

Corporate Governance Quality and Dividend Policy

Yahya Hassas Yeganeh¹, Zahra Poorzamani², Feraydoon Rahnamay Roodposhti³ and Asgar Pakmaram*⁴

Accounting Department, Science and Research Branch, Islamic Azad University, Tehran, IRAN

*Corresponding author's Email: pakmaram@gmail.com

ABSTRACT: Agency theory is one of the theories that has been tested widely in the different articles and gained supportive observations. With regard to agency theory, dividend distribution policy is determined by the agency costs resulted from the difference between ownership and control. Because of the agency costs managers may not ever adopt dividend policy that maximizes stockholder's value. Instead, they probably use the type of the dividend policy which maximizes their private benefits. It is argued that dividend payouts reduce agency conflicts by the reduction of amount of free cash flow that could be used for manager's private benefits rather than maximizing stockholder's wealth. Hence the present study goes to examine the effect of corporate governance quality dividend policy to solve agency costs problems. Our article acts as a descriptive-forth event research and is based on the combined data analysis. Eighty-one Tehran stock exchange listed companies between 2006 and 2010 have been selected as the sample of the research. Furthermore, corporate governance quality calculated according to the four controlling aspects of Board of Directors, ownership structure, financial information transparency which each contains measurable indexes. The Findings indicated that there is significant and positive relationship between dividend policy and Audit Quality, Timely Annual General Assembly, and Financial Information Transparency. On the other hand, Negative relationship between dividend policy and the board of director's proficiency is confirmed that corroborate substitution hypothesis of dividend policy. Also, the results of this study indicated significant and positive relationship between dividend policy and control variables such as cash dividends of the previous year, free cash flow, corporate profitability, and firm size in all models.

Key words: corporate governance quality, dividend policy, agency costs, substitution hypothesis, outcome hypothesis

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INTRODUCTION

Accounting debacles and fall of grand companies like Enron, WorldCom, Adelphi, Xerox ... for weak and corporate governance caused serious concerns about earning management, companies' performance and use of reported income also ethical problems of those who provide and audit the reports.

US legislator organizations according rules such as Sarbanes-Oxley (2002), obliged managers to ensure financial reports, strengthen corporate governance and improve auditor's independence in order to increase reporting quality. In general, similar incidents increase problems related with the nature of corporate governance-dividend policy relation. What is the effect of corporate governance quality on firm's dividend policy? To answer to this question would help us to understand how rules as Sarbanes-Oxley could influence reporting quality of companies differently? To maximize stockholder's wealth and dividend also observe ethics and social responsibilities form crucial goals of companies. To perform corporate governance principles properly, is one of the effective factors in reaching above mentioned goals (Razzaghi 2008). About 300 years ago when Adam Smith suggested executive (managers)separation discussion from their ownership in the book Nation Wealth ,mechanism for establishing balance between benefits of institutes owners (investors) and mangers have been suggested constantly (khoda Bakhshi, 2005). Value creation of companies is the effect of manager's performance.

This is considered seriously with development of publicly owned companies also suggestion of agency theory, increasing of duties and authorities of board of directors. Managers who aren't owner of the firm, how could follow stockholder's (Entity Owners) (KhodaBakhshi, 2005) and (Jensen&Mackling, 1976).

Jensen & Meckling (1976) suggested principles of agency theory. In general the theory demonstrates manager (Agent) and owner (client) Conflict of interest. They emphasize existing of the contrast between mangers and stockholder's as one of the main hypotheses of agency theory. According to this hypothesis, contract parties have logical expectations and intend to maximize their benefits (Laporta et al, 2000). Consideration of corporate governance has been developed significantly by



consigning indefinite authorities from owners to board of directors, especially chief executive officer (CEO) (Khodabakhshi, 2005). Corporate governance is a collection of internal and external controlling mechanisms that makes proper balance between stockholder's rights in one hand and needs and authorities of board of directors on the other hand. Finally these mechanisms provide reasonable assurance for stockholder's and financial resources providers and stakeholders that their investment would be returned by reasonable profit and value creation mechanism would be obtained (Ganbary, 2007).

Gamperz *et al.* (2003), Brown & Kaylor (2005), Black *et al.* (2006), Durnev & Kim (2005) and Vein Drobtz in similar results found that high governance score of the company lead to more profitability which increase stock price and dividend payments to stockholder's. They pointed out that value creation of well-governance companies is higher than others. Since 1961 when Miller-Modigliani implemented the first effort on irrelevant of dividend, many theories were represented in order to extend hypotheses in relation to full capital market. Agency theory is one of the important theories which has been tested widely in different articles and obtained supportive observations. With regard to agency theory of Jensen (1986) dividend policy is determined by agency costs that come from ownership and control differences. Because of agency costs managers may not adopt dividend policy which maximizes stockholder's value; instead they may adopt a policy to maximize their private benefits (Jiraporn *et al.*, 2011)

Dividend payouts are argued to reduce agency conflicts by reducing the amount of free cash flow, which could be used by managers for their private benefits rather than for maximizing stockholder's' wealth (Grossman and Hart, 1980; Easterbrook, 1984; and Jensen, 1986; DeAngelo *et al.*, 2006).

