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The relationship between firm's growth opportunities and firm size on changes ratio in retained earnings of listed companies in Tehran Stock Exchange

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ABSTRACT: The purpose of this research is to investigate the relationship between firms growth opportunities and firm size on changes ratio in retained earnings of listed companies in Tehran Stock Exchange. This study is a literature study and analysis - scientific, and is based on the analysis of panel data (panel data). In this study, the financial data of 101 companies listed in Tehran Stock Exchange during the period 2006 to 2011, has been reviewed (606 companies - the Year). To analyze the results of research, software Spss20, Eviews7, Minitab16 are used. in connection with the first hypothesis of research, we find that there is an inverse and significant relationship between company's growth opportunities and changes ratio in retained earnings ratio of companies. Finally, results of research in connection with the second hypotheses confirmation suggest that is a direct and significant relationship between firm size and with changes ratio in retained earnings of companies.

KEYWORDS: Capital structure, The Company's Growth Opportunities, Changes Ratio of Retained Earnings, Firm Size, Panel Data.

1 INTRODUCTION

The company's dividend policy is its long term financial strategy with regards to deciding how much earnings to pay out as against retaining them for investment in the company. It leads to division of profits between dividend payment to shareholders and reinvestment in the company. There are no transaction and bankruptcy costs associated with retained profits [2].Thus, retained earnings constitute a major source of finance for companies. Investors prefer capital gains over dividends, because capital gain taxes can be deferred into the future and are taxed at a minimum rate while taxes on dividends must be paid as soon as they are received and are taxed at a relatively higher rate. Whenever there is an increase in personal income tax of the shareholders, companies tend to retain and reinvest more of their earnings. Payment of earnings as dividend is associated with agency cost and an opportunity for existing shareholders is lost to reinvest their earnings for growth of the company.. The level of internal funds conveys information about growth prospects of companies [6]. Growth firms pay lower dividends, reinvest more of their earnings, and provide a greater percentage of their total returns in the form of capital gains. Companies with a few major investment opportunities would limit paying out a larger percentage of their earnings. For this reason, higher dividends are paid in stable, low-growth industries. By contrast, high-growth companies with lots of investment opportunities are likely to pay low dividends because they have profitable uses for the capital. So, growth is likely to place a greater demand on internally generated funds. Higher growth firms use less .[14] This is because conflicts of interest between debt and equity holders. Myers (1977) also argues that firms with growth potential would have less capital structure. Growth opportunities can produce moral hazard effects and push firms to take more risk. In order to mitigate this problem, growth opportunities should be financed with equity or retained earnings instead of debt. It has been predominantly supported by the empirical studies that internally generated funds have enormously contributed to financing growth of corporations in recent times.[16].Most previous researches investigated

company's growth factor with a factor, but in this paper, we focus on mentioned issues, we are looking for finding a convenient and effective relationship between several factors influencing the growth of the firm, and its relation to retained earnings. Finally, the main research question of research is that whether its growth parameters have impact on (growth opportunities, firm size) on the changes ratio in retained earnings of companies or not. The main purpose of this study is to find the relationship between various factors of the company's growth and sustainability of firms' capital structure.

2 REVIEW OF LITERATURE

Kim et al (2003) examine the relationship between corporate earnings management and the firm size. They investigate the earnings of the small, medium and large companies in relation to their size and the beginning of the market value of each year by taking a sample data of 18 years. They find that company size had a strong impact on the earning management. Small sized companies are avoiding the addition of earnings management as compared to large companies. On the other hand the medium and large size companies are more involved in earning management as compare to small firms.[8]

Iram Naz and et al (2011) in their study examined the Impact of Firm Size and Capital Structure on Earnings Management Evidence from Pakistan has paid The results indicate a significant negative impact of capital structure on earning management. Thus we concluded that firms with debt based capital structure have creditors acting as watchdog on its earning management practices, however results firm size were not significant.[12]

Ravi Thirumalaisamy, (2013). in their study examined the Firm Growth and Retained Earnings Behavior – A Study on Indian Firms ,The results suggest that across the classifications of sample companies cash flow and dividend are found to be the most influencing variables on retained earnings. Companies with low investment opportunities for growth and expansion prefer to distribute much of their earnings as dividend. The potential investment opportunities are likely to arise far off in the future for these companies. So profit, if retained, remains unutilized for long time or utilized in short-term investment opportunities which would yield low return on investment. Such companies prefer to pay out the earnings and raise capital whenever needed. Thus, the level of earnings retained is very much influenced by the growth rate of the companies.

