of ownership structure reflects the fact that legal entities and business owners can participate in the management of the institution by focusing on the control board, and conduct a more influentialmonitoring in selection of managers and granting them bonuses .

Family ownership:

Wide ownership structure are to be found only in the United States and Britain.In other countries, developed or developing, a substantial portion of companies are controlled by family ownership.According to studies, 85% of Spanish companies are run by family ownership,however, in England and America this proportion is respectively 10% and 20%[36].Institutions that are controlled by family foundations, due tolower represent costs,and must be more efficient than state institutions [20].

Results of Some studies show that family ownership can reduce agency costs between owner and manager, however, it increases conflicts of interest between minority shareholders and owners of the family.Although family ownership, especially in countries with fewer legal protections of shareholders, has always been accompanied with high efficiency, however due to existence of expropriation of minority shareholders, it might be harmful toward these shareholders.

Separation of ownership from management:

Before the advent of very large companies in the late eighteenth century, the owners were managers and managers were owners; but with the separation of ownership from management, the emergence of securities markets and Professional Administrators groups,the Joint Stock Company was introduced asa social phenomenon. This leads to the appearance of a conflict of interest between managers and owners.Shareholder composition may vary in different companies; but shareholder can have important roles in corporate governance of the company, therefore, their different compounds in the companies can have different effects on the performance of companies, the data reflection of the company's participation in the market, and information asymmetry. Therefore, companies differ due to the type of ownership and how they monitor management performance. Among these, what attracts attention, is the increasing presence of significant investors in thelandlords circle of public companies, and the effect of the active presence of this group on the quality of governance in organizations and their performance [5].

Also the importance of this issue is serious to the managers, in the sense of using the information obtained in both administration process and market analysis of their performance; therefore part of the managers' attention is focused on an issue that is referred to as dividend policy.But more important than the dividend policy, is finding the roots of adopting a dividend policy determined by the companies.This issue could pave the way for important economic decisions for different groups of stakeholders, especially investors.For the reasons and factors obtained from this root, not only helps explaining the companies' past behaviors, but also provides a tool to predict their future movement and path in this area.

Theories of dividend policy:

Financial analysts and economists have long been interested in studying the interactions between cash dividends and ownership of the company. Their main question is whether the ownership type and structure of the company affects the company Dividends or not. In general, three schools formed regarding the companies' dividend policy:

First: In this school, dividend is a fascinating subject in school which has a positive influence on the stock price.

Second: In this school, the level of dividends paid has a negative effecton the stock price.

Third: In this school, dividend policy does not influence the firm value and the dividend is irrelevant to stock price [21].

Miller and Modigliani(1961) claim that dividend payments in a perfect capital market, which is a competitive market without taxes and transaction costs, is considered irrelevant for investors and companies that have an economic logic.

Given that managers have more information than shareholders and are able to break the profits of this year into two categories of stable and unstable, signaling cash dividends are likely to remain valid, because managers try to maintain their integrity and honesty towards investors through granting access to other sources of information. Becausedestruction of managers' reputation, fear of the law and other opportunities to pony past accounts will influence their future income.

The late financial economist John Lintner of Harvard University, believed that as payment intention of dividends varies, profits news interaction and dividends also vary over time [37].

Theoretical and empirical models of dividend policy have been divided into three categories, based on qualitative criteria related to the nature of the market structureand rational functions of the investors:

A) *Models based on complete information*
B) *Models based on asymmetric information*
   1-B) Signaling Model
   2-B) Models based on agency costs
   3-B) Models based on free cash flow hypothesis

C) *Models based on behavioral principles:*
   1-C) Models based on management's beliefs
   2C)Theoretical behavior models

Harrad and Negoy (2006) studied the effect of ownership structure on dividend policy of Japanese firms.Research findings indicate that an inverse relationship between ownership concentration and dividend payments exists. In addition, it is less likely that firms with concentrated ownership, increase dividend while increasing profitability and it is more likely that they do not pay any benefits, with improvement of investment opportunities.

Nakur *et al*. (2006) investigated the factors influencing dividend policy in Tunisia Securities. The results of the study indicate that its profitability and stability influence Dividends paid directly, and stock market liquidity and size influence the dividends inversely.However, ownership concentration and leverage has no effect on the rate of dividend.

