

The Type of Institutional Ownership and Dividend in TSE

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ABSTRACT

Institutional investors affect on firms policies because of their substantial shareholdings. This study examines relationship between the type of institutional ownership and dividend policy. Not all institutional investors are equal. They have different interests and orientations. Therefore, we classify institutional investors in two categories (Active institutional ownership and Passive institutional ownership) and examine their relationship with dividend policy.

To examine these relations, three regression models are used. We obtain similar results about the types of institutional ownership. The types of institutional ownership (Active and Passive) are negatively associated with dividend. It means that there is no difference between institutional investors and they have similar preference about dividend. All of them prefer to retain cash in the company rather than dividend distribution.

KEYWORDS: Institutional Ownership; Active Institutional Ownership; Passive Institutional Ownership; Dividend.

1. INTRODUCTION

Different stockholders have different interests in relating to dividend [31]. In among stockholders, Institutional stockholders affect on corporate policies (include dividend policy) because of their substantial shareholdings. Nevertheless, whether the institutions actually affect on corporate policies is an empirical question. Institutional investors are not similar and have different effects on corporate dividend policy. Therefore, we classify institutional investors into two categories (Active Institutional ownership and Passive Institutional ownership) and examine their relationship with dividend policy. While there is empirical evidence for the relation between dividend and institutional ownership (e.g., [25],[29],[30],[31],[32],[33],[34]), the relation between institutional shareholdings types and dividend is relatively unknown.

This study examines the relationship between institutional ownership and dividend in Tehran Stock Exchange (TSE). Several studies have examined this relationship. For example Mehrani et. al. [25] show that institutional ownership is negatively associated with dividend payout and concentrated institutional ownership is positively associated with dividend. However, there is not a significant relationship between managerial ownership and dividend payout. This study differs from such researches. Firstly, this study divides the ownership into institutions that are long-term oriented and focus on long term performance (active institutional ownership) and those institutions that are short-term oriented and interest in current profit (passive institutional ownership). Thus, our study appropriately contributes to the literature.

Secondly, few studies exist about the relationship between institutional ownership and dividend policy in developing countries. In this study, we examine Iran, a developing nation with characteristics that are different from those of developed countries and many emerging economies and developing nations [23]. We have selected Iran because it has environmental characteristics different from other countries, such as religion, culture, capital market, corporate capital structure, and political and economical ties [5]. Moreover, dividend policy behavior of corporations in developing countries is significantly different from that of the developed countries [1]. Therefore, the relationship between institutional ownership and divided policies in different environments and countries is expected to be different. This study examines relationship between the type of institutional ownership and dividend policy on Tehran Stock Exchange. Glen et al. [14] find some substantial differences in dividend policy between developed countries and developing countries and show that Dividend policies are different in developed capital markets and emerging capital markets. One of the most important features of new capital markets, especially in developing countries, is large investors and acquisition of a great part of firm ownership rights by them.

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Iran is not an exception [27]. Therefore, the relationship between institutional ownership and dividend in different environments is different.

The rest of the paper is organized as follows: Section 2 reviews the literature. Materials and Methods are discussed in Section 3. Section 4 reports the results. Finally, discussion and conclusions are presented in section 5.

2. LITERATURE REVIEW

Ownership type is an effective factor on company policies (including dividend policy) [20]. Therefore, an association between the type of institutional ownership and dividend is expected. Institutional investors are large investors such as insurance companies, banks, pension funds, financial institutions, investment companies, and other nominee companies associated with the above categories of institutions [19]. The presence of institutional investors may lead companies to change their behavior. They have the influence on investee corporations and can affect on their policies because of their substantial shareholdings.

One of these policies is dividend policy. There are different theories about this relation. According to agency theory, a potential conflict of interest exists between managers and shareholders. Managers can use a corporation's resources to their own benefit rather than using them in the best interest of shareholders. The partial solution to this conflict is to minimize cash that management controls by distributing dividend to shareholders [1]. Thanatawee [30] shows that Thai firms are more likely to pay dividends when they have higher ownership institutional. The findings mostly driven by the ownership of domestic investors. Truong and Heaney [31] show that a positive relationship exists between institutional ownership and dividend payments in 37 countries. Wiberg [33] shows institutional ownership are positively associated with dividend payments among Swedish companies. Lee and Xiao [21] report the higher the percent of institutional shareholders, the higher the level of cash dividend payment in China.