3 THEORETICAL LITERATURE OF RESEARCH

According to the theory of stable equilibrium, growing companies in bankruptcy more than other lose their value. Several theories which have been proposed in the theory of agency costs, have confirmed this negative relationship. In contrast, the hierarchy theory of financing options suggests that we expect firms with high investment projects, over time, have accumulated a lot of debt [9].Theoretically, the relationship between firm size and financial leverage is not clear. According to ISNA balance model, larger firms have greater debt capacity. Also, larger companies usually have more diversity, and therefore, have more stable cash flows. Stability of cash reduces the risk and their bankruptcy. They also during the use of debt, have more bargaining power, and can reduce transaction costs associated with the release of long-term debt. Another possibility is that larger companies have more diverse shareholders causing less control over the management of the company. Thus it is likely that managers for reducing the risk of personal loss arising from bankruptcies use more debt. However, when the size of the company as a risk default variable, is considered, where the costs of financial distress is trivial, should not there is a significant positive relationship between financial leverage and firm size.[11]

4 THE HYPOTHESIS OF THE RESEARCH

1. There is a significant relationship between growth opportunities of the company and changes ratio in retained earnings of companies.
2. There is a significant relationship firm size and the ratio of the changes in retained earnings of the companies.

5 METHODOLOGY

5.1 RESEARCH METHODOLOGY IN TERMS OF NATURE, PURPOSE AND METHOD FOR DOING RESEARCH

Present study in terms of nature and content is Correlation study, and in terms of type of work is a research study and in terms of purpose in a applicable study, and as well as in terms of the method for doing research is in the framework of deductive-inductive reasoning.

5.2 DATA COLLECTION TOOLS

To study theoretical foundations and literature review, the library method with using books and papers and theses have been used, and information needed is extracted from financial statements of listed companies on the Stock Exchange.

5.3 VARIABLES OF RESEARCH

5.3.1 INDEPENDENT VARIABLE

Growth opportunities (M/B): Growth opportunities is the ratio of market value to book value (Cheng et al, 2009)

Firm Size ($Size_{i,t}$): is equal to the natural logarithm of the book value of total assets .[18]

5.3.2 DEPENDENT VARIABLES

The ratio of changes in retained earnings ($GRE_{i,t}$): This formula is derived from the research of Graham and Harvey (2001):[7]

$$GRE_{i,t} = \frac{\text{retained earnings at end of year t} - \text{retained earnings at end of year (t-1)}}{\text{Book value of total assets}}$$

5.3.3 CONTROL VARIABLES

Tangible assets ratio ($Tang_{i,t}$): Net property and equipment and machines divided by the book value of total assets .[13]

Investment policy ($Inv_{i,t}$): To get the investment policy, the ratio of capital expenditure to book value of assets is used.[17]

Dividend of the Company ($DivPayer_{i,t}$): Dummy Variable that if the company has paid a cash dividend, it is equal to 1 otherwise it is equal to zero .[3]

Cash assets ratio ($CashHolding_{i,t}$): cash assets divided by the book value of total assets .[15]

Sales growth rate of company ($SG_{i,t}$): This formula is derived from the research of Cooney et al (1993):[5]

$$SG_{i,t} = \frac{S_{i,t} - S_{I,t-1}}{S_{i,t-1}}$$

$SG_{i,t}$: Sales growth of firm i in year t
$S_{i,t}$: Net sales of firm i in year t
$S_{i,t-1}$: Net sales of firm i in year t-1

5.4 THE POPULATION

The population of the study is all listed companies in Tehran Stock Exchange during the period of 2006-2011, of the 520 companies listed in Tehran Stock Exchange, which meet all of the following criteria:

1) To March 2006 are listed, and their names until the end of March 2012 from the list of listed companies are not removed.
2) During the desired period, their shares are traded actively on an exchange.
3) Their financial period must be ended 29 March, and in the course of the study, the financial terms have not changed.
4) They are not among financial intermediation companies (investment, holding, leasing, and banking and insurance) because of their different performances.
5) The information you need is available.

