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Impact of Dividend Policy on Stock Price Volatility in Companies Listed on the Tehran Stock Exchange

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Abstract

Dividend payout directly utilizes the stockholders, influences ability of company in retained earnings in order to use the growth opportunities, and dividend policy is one of the cases that are influenced by agency conflicts. Current study investigates impact of dividend policy on stock price volatility in the companies listed on the Tehran Stock Exchange. This study is applied and experimental research. Statistical population of current research included all companies listed on the Tehran Stock Exchange during 2009 - 2015, and 94 companies were selected as sample following some restrictions. Sampling was not used in this work, and all population members were investigated. T test at 95 percent level was used for testing hypotheses. According to the findings, there is inverse significant relationship between dividend policy and stock price volatility. There is inverse significant relationship between dividend payout ratio and stock price volatility, and dividend volatility has no effect on stock price volatility.

Keywords: Dividend Policy, Stock Price Volatility, Dividend Payout Ratio

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1. Introduction

Stock price volatility is one of the factors affecting behavior of investors, and Graham et al. (2005) found that 97 percent of financial managers smooth profit in order to avoid severe volatility in earnings. Thus, all financial managers justify profit smoothing for the fear of earnings volatility, because they believe that earning volatility reduces profit predictability. Many factors affect stock price volatility, one of which is dividend policy. Dividend policy is one of the main issues in financial literature, because it represents main cash payouts of the companies and it is regarded as one of the main alternatives and decisions of progress for the managers. Managers and owners should decide how much of the company's profit should be divided, and how much of it should stay and be invested in the companies in the form of retained earnings or other accounts. The profit that is distributed among company's stockholders is known as dividend.

Dividend changes require information and this information include dividends and historical earnings. Profit and dividend patterns carry value properties of the company, and are valued by the market, thus they influence management's decision-making policies. Especially when the patterns are decomposed. Therefore, effect of historical profits and dividend at the time of earning reduction on information content of profits was investigated. It seems that patterns of profit and dividend increase are related to higher market rewards (Barth et al., 1999). Focus of managers on stabilizing or increasing profits is regardless of unexpected profits related to dividend smoothing, and deviation from dividend policies is doubted (DeAngelo et al., 2006). Although dividend payout directly benefits stockholders, it influences ability of company in retained earnings for utilizing growth opportunities (Baker, 2002).

2. Research Hypothesis

- Dividend policy influences stock price volatility.

3. Review of Literature

Profitability of investments of an institution may influence its dividend policy. Young institutions with high growth situations may conclude that their profit should be allocated to potentially profitable investments. Thus, they tend less to distribute the profit. This policy is based on the principle that given cost of capital and internal financing, internal financing is lower than external financing, and considering status and significance of profit of companies in their initial stages of life cycle or the companies needing financial resources, they are motivated to distribute fewer profit, and use the company's profit as the financing source (Ronny Manos et al., 2012).

The companies with higher stability in profitability than other companies are probable to distribute their profit. The companies with variable cash flows and investment needs should not pay regular and high dividend. These companies are better to impose low regular dividend so that they can afford its payment even in periods when their profit is very low (Izadinia et al., 2010).

Since some stockholders prefer fixed progress in dividend, the companies may attempt to achieve a defined dividend ratio gradually over a time period. Thus, presence of a continuous trend in dividend may be considered as an effective factor on dividend policy in the related decisions (Purheydari and Khaksari, 2008).

Dividend requires cash payment, thus the liquidity situation of the company influences its dividend decisions. Hence, a company may tend to distribute larger dividends, but due to lack of sufficient liquidity, it is not able to distribute a small portion of accounting profit (Karami, Mehrani and Eskandar, 2010).

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In general, a company that has easy access to financing sources may feel less constrained in its dividend decision. For such a company, given the availability of outsourcing resources, the dividend decision is somewhat independent of the investment decision (Khodamipur et al., 2013).

In addition to the above-mentioned factors, the stock price-to-profit ratio, effect of the dividend policy on the stock value, the history and size of the firm, the type of industry in which the firm is engaged, the net profit ratio of the company and the expected profits for the coming years are among the factors that can affect dividend decisions (Purheydari and Khaksari, 2008).