According to signaling theory, Information asymmetry exists between managers and stockholders. Managers have private information while stockholders have not. Managers would take measures to transfer information. One of these measures is dividend. Therefore, dividend policy is a signal to transfer the information of future profitability ([28],[26]). Management uses dividends to convey private information not available to other market participants. Institutional shareholders may be viewed as alternative for dividend to signal good performance. The existence of institutional shareholders may mitigate the use of dividends as a signal of good performance, as these investors themselves can act as a (more) credible signal. Under this theory, a negative relation is predicted between dividends and institutional shareholders [34]. Al-najjar [4] shows that the dividend policy in Jordan, as a developing country, is influenced by factors similar to those relating to developed countries such as leverage ratio, institutional ownership, profitability, business risk, asset structure, growth rate and firm size. He finds that the number of shares owned by institutions is negatively associated with the dividend payments decision. This could be explained in a way that dividends and institutional ownership are alternative signaling devices. The existence of institutional ownership mitigates the need for dividends to signal good performance. Eskandar [12] and Mehrani *et al.* [25] show that institutional ownership is negatively associated with dividend payout. It indicated that the presence of institutional investors results in less usage from dividend as a signal for good corporate performance. Henry [15] and Desai and Jin [11] argues that institutional owners demand lower dividends. Azzam [7] paper examines the effect of institutional ownership on stock volatility, returns, and dividend policy in Egypt. It also investigates the impact of dividend policy on the direction of the relation between institutional ownership and stock volatility and returns. His results show that institutional ownership has significant and positive effect on stock volatility while it has no effect on returns. We find that private institutional ownership has negative effect on dividend payout ratio. Moreover, he shows that private institutional ownership significantly increases volatility for non-dividend paying stocks only because these stocks are more subject to institutional herding than dividend paying stocks.

In this study, we investigate whether this classification also is useful in predicting the impact of institutional ownership on dividend. A few studies suggest that not all institutional investors are equal (see [8],[3],[10]). They have different interests and orientations. Some may be transient and interested in short-term profits and others may be interested in long-term profits. Therefore, institutional investors can be divided into passive institutional investors (short-term oriented) and active institutional investors (long-term oriented).

Passive institutional investors are short-term oriented investors (Transient). These investors are pressure-sensitive. It means that they liquidate their investments if the firm performs poorly [24]. They do not have interest in contributing to companies activities and do not have representation in the companies' board of directors. They likely prefer dividend distribution rather than retaining it because of their short time horizons. Bushee [9] further shows that transient investors prefer short-run returns.

H1: “There is a significant relationship between the passive institutional ownership and dividend”.

Active investors are long-term oriented. They interest in contributing to the companies activities and have representation in companies’ board of directors. Therefore, these investors have greater incentive to monitor and affect on corporate policies [24]. Attig et al. [6] argue that institutional investors with longer investment horizons have greater incentives and efficiencies to engage in effective monitoring. This improved monitoring mitigates asymmetric information and agency problems, and in turn reduces the wedge between the costs of internal and external funds. As a result, the sensitivity of firms’ investment outlays to internal cash flows decreases in the presence of institutional investors with long-term investment horizons. Consistent with this view, long-term institutional investors are less likely to apply pressure on firms for profit distribution as dividend. Maybe, they are more likely to retain profits for investing in profitable projects and for reaching on more profits in long-term and increasing in corporate value.

H2: “There is a significant relationship between the active institutional ownership and dividend”.

3. MATERIALS AND METHODS

3.1. Models

Similar to Short et al. [29], we use three models to test the hypothesized link between institutional ownership and dividend and to test the hypothesized link between institutional ownership types (active and passive) and dividend.

