

Evaluation of the effect of cash holding, dividends and financial leverage on competitive power of firms accepted in stock market

ZohreAsayesh¹, AmirhosseinJamali²

1. Student of Islamic Azad University Science & Research Boushehr Branch
2. Supervisor: DR of Islamic Azad University Science & Research Boushehr Branch

Corresponding Author email: asayeshzohreh@yahoo.com

ABSTRACT: Cash is a great part of a firm asset. Therefore, it is a vital resource of each business institution which is paid attention by managers and investors. Current paper is an applicable one which is aimed at investigating the effect of cash holding, c and financial leverage on competitive power of firms accepted in Tehran stock market. To the end, financial information of firms involved in Tehran stock market between 1387 and 1391 is used. Also, other variables including cash holding, c to financial leverage ratio are controlled in this paper. To analyze data obtained from conclusive statistic of multi-variable regression and to test statistic hypotheses, Eviews is used. Results indicate that cash holding, c and financial leverage meaningfully affect competitive power of firms. It is concluded that profitability, fixed asset and sale growth meaningfully and positively affect competitive power of firms.

Keywords: cash holding, dividends, financial leverage, competitive power.

INTRODUCTION

From the managers' point of view, there is a question that whether cash should be saved or consumed. This question relates to more current profit or more future flexibility. Investment quality is detected late and cash resources are vital measures for shareholders to make a judgment. Historical information related to cash flow is useful to control the accuracy of previous evaluations and to show relation between business institutions and payments and receives. Evaluation of opportunities and risks of business tasks requires getting information of nature of business task including the way of producing and consuming cash by business institution. On the other hand, firms try to manage cash and dividends and also to get loans or to buy products in credit in order to support cash. These are helpful for firms to have financial leverage. Financial leverages are important for creditors because they show whether or not earning covers expenditures and interest and whether assets are enough to pay loans in case of bankruptcy. If loan and interests are more than usual, so it is possible for firm to go bankrupt. The more predictable earning and return firm has, the more loans are acceptable because it is less likely for firm to be able to repay loans. In this case, firm can affect the competitive power of other firms. Consequently, according to the importance of mentioned parameters, their effect on competitive power of firms is investigated in this paper.

Background of research hypotheses

Soghra, Mehregan and Asgharizade (1387) investigated competitive power of national petrochemical industry. In preparing a conceptual model of competitive power at firm level, national industry was investigated. Accordingly, main procedures used in conceptual model have been detected. They are systematic, asset-process-performance and market-based procedures. Results have shown that competitive power of petrochemical industry depends on organizational resource. Banimahd et al. (1390) found out that there is a meaningful and positive relation between capital structure and competitive power. On the other hand, firms relying on long-term loans to support required resource own more share. Smith et al. (2008) investigated the relation between asset and competitive power of New Zealand firms between 1993 and 2006. They were looking for the answer of the question that whether long-term loans affect competitive power. Results have shown that if sale rate of one industry is more than the other, then more long-term loans are used. It is worth nothing that firms with increasing sale rate exploit

competitive strategies (for example, to sell products at lower price). Therefore, they greatly rely on financial leverage to continue competition. They conclude that more long-term loans lead to higher sale rate. Soku (2010) investigated capital structure of multi-national firms and concluded that foreign firms with higher competitive power are less in debt. Gani et al. (2013) evaluated relation between competition in product market and ways of financing of Chinese stock firms. They concluded that relation between competition and ways of financing is of non-linear type and depends on three factors including industry type, firm size and growth opportunity. Therefore, as mentioned and according to results of other researches, research hypotheses are:

H1: there is a meaningful relation between cash holding and competitive power of firms.

H2: there is a meaningful relation between dividends and competitive power of firms.

H3: there is a relation between financial leverage and competitive power of firms.

Data and variables

data and sample

This research sample includes 135 firms accepted in Tehran stock market between 1386 and 1391.

METHODS AND VARIABLES

To test the research hypotheses, the following model is used:

Model (1)

$$COM_{i,t} = \beta_0 + \beta_1 Cash_{i,t} + \beta_2 D_{i,t} + \beta_3 LEV_{i,t} + \beta_4 pro_{i,t} + \beta_5 FAR_{i,t} + \beta_6 sG_{i,T} + \varepsilon_{i,t}$$

Where $cash_{i,t}$ indicates competitive power, D is dividend, LEV means financial leverage, $pro_{i,t}$ represents profitability, $FAR_{i,t}$ is fixed assets and $sG_{i,T}$ represents sale growth.

Competitive power: in this paper, dependable variable is competitive power. To measure competitive power of firms, David-J. Smith et al. (2008) index is used. To measure competitive power of business institution, each sale to total sale ratio of firms involving in the same industry is used.

Dividends: in this paper, dividend is independent variable which is equity per share (EPS) paid to shareholders at the end of the fiscal year. The mentioned ration is calculated by dividing dividend of each share by profit of each share at the end of a fiscal year.

Financial leverage: financial leverage is an independent variable in the current paper. To calculate financial leverage, total debt to total assets ratio is used.

Cash holding: cash holding is the amount of cash deposited in bank accounts or corporate bank of deposit. Cash holding is an independent variable in this paper. It is calculated by dividing cash reported in balance sheet by total assets.

Control variables: to accurately evaluate the effect of financial leverage, cash holding and dividends on competitive power according to Smith (2008) and Basil (2013), sale growth, profitability index and fixed assets to total assets ratio are used as control variables. To measure profitability, profit before interest and tax is divided by total assets of firm.