Shaker and Hajiha (2014) in their work entitled "Profit volatility effect on increased risk of stock price reduction in companies listed on Tehran Stock Exchange" stated that profit volatility is one of the most effective variables in determining investment strategy in financial markets. In addition, profit volatility is one of the factors affecting behavior of investors. When negative news is retained in the company and profit of the economic unit has severe volatilities, it suddenly leads to drop of stock price. Thus, current research investigates profit volatility effect on increased risk of stock price in companies listed on Tehran Stock Exchange. 124 companies during 2008 - 2012 were investigated in this research. Logistic regression model was used for testing hypotheses. Research findings indicate that profit volatility has positive and significant effect on increased risk of stock price reduction.

Shakeri and Tirgari (2013) conducted a research entitled "Effect of dividend policy on stock price volatilities in companies listed on Tehran Stock Exchange (with emphasis on type of industry)". The main research goal was relationship between dividend policy and stock price volatilities in companies listed on Tehran Stock Exchange. They used data of 201 companies listed on Tehran Stock Exchange during 2006 - 2010. This experimental test is based on cross-sectional regression of relationship between stock price volatilities and dividend policy following controlling firm growth, earning volatility, long-term debts, and asset growth factors. Research findings indicate that at the level of companies listed on Tehran Stock Exchange, dividend policy (dividend ratio) had no significant effect on stock price volatility. This finding is also true for food and beverage industries, chemical materials and products, and non-metallic mineral materials. In addition, they also showed that dividend policy criterion (dividend ratio) had significant and positive effect on stock price volatility in automotive industry.

Jabarzadeh and Motavasel (2012) showed that managers in companies listed on Tehran Stock Exchange do not attempt for satisfying stockholders and do not have stable dividend policy. In addition, company life cycle and systematic risk are not the determinants of dividend policy, while uncertainty in cash flow, fixed assets, cash, firm size, and investment opportunities are factors that affect dividend.

Hashemjoo et al. (2012) examined effect of dividend policy on stock price volatility in the stock market. The results showed that dividend policy, which is the profit and dividend payout, has a negative and significant relationship with the stock price volatility. In addition, there is a significant negative relationship between stock price volatility and firm size.

Aubur and Bokpin (2010) studied effect of company's investment opportunities and financing on dividend policy. Their findings indicated negative relationship between collection of investment opportunities and dividend policy. In addition, relationship of dividend criteria was not significant.

Daisy et al. (2010) studied effect of monetary policy shocks on stock price. They provided evidence from Canada and USA and experimentally investigated that if liberalization of financial and commercial markets is critical to the shocks of monetary policy on stock prices or not. Findings of the research indicate that monetary policy shocks of USA have interesting impact on stock prices in Canada.

4.1. Methodology

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Current study investigates impact of dividend policy on stock price volatility in the companies listed on the Tehran Stock Exchange. Thus, it is an applied research in terms of purpose. It is quais0experimental research since research data were collected without direct interference of the researchers. Status of variables is investigated using data collection through the past information, thus it is an event-descriptive study.

Data were collected using library sources and observation of financial statements of the companies listed on Tehran Stock Exchange. Data collection tool was observation of financial statements and reports of the companies and stock exchange organization.

4.2. Hypothesis Test Model

Following model is used for testing research hypothesis:

$$PVOL_{it} = \alpha_0 + \alpha_1 DYIELD_{it} + \alpha_2 PAYOUT_{it} + \alpha_3 SIZE_{it} + \alpha_4 EVOL_{it} + \alpha_5 DEBTA_{it} + \alpha_6 GROWTH_{it}$$

$$PVOL = \alpha_0 + \alpha_1 DYIELD + \alpha_2 PAYOUT + \alpha_3 SIZE + \alpha_4 EVOL + \alpha_5 DEBT \alpha_6 GROWTH$$

$$PVOL = \alpha_0 + \alpha_1 DYIELD + \alpha_2 PAYOUT + \alpha_3 SIZE + \alpha_4 EVOL + \alpha_5 DEBT \alpha_6 GROWTH$$