In this study, 101 companies as sample are selected.

5.5 DATA ANALYSIS METHOD

In this study, to evaluate and determine the appropriate model, panel data method of Chow test using, Hausman test is used and to test the significance of the model, the F statistic and for significance of the coefficients, T-statistics and for normalizing variables, Kolmogorov-Smirnov test is used and software Spss 20, Eviews7 and Minitab16 are used for analysis.

6 DESCRIPTIVE STATISTICS FOR RESEARCH VARIABLES

Mean is the most important central index, and shows mean data so that, if the data are aligned on an axis on a regular basis, the mean value is precisely the balance point or center of distribution. Standard deviation is a distribution parameter, and shows scattering of data. Skewness is determining parameter of deviations from symmetry and is symmetry index of data. Summary descriptive statistics of the variables modeled after the screening and removal of outliers using software Spss20 are presented in table 1.

Table 1. Descriptive statistics of variables of Research

Variable	Number	Average	Standard deviation	The Minimum amount	The maximum amount	Skewness	Elongation
The ratio of changes in retained earnings	606	0.0052	0.1069	-0.9446	0.5119	-1.701	16.168
Growth opportunities	606	1.0068	1.0068	-3.0076	4.5546	-2.231	9.387
Company size	606	0.1018	0.1018	1.5383	2.0781	0.499	0.145
Tangible assets ratio	606	0.1889	0.1889	0.0008	0.8786	0.859	0.391
Investment policy	606	0.0348	0.0348	0.0000	0.4803	4.616	46.689
Dividend	606	0.4259	0.4259	0.0000	1.0000	-1.226	-0.474
The ratio of cash assets	606	0.2179	0.2179	0.0713	0.9723	-0.547	-0.547
Rate of sales growth	606	2.0804	2.0804	-1.0000	49.1606	21.763	5.6.818

According to table 1, the average the ratio of changes in retained earnings of sample companies has been 0.0052 , and minimum and maximum value, respectively, has been -0.9446 and 0.5119. Evaluation of skewness and elongation of this variable, which should be 0 and 3, to variable has normal distribution indicates that this variable does not has normal distribution. Based on the descriptive statistics presented in table 1, the average variables of growth opportunities and firm size, sample companies during the positive period, respectively are 1.0068 and 0.1018. The positive mean the ratio of Tangible assets, investment policy, dividend, ratio of cash assets and the growth rate of sales respectively are 0.1889, 0.0348, 0.4259, 0.2179 and 2.0804.

7 TEST FOR NORMAL DISTRIBUTION OF THE DEPENDENT VARIABLE OF RESERCH

In this study, this issue through Kolmogorov-Smirnov (KS) is investigated. H_1 and null hypothesis in this test is as follows:

$$\begin{cases} H_0 : Normal \;\; Distrbuton \\ H_1 : Not \;\; Normal \;\; Distributi \;\; on \end{cases}$$

If the level of significance of the test statistic is more than 0.05 (Prob> 0.05), H_0 hypothesis based on normal variable distribution will be accepted. In table 2, the K-S Statistics results for factors of the changes in retained earnings ratio of companies in the sample are provided.

Table 2. Descriptive statistics of variables of Research

Variable	Number (N)	Statistics (KS)	Significance level (Sig)
The ratio of changes in retained earnings	606	4.322	0.000

Given that, for a variable of changes in retained earnings, significance level of K-S Statistics is less than 0.05, therefore, H_0 hypothesis based on normal variable distribution is rejected at the 95% confidence level, indicating that the variables of the ratio of changes in retained earnings don't normal distribution. Being normal of dependent variable is necessary condition for regression models, so it is necessary that before hypothesis test, this variable is normalized. In this study, for normalizing data, Johnson's Transformation function is used, and it is analyzed by software Minitab16. The results of the K-S test, after normalizing the data, are provided in table 3.