EMPIRICAL RESULTS

Table 1. descriptive statistics

Descriptive statistic	Competitive power	Profitability index	Fixed assets	Sale growth	dividends
Average	0/074	0/108	0/2609	0/161	59/33
Maximum	0/93	0/7	0/892	5/212	705/48
Minimum	0/0	-0/718	0/0	-1	0/0
Standard deviation	0/122	0/148	0/183	0/406	46/98
?????????	0/012	-0/022	0/513	-0/0452	0/13

Stagnation test

Before estimating regression in order to be sure that there is no inaccurate regression and consequently no invalid result, it is required to test variables. Therefore, Britnag test is used which has optimized intervals set by Schwartzbianmeasure. In this test, hypothesis zero is lack of unit root.

Table 2. results of stagnation test of variables with intercept

Result	sig	interval	calculative variable	Variable name	abbreviation
Static	0/0000	0	-3/9	COM	Competitive power
static	0/000	0	-5/8	CASH	Cash flow
static	0/000	0	-4/3	PRO	Profitability index
static	0/0000	0	-3/68	FAR	Fixed assets
static	0/0000	0	-3/99	SG	Sale growth
static	0/000	0	-3/98	D	dividends
static	0/0000	0	-3/11	LEV	Corporate financial leverage

Hasman test

It is required to determine fixed effects or random effect methods should be used for estimation. Therefore, Hasman test is used.

Table 3. results of Hasman test using X² at 5% level

hypothesis	calculative variable	value of calculative variable	prob	result
1	X ²	11.7	0.000	H ₀ claiming the usage of random effects method is not accepted
2	X ²	15	0.000	H ₀ claiming the usage of random effects method is not accepted
3	X ²	20	0.000	H ₀ claiming the usage of random effects method is not accepted

Research hypotheses test

Table 4. results of regression of cash holding and competitive power with the help of fixed effects method

F	Calculative F in LM test	Calculative F in white method	D.W	R2	Sig	t	coefficient	Independent variable	symbol
4/37	0/29	0/53	1/92	.950	0/0000	7/6	1/3	intercept	
					0/0000	7/5	0/07	Cash flow	CASH
					0/0000	-3/2	-0/7	dividends	D
					0/0000	-2/1	-0/2	Financial leverage	LEV
					0/0000	4/6	0/04	Profitability index	PRO
					0/000	3/83	0/45	Fixed assets	FAR
					0/0000	7/5	/17	Sale growth	SG

Above results mentioned in table 4 related to T indicate that independent variable is meaningful at 5% level. Therefore, the first hypothesis is confirmed. In this way, increasing cash by 1% leads to 7% increase of competitive power. Consequently, cash flow positively and meaningfully affects competitive power. According to results, 1% increase of dividends leads to 7% decline of competitive power. Therefore, dividend negatively and meaningfully affects competitive power because firm loses its future opportunities by paying equity per share (EPS) and reducing cash flow. Therefore, the second hypothesis is confirmed. Also, results show that higher reliance on financial leverage (1% increase) leads to 2% decline of competitive power. Consequently, financial leverage negatively and meaningfully affects competitive power. Managers are forced to pay future cash flows by making debt. It reduces cash flow and agency expenditures. It is a control effect. In conclusion, it negatively affects competitive power. In this way, financial leverage meaningfully affects competitive power. So, the third hypothesis is confirmed. Other results show that 1% increase of profitability index leads to 0.04% increase of v. therefore, there is a positive and meaningful relation between profitability and competitive power. 1% increase of fixed assets leads to 0.45% increase of competitive power. So, the size of board positively and meaningfully affects competitive power. 1% increase of sale growth leads to 0.17% increase of competitive power.

CONCLUSION

In this research, data are obtained from under-study firms between 1386 and 1391. Results are as below: There is a meaningful relation between cash holding and competitive power of firms so that increase of cash flow leads to increase of competitive power. Results of testing the second hypothesis shows that there is a meaningful relation between dividend and competitive power of firms accepted in Tehran stock market so that increase of dividend leads to decline of competitive power of firms. Therefore, dividend negatively and meaningfully affects competitive power of firms because paying EPS and reducing cash flow threatens future opportunities of firms. Results of study done by Grolan et al. (2003) and Razzof (1982) are the same. Results of testing the third hypothesis indicate that there is a meaningful relation between financial leverage and competitive power of firms so that increase of financial leverage leads to decline of competitive power of firms. Therefore, financial leverage negatively and meaningfully affects competitive power of firms. Managers are forced to pay cash flows. It prevents managers to spend cash flow on their own. Consequently, it reduces the agency expenditures. Also, it has a kind of control effect and negatively affects competitive power of firms. Results are consistent with the results of study conducted by Jagnatan et al. (2000).

Recommendations

Decisions of cash management are not separated from decisions related to investment and financing. Therefore, if decisions are aimed at maximizing competitive power of firms, it is recommended that decisions related to cash flow should be made according to other decisions aimed at financing. It is recommended that managers increase current cash and reduce current debts. On the other hand, they try to increase competitive power of firm by cash management. Reduction of financial leverage leads to a safe margin for firm against financial crisis. It is practical by relying on a correct management procedure to increase competitive power of firms. Managers should try to keep profit undistributed because paying EPS and reduction of cash flow threaten future opportunities of firm for financing. Also, it reduces competitive power of firms.

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