where:= 0+1+2+3+4+5+6

$PVOL_{it}$: Stock price volatility of company i at year t

$PAYOUT_{it}$: Dividend payout ratio of company i at year t

$EVOL_{it}$: Dividend volatility of company i at year t

$DYIELD_{it}$: Dividend policy of company i at year t

$DEBTA_{it}$: Debt ratio of company i at year t

$SIZE_{it}$: Firm size of company i at year t

$GROWTH_{it}$: growth of company i at year t

4.3. Variables and Their Calculation

Research variables include following cases:

A. Independent Variables

1. Dividend Policy

It is ratio of divided profit to net profit that represents dividend policy (Hashemjoo et al., 2012).

$$DYIELD = \sum_{i=1}^{6} \frac{\frac{D_i}{MV_i}}{7}$$

where:

D_i: Total annual cash profit paid to stockholders at year i

MV_i: Company's market value at the end of year t that is calculated through stock price multiplied by number of stocks

2. Dividend Payout Ratio

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Dividend payout ratio is defined as total dividend paid in a fiscal year (Jiang et al., 2016).

3. Dividend Volatility

It is seven-year standard deviation of operating profit to assets,

where:

R_i = Ratio of operating income tot total assets for year i

$\frac{R_i R_i}{7\ 7} = \overline{R}\overline{R}$, 7 : Number of years

$$E.VOL = \sqrt[2]{\frac{\sum_{i=1}^{6}(R_i-\bar{R})}{7}}$$

B. Dependent Variable:

Stock price volatility

H_i: The highest stock price for year i

L_i: The lowest stock price for year i

7: Number of years (Hashemjoo et al., 2012).

$$P.VOL = \sqrt{\sum_{i=1}^{7}\frac{(\frac{H_i-L_i}{H_i-L_i})^2}{7}H_iH_i}$$

C. Control Variable:

1. Firm size

It is obtained from sum of book value of assets.

2. Debt ratio

$$DEBT = \sum_{i=1}^{6}\frac{LD_i}{ASSET_i}{7}$$

LD_i: Long-term debt of the company in year i

$ASSET_i$: Sum of firm assets in year i (Hashemjoo et al., 2012).

3. Firm growth

$$GROWTH = \sum_{i=1}^{6}\frac{\Delta ASSET_i}{ASSET_i}{7}$$

$:\Delta ASSET_i$ Change in total assets of the company in year i

4.4. Statistical Population and Statistical Sample

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Statistical population of current research included all companies listed on the Tehran Stock Exchange during 2009 - 2015, and 94 companies were selected as sample following some restrictions. Sampling was not used in this work, and all population members were investigated.

Table 1. Research Population

all companies listed on the Tehran Stock Exchange 635		
	331	Companies that are not present in Stock Exchange during temporal domain of research
	74	Companies that their fiscal year does not end in 20 March
	35	Leasing and financial agency companies
	101	Companies that their information is not available
	541	Total of companies that did not consider respective criteria
94		Companies selected in research

4.5. Data Analysis Method

Analysis of statistical data is one of the main stages of research. Using proper statistical methods provides presentation of effective results. Statistics is a set of techniques or mathematical methods used to collect, adjust, analyze, and interpret numeric data. Because it is an evaluation and research. Panel data is used for analysis of data collected to prove or reject the hypotheses. The statistical software used in this study is Eviews software.

4.6. Investigation of Stationarity of Variables

Before model estimation, it is necessary to check the stationarity of the variables. If the probability of each variable is greater than 5%, the variable is non-stationary. In this case, its stationarity is checked on the first difference, and if it is non-stationary this case, its stationarity is examined on the second difference. It helps that results obtained from estimation are not false, and results that are more reliable are obtained from the model. There are various test for determining stationarity of panel data such as Levin Lin, Fisher, Im-Pesaran and Shin tests. Levin Lin and Im-Pesaran and Shin tests were used in this work for examining stationarity test, results of which are given in table below.