Table 3. Descriptive statistics of variables of Research

Variable	Number (N)	Statistics (KS)	Significance level (Sig)
The ratio of changes in retained earnings	606	0.637	0.812

According to table 3, since after normalizing data, significance level (Sig) of statistic Kolmogorov - Smirnov for the dependent variable is greater than 0.05 (0.812), thus the hypothesis at 95% confidence level is confirmed and indicates that the variables of ratio of changes in retained earnings, after normalization process, have normal distribution.

8 THE INVESTIGATION OF CORRELATION VARIABLES

In this section, using Pearson's correlation coefficient, the relationship between variables of research and the correlation between them is examined. Matrix of correlation coefficients between variables is presented in table 4. The ratio of changes in retained earnings also has significant and positive correlation with ratio of dividend and has significant and negative correlation with the investment policy. Growth opportunities have significant and positive correlation with ratio of tangible assets. In connection with the company's size, this variable has negative and significant correlation with the ratio of cash assets. Tangible assets ratio also has significant and negative correlation with investment policy, and the ratio of cash assets and the investment policy also has significant and positive correlation with the ratio of cash assets.

Table 4. The matrix of Pearson correlation coefficients between variables

	The ratio of changes in retained earnings	Growth opportunities	Company size	The ratio of Tangible assets	Investment policy	Dividend	The ratio of cash assets	Rate of Sales growth
The ratio of changes in retained earnings (P-Value)	0 1							
Growth opportunities (P-Value)	0.025 (0.541)	1						
Company size (P-Value)	0.008 (0.852)	-0.005 (0.899)	1					
The ratio of Tangible assets (P-Value)	-0.004 (0.924)	0.090 (0.027)	-0.045 (0.682)	1				
Investment policy (P-Value)	-0.314 (0.000)	-0.063 (0.121)	0.052 (0.197)	-0.132 (0.001)	1			
Dividend (P-Value)	0.249 (0.000)	-0.001 (0.988)	-0.054 (0.186)	-0.053 (0.194)	0.030 (0.463)	1		
The ratio of cash assets (P-Value)	-0.050 (0.216)	-0.069 (0.090)	-0.163 (0.000)	-0.669 (0.000)	0.200 (0.000)	0.075 (0.063)	1	
The ratio of sales growth (P-Value)	0.064 (0.114)	-0.019 (0.641)	0.052 (0.203)	0.002 (0.952)	-0.043 (0.290)	0.004 (0.920)	- 0.026 (0.525)	1

9 RESULTS OF HYPOTHESIS TESTING

9.1 TEST RESULTS OF THE FIRST HYPOTHESIS TEST

In the first hypothesis, the relationship between growth opportunities and the ratio of Changes in retained earnings of companies is studied, and its statistical hypothesis is stated as follows:

H_0: There is no significant relationship between growth opportunities and the ratio of Changes in retained earnings of companies.

H_1: There is a significant relationship between growth opportunities and the ratio of Changes in retained earnings of companies.

This hypothesis using the model (1) as the panel data is estimated, and if the coefficient β_1 is significant at a confidence level of 95%, it will be confirmed.

$$GRE_{i,t} = \beta_0 + \beta_1 M/B_{i,t} + \beta_4 Tang_{i,t} + \beta_5 Inv_{i,t} + \beta_6 DivPayer_{i,t} + \beta_7 CashHolding_{i,t} + \beta_8 SG_{i,t} + \varepsilon_{i,t} \quad (1)$$

The results of the Chow test (to determine the use of panel data or hybrid data method) and Hausman (to determine the use of fixed or random effects in the method of panel data) for model (1), are presented in Table 5.

Table 5. The results of Chow and Hausman results for model (1)

Test	Number	Statistics	Degrees of freedom	Statistics value	P-Value
Chow	606	F	(100.499)	1.6054	0.0087
Hausman	606	χ^2	6	6.4038	0.0495

According to the results of the Chow test and P-Value, panel data methods can be used, and also according to the results of Hausman test and P-Value, it is necessary to estimate the model using fixed effects. In investigation of assumptions of the classical regression, the results of Jarque-Bera indicate that, the remaining of the research model at 95% confidence level have normal distribution, and Breusch-Pagan test results based on this issue that model has problem of non-homogeneity of variance. In this study, to solve this problem, generalized least squares estimation (GLS) is used. Statistic of Durbin-Watson also indicates that the residuals are independent (because Durbin-Watson Statistics is between1.5 - 2.5). In addition, Ramsey test results indicate that the model does not have clear error. Summary results of these tests are presented in Table 6.