The Full Adjustment Model (FAM). Lintner [22] represented this Model in the first time. In this model, the relationship between changes in earnings (E) and changes in dividends (D), for firm i at time t, will be given by:

$$D_{ti} - D_{(t-1)i} = \alpha + r (E_{ti} - E_{(t-1)i})$$

We include institutional ownership types (active institutional ownership and passive institutional ownership). This model will be as follows:

$$D_{ti} - D_{(t-1)i} = \alpha + r (E_{ti} - E_{(t-1)i}) + r_A (E_{ti} - E_{(t-1)i}) \times AC + r_I (E_{ti} - E_{(t-1)i}) \times PASS + \varepsilon \quad (1)$$

Where:

D: the total amount of ordinary dividends relating to the accounting year.

AC: the percentage of equity held by active institutions (long-term oriented with the board representation) at the beginning of the accounting year.

PASS: the percentage of equity held by passive institutions (short-term-oriented without board representation) at the beginning of the accounting year.

E: net profit derived from normal trading activities after depreciation and other operating provisions.

The Partial Adjustment Model (PAM). Lintner [22] represented this Model. In this model, the target level of dividend, D^* , for firm i at time t is relating to profits, E_{ti} , by a desired payout ratio, r:

$$D_{ti}^* = r E_{ti}$$

And it is argued that: $D_{ti} - D_{(t-1)i} = \alpha + c (D_{ti}^* - D_{(t-1)i})$

We include institutional ownership types (active institutional ownership and passive institutional ownership). This model will be as follows:

$$D_{ti} - D_{(t-1)i} = \alpha + crE_{ti} + cr_A E_{ti} \times AC + cr_I E_{ti} \times PASS - c D_{(t-1)i} + \varepsilon \quad (2)$$

Variables defined as above.

The Waud Model. This model was represented by Waud [32]:

$$D_{ti} - D_{(t-1)i} = \alpha d + cdrE_{ti} + (1-d-c) D_{(t-1)i} - (1-d)(1-c) D_{(t-2)i} + \varepsilon$$

We include institutional ownership types (active institutional ownership and passive institutional ownership). This model will be as follows:

$$D_{ti} - D_{(t-1)i} = \alpha d + cdrE_{ti} + cdr_A E_{ti} \times AC + cdr_I E_{ti} \times PASS + (1-d-c) D_{(t-1)i} - (1-d)(1-c) D_{(t-2)i} + \varepsilon \quad (3)$$

Variables defined as above.

3.2. Sample selection

The sample includes all firms listed in TSE excluding of financial firms. Sample period is from 2000 to 2008. We exclude the firms with insufficient data. After applying the above criteria, we included 103 firms in our sample.

4. THE RESULTS

4.1. Descriptive statistics

The following table shows that sample companies averagely distribute 82% of their earnings as dividend ($162496.6 \div 197912.71$). The mean active institutional ownership is approximately 30% of common shares outstanding, but the mean passive institutional ownership is more less (approximately 14% of common shares outstanding).

Table 1. Descriptive statistics of dependent, independent and control variables				
Variable	MIN	MAX	MEAN	SD
$D_{it} - D_{(t-1)i}$	-2475216.00	8788612.00	40863.81	536498.75
AC	0.00	0.97	0.30	0.30
PASS	0.00	0.47	0.14	0.10
$E_{it} - E_{(t-1)i}$	-3024809.00	2889601.00	28451.90	249195.34
E_{it}	-95468.00	6814114.00	197912.71	683834.64
$E_{(t-1)i}$	-95468.00	6814114.00	169460.80	605229.95
D_{it}	0.00	10000000	162496.6	672276.23
$D_{(t-1)i}$	0.00	5353892.00	142178.64	501010.33
$D_{(t-2)i}$	0.00	5353892.00	130162.16	480586.73
Dividend and earnings are in 1,000 Iranian Rial (IRR)				
Where:				
D	=	the total amount of ordinary dividends in year t;		
AC	=	the percentage of equity held by active institutions (long-term oriented with board representation) at the beginning of year t;		
PASS	=	the percentage of equity held by passive institutions (short-term-oriented without board representation) at the beginning of year t;		
E	=	net profit from normal trading activities after depreciation and other operating provisions in year t;		

4.2. Empirical results

Table 2 shows the results of the first model. Durbin-Watson (1.99) indicates that there is no correlation between model error components. Passive institutional ownership is negatively associated with dividend (coeff. = -10.52, p-Value = 0.000). Therefore, this model approves the first hypothesis. However, active institutional ownership is not significantly associated with dividend (coeff. = 0.51, p-Value = 0.569). Therefore, this model does not approve the second hypothesis. Moreover, earnings changes are positively associated with dividend changes (coeff. = 1.98, p-Value = 0.000).