Table 2. Results of stationarity of variables

Variable	Test statistics Levin, Lin & Chu t	Test statistics Im-Pesaran and Shin	Result Test
Dividend policy	93.85- 0.000	23.10- 0.000	Stationary at zero level
Debt ratio	38.25- 0.000	8.12- 0.000	Stationary at zero level
Payout ratio	11.93- 0.000	1.67- 0.000	Stationary at zero level
Dividend volatility	98.35- 0.000	32.12- 0.000	Stationary at zero level

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Variable	Test statistics Levin, Lin & Chu t	Test statistics Im-Pesaran and Shin	Result Test
Stock price volatility	47.31- 0.000	7.31- 0.000	Stationary at zero level
Firm growth	35.95- 0.000	8.55- 0.000	Stationary at zero level
Firm size	20.90- 0.000	4.40- 0.000	Stationary at zero level

According to results of Levin Lin test, it was found that all variables are significant at zero level with 0.000 probability, and null hypotheses can be rejected. Therefore, all model variables are stationary at zero level.

5. Results

5.1. Investigation and description of information related to independent and dependent variables of research

In this research, descriptive indexes of variables under study are obtained as Table 3.

Table 3. Descriptive statistics related to independent and dependent variables of research

Max.	Min.	SD	Median	Mean	Variable
1.12	0.10	0.26	0.16	0.18	Debt ratio
0.89	0	0.11	0.04	0.08	Dividend policy
2.37	0	0.32	0.74	0.73	Payout ratio
2.19	-0.57	1.28	-0.15	-0.22	Dividend volatility
23.65	-18.12	6.4	2.6	3.8	Stock price volatility
23.11	0.21	3.67	3.01	4.36	Firm growth
18.54	18.10	1.13	13.47	13.26	Firm size

Table 3 indicates characteristics of research variables. First column of this table indicate all research variables and second column provides median of collected variables separately. The third column indicates standard deviation or dispersion of variables. Fourth and fifth columns describe maximum and minimum changes of values as range of changes. The most important central index is mean that indicates equilibrium point and concentration of distribution and it is suitable index for indicating centrality of data. Mean of dependent variable, which is stock price volatility in sample companies, is almost 3.8 units, which denotes that volatility of stock price is evaluated at average level. The lowest value in this variable in the sample is -18.12 and highest value is 23.11. Mean of independent variable, which is dividend policy in sample companies, is almost 0.80 units, which denotes that dividend policy is evaluated at average level. The lowest value in this variable in the sample is 0 and highest value is 0.89.

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Regarding debt ratio as control variable: The mean obtained in this variable is 0.18. The lowest value in this variable in the sample is 0.01 and highest value is 1.12. Regarding payout ratio variable: The mean obtained in this variable is 0.73. The lowest value in this variable in the sample is 0 and highest value is 2.37. Regarding firm growth variable, the mean obtained in this variable is -0.22. The lowest value in this variable in the sample is -0.57 and highest value is 2.19. Regarding dividend volatility variable: The mean obtained in this variable is -0.22. The lowest value in this variable in the sample is -0.57 and highest value is 2.19. Regarding firm size variable, the mean obtained in this variable is 13.26. The lowest value in this variable in the sample is 18.10 and highest value is 18.54.

5.2. Kolmogorov-Smirnov Test

H_0: Distribution of data related to variables is not normal.

H_1: Distribution of data related to variables is normal.

Results of normality test are given in Table 4.

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Table 4. Results of variable normality test

Probability	Statistics value	Variable
0.53	0.92	Debt ratio
0.64	0.87	Dividend policy
0.68	0.57	Payout ratio
0.54	0.91	Dividend volatility
0.23	1.27	Stock price volatility
0.86	0.46	Firm growth
0.73	0.69	Firm size

As it is clear, since test statistics is larger equal to 0.05 for all research variables, thus there would be no reason for rejection of alternate assumption on normality of data. In other words, distribution of data would be normal.

5.3. Kao Cointegration Test

Now cointegration test is investigated so see if all variables are cointegrated. That is, according to Kao cointegration test, if long-term relationships are supported or not.