Table 6. the results of the first hypothesis test using fixed-effects method

Jarque-Bera statistic		Breusch-Pagan test		Durbin Watson statistic	Ramsey test	
χ^2	P-Value	F	P-Value	D	F	P-Value
3.3482	0.1874	6.4049	0.0000	2.18	23.9161	0.1132

According to the results of Chow and Hausman tests, and also the results of test the assumptions of the classical regression, model (1) using panel data and as fixed effects be estimated. The results are presented in Table 7.

Table 7. The results of the first hypothesis test using fixed-effects method

The dependent variable ratio of Changes in retained earnings (Number of views: 606 years – now)				
Variable	Coefficient	Statistics (t)	P-Value	Relation
Fixed component	-0.0298	-1.1400	0.2548	Meaningless
Growth opportunities	-1.0006	-1.4349	0.0038	Negative
The ratio of Tangible assets	-0.0123	-0.4360	0.6630	Meaningless
Investment policy	-0.5377	-4.4987	0.0000	Negative
Dividend	0.0469	10.2654	0.0000	Positive
The ratio of the cash assets	0.0355	1.1074	0.2686	Meaningless
Rate of sales growth	0.0023	1.0319	0.3026	Meaningless
The determination coefficient of model				0.2870
Statistics F (P-Value)				1.8955 (0.0000)

The model is estimated using Eviews 7 software as follows:

$$GRE_{i,t} = -0.0298 - 1.0006M/B_{i,t} - 0.0123Tang_{i,t} - 0.5377Inv_{i,t} + 0.0469DivPayer_{i,t} + 0.0355CashHolding_{i,t} + 0.0023SG_{i,t} + \varepsilon_{i,t}$$

In investigation of being significant of model, given that the probability of F-statistic is smaller than 0.05 (0.0000), with 95% confidence, being significance of the model is confirmed. Determining coefficient of model also indicates that, 28.70 percent of ratio of Changes in retained earnings is explained by the variables entered in the model. In investigation of being significant of coefficients given the results presented in Table 7, since the possibility of t-statistic for variable coefficient of growth opportunities is smaller than 0.05 (0.0038), therefore, it is confirmed that there is significant relationship between Growth opportunities and ratio of Changes in retained earnings at the 95 percent confidence level. A negative coefficient for this variable (-1.0006), indicating that there is an inverse relationship between Growth opportunities and ratio of Changes in retained earnings.

10 THE RESULTS OF SECOND HYPOTHESIS TEST

The purpose of the second hypothesis is to examine asymmetric relationship between cash flows due to company size and the ratio of changes in retained earnings of the companies, and its statistical hypothesis is stated as follows:

$H_{0:}$ There is no significant relationship between firm size and the ratio of changes in retained earnings of the companies.

H_1: There is a significant relationship between company size and the ratio of changes in retained earnings of the companies.

This hypothesis using the model (2) as the panel data is estimated, and if the coefficient β_3 is significant at a confidence level of 95%, it will be confirmed.

$$GRE_{i,t} = \beta_0 + \beta_3 LnSize_{i,t} + \beta_4 Tang_{i,t} + \beta_5 Inv_{i,t} + \beta_6 DivPayer_{i,t} + \beta_7 CashHolding_{i,t} + \beta_8 SG_{i,t} + \varepsilon_{i,t} \quad (2)$$

The results of the Chow test (to determine the use of panel data or hybrid data method) and Hausman (to determine the use of fixed or random effects in the method of panel data) for model (2), are presented in Table8.