Table 2. The results of model (1).				
Model (1)	coeff.	t- statistic	P-Value	
constant	-911750.03	-3.55	0.000	
$(E_{it} - E_{(t-1)i})$	1.98	4.36	0.000***	
$(E_{it} - E_{(t-1)i}) \times AC$	0.51	0.57	0.569	
$(E_{it} - E_{(t-1)i}) \times PASS$	-10.52	-5.71	0.000***	
Adjusted R Square	13.20%			
Durbin-Watson	1.99			
F	13.29			

***, **, *denote significance at 0.001, 0.05, and 0.10 levels, respectively, based on t-tests (two-tail).

Table 3 shows the results of model (2). Durbin-Watson (1.95) indicates that there is no correlation between model error components. Passive institutional ownership is negatively associated with dividend (coeff. = -2.45, p-Value = 0.000). Moreover, active institutional ownership is negatively associated with dividend (coeff. = -0.79, p-Value = 0.064). Therefore, this model approves first and second hypotheses.

Table 3. The results of model (2).				
Model (2)	coeff.	t- statistic	P-Value	
constant	-495868.21	-1.84	0.065	
E_{it}	0.50	3.50	0.000***	
$E_{it} \times AC$	-0.79	-1.85	0.064*	
$E_{it} \times PASS$	-2.45	-4.57	0.000***	
$D_{(t-1)i}$	0.39	5.20	0.000***	
Adjusted R Square	11.00%			
Durbin-Watson	1.95			
F	9.50			

***, **, *denote significance at 0.001, 0.05, and 0.10 levels, respectively, based on t-tests (two-tail).

Table 4 shows the results of model (3). Durbin-Watson (1.94) indicates that there is no correlation between model error components. Passive institutional ownership is negatively associated with dividend (coeff. = -2.70, p-Value = 0.000). Moreover, active institutional ownership is negatively associated with dividend (coeff. = -0.81, p-Value = 0.058). Therefore, this model approves first and second hypotheses.

Table 4. The results of model (3).			
Model (3)	coeff.	t- statistic	P-Value
constant	-509600.76	-1.89	0.059
E_{it}	0.49	3.40	0.001***
E_{it} × AC	-0.81	-1.89	0.058*
E_{it} × PASS	-2.70	-4.97	0.000***
D_{(t-1)i}	0.36	4.81	0.000***
D_{(t-2)i}	0.18	2.65	0.008**
Adjusted R Square	12.20%		
Durbin-Watson	1.94		
F	9.25		

***, **, *denote significance at 0.001, 0.05, and 0.10 levels, respectively, based on t-tests (two-tail).

5. DISCUSSION AND CONCLUSION

Institutional investors have the influence on investee corporations policies (include dividend policy) because of substantial shareholdings. This study investigates the relationship between institutional ownership and dividend policy. Institutional investors are not similar and have different effects on corporate policies. Therefore, we classify Institutional investors into two categories (active Institutional ownership and passive Institutional ownership) and examine their relationship with dividend policy.

To test these relations, three regression models are used. We obtain similar results about the types of institutional ownership. Active institutional ownership is negatively associated with dividend in two of three models. Also, there is a similar association between passive institutional ownership and dividend in the all models. Therefore, the types of institutional ownership (active and passive) are negatively associated with dividend. It means that there is no difference between institutional investors and they have similar preference for dividend. All of them prefer to retain cash in the company rather than to distribute dividend. The existence of these shareholders mitigates the use of dividends as a signal of good performance, as these investors themselves can act as a (more) credible signal.

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