Table 5. Kao cointegration test results

ADF	t	prob
	-9.24	0.000
Residual variance	0.024	------
HAC Variance	0.013	-----

Results obtained in table denote long-term relationship between variables under study, and variables show convergence over the time.

5.4. Estimation Test or Method (F Limer and Hausman Test Results)

In investigation of cross-sectional data and time series data, if the coefficients of cross-sectional effect and time effect are insignificant, then all the data can be combined and integrated regression can be used for estimation. However, if there were heterogeneity or individual differences between observations, panel models (fixed effects or random effects) are used.

H_0: 0= μ_n= ... = μ_1

H_1: At least one of $\mu_i\mu_i$should be non-zero.

Here μ_i represent individual effects or heterogeneities.

In order to specifying usage of panel data, F Limer test was used, results of which are given in table below.

Table 5.4 gives results of this estimation.

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Table 6. Result for model selection (F Limer test and Hausman Test)

Test type	Test statistics	Test statistics value	p-value
Constrained F test	F	39.15	-
Hausman	H	25.09	0.00

It is observed that the model under investigation is not integrated. In other words, panel data should be used.

In Hausman test, null hypothesis and alternative hypothesis is stated as following:

Null hypothesis in Hausman test means that there is no relationship between interruption element related to intercept and explanatory variables and they are independent. While alternative hypothesis states that there is correlation between interruption element and explanatory variable. If null hypothesis is rejected, fixed effects method is compatible. In this research, investigation of Hausman test results in Table 5.4 indicate that null hypothesis is rejected and fixed effects method is used.

5.5. Heterogeneity of Variance Test and Collinearity Test

One of the assumptions of regression equation is fixed variance of errors, which is recognized as homogeneity of variance assumption. If there is no fixed variance in errors, it is said that there is heterogeneity of variance. The other assumption in linear regression is zero covariance between error elements over the time.

Breusch-Pagan test is used in this work for examining heterogeneity of variance.

H_0: There is no heterogeneity of variance in model variables.

H_1: There is homogeneity of variance in model variables.

Table 7. Heterogeneity of Variance Test

Assumptions	homogeneity of variance test			Model
H_0	Chow Test	Sig. level	Heterogeneity	
Supported	0.03	0.42	No	Stock price volatility

Investigation of results for heterogeneity of variance test suggests significance level over 5 percent. Thus, null hypothesis is not rejected. It means that research variables have homogeneity of variance.

Collinearity means existence of linear relationship between all or some explanatory variables. In linear regression, it is assumed that there is no exact linear relationship between any of explanatory variables. Violation of this assumption leads to problem of collinearity. Of course, there is two type of collinearity including perfect collinearity and imperfect collinearity. If collinearity is perfect, this assumption is violated.

When there is perfect linear relationship between explanatory variables of the regression model, estimations of the regression model cannot be uniquely calculated. Collinearity denotes that two variables have closely leaner combination. It means that there is high correlation between independent variables and it is possible that the model lacks high reliability despite high R2. In other words, though the model seems

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good, it does not have significant independent variables. If collinearity is supported, there is a collection of problems in determining accuracy of regression equation.

Variance Inflation Factor (VIF) for Investigation of Collinearity

Variance Inflation Factor (VIF) is used for examining presence of collinearity. If VIF index of an independent variable is larger than 5, it has probably collinearity with other variables. In this case, it should be more studied. Otherwise, there is no collinearity problem among independent variables.

Collinearity test (VIF) of the research variables are as follows:

Table 8. Collinearity test

Variable	Model
Dividend volatility	1.27
Dividend payout ratio	1.22
Financial leverage	1.07
Dividend policy	1.36
Firm size	1.81
Firm growth	1.64

Collinearity values above 10 indicate probability of collinearity between independent variables, and values above 15 implies serious problem in using regression in existing status (Hasas Yeganeh et al., 2009). On the other hand, collinearity values smaller than 10 suggest lack of collinearity among independent variables.