Keran *et al*. (2013) investigated the effects of institutional ownership on dividend policy. The results indicated that increased institutional ownership increases dividend and purchase ofshares of the corporation more.

Mustafa Suleiman (2013) in a study investigatedthe effect of ownership structure and board characteristics on dividend policy on Saudi bourse using the information of 68 companies and within a time period of 2005-2008 with the combined data method. The results of the study indicated that there is a positive and significant relationship between the Dividend policy and board independence, board size, institutional ownership and management.

In a study conducted by Khodadadi *et al*. (2005) investigated the effects of companies' ownership structure (the influence of institutional investors and individual shareholders) ondividend policies adopted by them. These effects were tested by regression models of the least square error and logistic model with error level of 5%. Results of the first model test demonstrated that there is a positive and significant relationship between ownership structure and dividend policy and also the results of the logistic model indicated that ownership structure has a significant influence on dividend policy.

In the research done by Khodadadi and Aqajari (2009) the influence of companies' ownership structures (The influence of institutional investors and individual shareholders) on the dividend policies adopted by them was investigated. These effects were tested by regression models of the least square error and logistic model with error level of 5%. Results of the first model test demonstrated that there is a positive and significant relationship between ownership structure and dividend policy and also the results of the logistic model indicated that ownership structure has a significant influence on dividend policy.

Regular dividend policy:

In this fashion, the company follows a coherent policy and regulatory compliance in the payment of dividendsand tries to maintain regularity in dividend payments, despite the profit fluctuations in different years. Companies that already have such a policy, compensate deficit in periods with of lack of funds by reserving a part of the income in the periods when the income of the company is high and has good liquidity, in order to sustain the payment of dividends. Adopting such a policy can be important due to the following reasons .

1) Such a policy would increase investors' loyalty to the corporation.In a manner that the investors will not consider the stocks of companies as a means of speculation, but consider it as a tool for long-term investment.

2) Regular benefit payments increases market confidence towards the company and its management.In a way that the possibility of financing through the sale of new equity or bond markets is facilitated.

3) Triggered expansion of ownership and largely cancels the risk of loss of company control.

4) This policy is in favor of micro investors, because it maintains a suitable proportion of the company control for them.

Determinants of dividend policy:

Many factors could affect the company's profit distribution policyand sometimes restrict dividend. These factors are either determinedmandatory for companies in the context of laws and regulations or the companies require maintaining these regulations optionally. **1) Regulatory Issues:** Laws and regulations do not oblige companies to pay dividends, rather it explains the circumstances in which dividends shall not be paid.**2) Contractual Issues:** Firms may bearrestrictions on the payment of dividends, whenreceiving foreign investment. These limitations are sometimes due to the loan agreements, lease or distribution and creation of preferred shares.**3) Internal Factors:** In addition to legal and contractual restrictions, other factors could affect a firm's payout. Some of these factors are discussed later.

Discussion and Conclusion:

Dividend policy is one of the most important issues in financial management.Incentives of institutional investors in the free-rider field of regulatory activity causesthis group of investors not to have any willingness towards monitoringby them. Instead of direct monitoring, these investors force the companies to increase dividend; In other words, institutional investors prefer free cash flow to be distributed in the form of dividends to reduce agency costs regarding free cash flows [47].

This research is aimed to analyzethe amount of ownership byinstitutional shareholder companiesandfeatures of the management team on their dividend policy. If the results of this study show that the ownership of institutional shareholders has an important relation with the dividend policy of the companies surveyed, it will promise the shareholders and managers of the mentioned companies to pay more attention to these issues. Based on this study that has empirically investigated the effect of the dividend policy of listed companies in the Tehran Stock Exchange, the results of the studies has shown the relationship between the ownership structure and Dividend to be positive, therefore, this relationship is a confirmation of the representation theory. Also regarding the significant and positive relationship between the control variables of earnings per share and firm size and negative financial leverage ratio of dividends in assessed theories, the signaling theory,based on the fact that companies increased their dividend when profits are expected to increase, is also confirmed. This conclusion is also in coordination with the findings of JahanKhani and Qorbani’s research (2005).

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