Table 8. The results of Chow and Hausman test for the model (2)

Test	Number	Statistics	Degrees of freedom	Statistics value	P-Value
Chow	606	F	1.6749	(100.499)	0.0016
Hausman	606	χ^2	6.8950	6	0.0199

According to the results of the Chow test and P-Value, panel data methods can be used, and also according to the results of Hausman test and P-Value, it is necessary to estimate the model using fixed effects. In investigation of assumptions of the classical regression, the results of Jarque-Bera indicate that, the remaining of the research model at 95% confidence level have normal distribution, and Breusch-Pagan test results based on this issue that model has problem of non-homogeneity of variance. In this study, to solve this problem, generalized least squares estimation (GLS) is used. Statistic of Durbin-Watson also indicates that the residuals are independent (because Durbin-Watson Statistics is between1.5 - 2.5). In addition, Ramsey test results indicate that the model does not have clear error. Summary results of these tests are presented in Table 9.

Table 9. The results of test related to the statistical assumptions of the model (2)

Jarque-Bera statistic		Breusch-Pagan test		Durbin Watson statistic	Ramsey test	
χ^2	P-Value	F	P-Value	D	F	P-Value
3.1077	0.2114	5.8643	0.0000	2.01	22.4094	0.1612

According to the results of Chow and Hausman tests, and also the results of test the assumptions of the classical regression, model (2) using panel data and as fixed effects be estimated. The results are presented in Table 10.

Table 10. The results of the first hypothesis test using fixed-effects method

The dependent variable ratio of Changes in retained earnings (Number of views: 606 years – now)				
Variable	**Coefficient**	**Statistics (t)**	**P-Value**	**Relation**
Fixed component	-0.3730	-2.9809	0.0030	Negative
firm size	1.1995	2.8131	0.0051	Positive
The ratio of Tangible assets	-0.0132	-0.4643	0.6426	Meaningless
Investment policy	-0.5200	-4.3414	0.0000	Negative
Dividend	0.479	10.6815	0.0000	Positive
The ratio of the cash assets	0.5844	0.5473	0.5844	Meaningless
Rate of sales growth	0.0020	0.8856	0.3762	Meaningless
The determination coefficient of model				0.2964
Statistics F (P-Value)				9 (0.0000)

The model is estimated using Eviews 7 software as follows:

$$GRE_{i,t} = -0.3730 + 1.1995 LnSize_{i,t} - 0.0132 Tang_{i,t} - 0.5200 Inv_{i,t} + 0.0479 DivPayer_{i,t} + 0.0178 CashHolding_{i,t} + 0.0020 SG_{i,t} + \varepsilon_{i,t}$$

In investigation of being significant of model, given that the probability of F-statistic is smaller than 0.05 (0.0000), with 95% confidence, being significance of the model is confirmed. Determining coefficient of model also indicates that, 29.64 percent of ratio of Changes in retained earnings is explained by the variables entered in the model. In investigation of being significant of coefficients given the results presented in Table 10, since the possibility of t-statistic for variable coefficient of growth opportunities is smaller than 0.05 (0.0051), therefore, it is confirmed that there is significant relationship between company size and ratio of Changes in retained earnings at the 95 percent confidence level. A positive coefficient for this variable (1.1995), indicating that there is a direct relationship between company size and ratio of Changes in retained earnings.

11 CONCLUSION

In this study, we have examined the relationship between various measures of company growth and sustainability of the capital structure of listed companies in Tehran Stock Exchange with a total of 101 samples in 2006 to 2011. To gather information, the library method, and also for extracting statistical information, the audited financial statements of listed companies in Tehran Stock Exchange are used, and for analysis, panel data method is used. Using the first hypothesis can be concluded that there is a direct relationship between company's growth opportunities and the ratio of changes in debt. The result of the first hypothesis is in accordance with the significant relationship between the independent variable and dependent of research of Alti (2006), but in terms of the type of relationship (direct or inverse), it is related to the results of Cheng et al (2009) and it is inconsistent with the research of Graham and Harvey (2001). In relation to confirmation of the first hypothesis, it can be concluded that there is significant and inverse relationship between growth opportunities for the company and the ratio of changes in retained earnings of companies. In relation to confirmation of the second hypothesis, it can be concluded that there is significant and direct relationship between company size and the ratio of changes in retained earnings of companies. The results of second hypothesis of our study in terms of relationship are consistent with the results of some studies such as Liu (2009) and pastor and veronesi (2003), and it is inconsistent with the results of other research such as: Kachik and colleagues (1990).

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