5.6. Testing Research Hypotheses

In this section, firstly the model specified for investigation of effect of explanatory variables on stock price volatility is estimated with fixed effects method. Results are given in Table 9.

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Table 9. Results obtained from model estimation for panel data

Variable	Coefficient	T statistics	Significance level
Dividend volatility	0.87	0.68	0.49
Payout ratio	-0.12	-3.28	0.0007
Firm growth	-0.10	-4.07	0.000
Financial leverage	-0.03	-0.72	0.466
Firm growth	0.11	1.33	0.28
Firm size	-0.20	-2.24	0.03
Y-Intercept	2.00	2.67	0.007
Coefficient of Determination Adjusted Coefficient of Determination	0.47 0.37	Durbin- Watson Statistics	1.74

According to results in Table 9, considering Durbin- Watson Statistics in estimation, above variables lack autocorrelation.

R^2, coefficient of determination also shows that the variations of the independent variables of the model are capable of explaining 47 percent of the dependent variable variations.

5.6.1. First Hypothesis: Dividend policy influences stock price volatility.

H_0: Dividend policy does not influence stock price volatility.

H_1: Dividend policy influences stock price volatility.

Since t statistics related to dividend policy variable is 3.28 and it is larger than 1.96, thus with 95 percent confidence it can be stated that dividend policy has significant effect on stock price volatility. Therefore, H_1 is supported.

5.6.2. Second Hypothesis Dividend payout ratio influences stock price volatility.

H_0: Dividend payout ratio does not influence stock price volatility.

H_1: Dividend payout ratio influences stock price volatility.

Since t statistics related to dividend payout ratio variable is 4.07 and it is larger than 1.96, thus with 95 percent confidence it can be stated that dividend payout ratio has significant effect on stock price volatility. Therefore, H_1 is supported.

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5.6.3. Third Hypothesis Dividend volatility influences stock price volatility.

H_0: Dividend volatility does not influence stock price volatility.

H_1: Dividend volatility influences stock price volatility.

Since t statistics related to dividend payout ratio variable is 0.68 and it is smaller than 1.96, thus with 95 percent confidence it can be stated that dividend volatility does not have significant effect on stock price volatility. Therefore, H_1 is not supported.

6. Conclusion

According to first hypothesis, dividend policy influences stock price volatility. Panel data was used for testing this hypothesis. Results of Table 5.7 indicate there is inverse significant relationship between dividend policy and stock price volatility (significance level at 0.0007). Therefore, this hypothesis is accepted.

According to second hypothesis, dividend payout ratio influences stock price volatility. Panel data was used for testing this hypothesis. Results of Table 5.7 indicate there is inverse significant relationship between future profitability and cash changes (significance level at 0.0007). Therefore, this hypothesis is accepted.

According to third hypothesis, dividend volatility influences stock price volatility. Panel data was used for testing this hypothesis. Results of Table 5.7 indicate there is no relationship between dividend volatility and stock price volatility (at significance level at 0.49). Thus, this hypothesis was rejected.

6.1. Recommendations

Following recommendations are made according to the research findings:

A. Considering effect of dividend policy on stock price volatility, it is suggested to stockholders to gain more information about the company's dividend policy and factors that may affect it when choosing the company.
B. Considering the result of the hypothesis that dividend payout ratio affects stock price volatility, it is recommended that investors in listed companies consider investing in companies that have high earnings and that company's managers should provide transparent new information of companies in relation with the profit and stock price so that the investment risk is reduced and stock value is increased and provides more capital investment in the capital market.

6.2. Research Limitations

Every research work faces some limitations and problems because of interference of emotions and attitudes as well as other environmental factors in research. Following cases were limitations in the current research work:

A phenomenon in the real world may be influenced by multiple factors and variables. Some of these factors and variables are known for the researcher and he can specify effect of these factors on the respective phenomenon to some extent. While there are some other factors that the researcher is either unaware of them or it is not possible to determine their effect on the dependent variable quantitatively. Thus, in every research the researcher is able to investigate limited number of these independent variables. In the current work, other factors such as economic status, inflation rate, political conditions, etc. that were out of researcher's control, may influence the research findings.

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