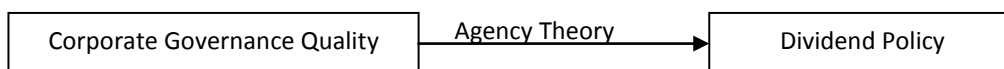
Motivated by agency theory, we explore the role of agency costs as an explanation of dividend payouts after controlling other determinants of dividend such as firm size, growth opportunities, life cycle, and profitability. Corporate governance exists to provide checks and balances between stockholder's and management and thus to mitigate agency problems. Hence, firms with better governance quality should incur less agency conflicts. In such firms, managers should be less likely to adopt a sub-optimal dividend policy. As a result, the quality of corporate governance should have an impact on dividend policy (Jiraporn *et al.*, 2008).

Several recent notable studies investigate how dividend payouts are affected by corporate governance (Officer, 2007; John and Knyazeva, 2006; Pan, 2007; Nielsen, 2006; Jiraporn and Ning, 2006). Useful though these studies may be, one critical limitation of these studies (and others in the literature) is that they do not capture the overall quality of corporate governance. Previous studies examine only a few selected aspects of corporate governance, such as board structure and ownership structure, or simply use a narrow governance index to represent governance quality. Because specific governance mechanisms can and do interact with each other (Agrawal and Knoeber, 1996), studying individual governance mechanisms is not adequate. It is imperative to examine how the aggregate quality of corporate governance influences dividend policy (Jiraporn *et al.*, 2008).

However comprehensive aspects for quality of corporate governance neither exist nor defined, but it would be defined with regard to countries legal conditions in addition to their exclusive environment.

In summary, the existing findings are inconclusive as to the nature of the relationship between corporate governance quality and dividend payouts. On the one hand, some studies suggest that dividends would allow reducing the agency costs of free cash flow, and hence would protect investors from management expropriation. This would induce a positive association between the quality of corporate governance and dividend policy. On the other hand, other studies propose a substitute role for dividends in protecting investors when firms are well-governed. In this context, dividend payouts should be lower in firms with higher corporate governance quality. However, the dividends role becomes crucial when corporate governance is weak, which in turn implies a negative relationship between dividend and corporate governance.

We mixed evidence of prior financial research evaluation and explanation of corporate governance quality effect on dividend policy with consideration of controlling variables is the main focus of this article. According to existing theories, conceptual frame of the research is presented as:



Our research continues by summary of literature review and hypotheses. Also next after variables description, the model of research is presented. Furthermore next parts involve method, society and static sample and results.

Literature Review

There are 5 major tendency used in accounting researches. Decision model approach, capital market research, behavioral research, agency theory and others (critical perspective research and information economics) form primary principles of accounting researches (Shabahang, 2002).

Corporate governance is explained by several chief and various bases. Each base applies different words and considers different aspects of corporate governance originated from scientific area of related group. Agency theory results from finance

and economic field, transaction cost theory results from economy and institutional theory and stakeholder's theory results from a social perspective on corporate governance (Hassas Yeganeh, 2005).

Fama&Jensen (1983) believed that in the most of accounting and financial management works, corporate governance is defined as an aspect of controlling mechanisms which protect stockholder's benefits results in their wealth growth.

Cohen and Hanno (2000) indicate that prior researches in accounting, finance and management have shown three views of CG. The first approach, which is widely held in accounting and finance, relies on agency theory (Core et al.,1999). The agency theory emphasis that those executing the monitoring function should be independent from those being monitored. Hence, the most desirable attributes for board members under the agency theory perspective are independence from management and expertise in monitoring and control. Under the second approach, resource dependence perspective, the main role of the board of directors is cooperating with managers to set policies and strategies and helping management to perform the strategic plans (Boyd 1990). Hence, the most valuable attributes of a board member under the resource dependence perspective are industry expertise, knowledge and the ability to provide access to external resources (Cohen and Hanno 2000). The third view is hegemonic perspective that CG mechanism is viewed as being ineffective at monitoring and largely symbolic in terms of oversight of management.

Brown and Caylor (2006) find that firms with better governance quality as measured by the governance score are more profitable and more valuable (higher Tobin's q). Their results imply that firms with better governance quality experience lower agency costs and, hence, exhibit better performance and higher firm value.

Inspired by agency theory arguments, recent research has explored the relation between a firm's corporate governance quality and its payout policy. These studies offer a test of two opposing hypotheses. First, according to the outcome model of dividends (La Porta et al., 2000), corporate governance quality should be positively related to dividend payouts since better-governed firms offer stronger protection rights to their stockholder's. Given this power, stockholders will pressure managers to pay higher dividends rather than using the excess cash for their own private benefits (La Porta et al., 2000; Mitton, 2004; Jiraporn and Ning, 2006). In contrast, the substitution hypothesis of dividends stipulates that governance quality should be a substitute for dividend payments in the way that better-governed firms are associated with lower agency costs resulting from the separation of ownership and control. They should thus be less likely to use dividends as a device to mitigate agency conflicts opposing managers to stockholder's (La Porta et al, 2000; and John and Knyazeva, 2006).

Several studies document that the institutional and legal environments affect firms' payout policies. For instance, La Porta et al. (2000) report that firms in common law countries pay higher dividends than those operating in Civil Law countries where minority stockholders suffer from weaker legal protection. Thus, dividend payout may serve as a device protecting investors against management and large stockholder's' expropriation.

Liu (2002) in research at more than 22 emerging market showed that, whatever external corporate governance factors, including information disclosure requirements, business rules and regulations of the stock market improved, the role of dividends in controlling agency costs are reduced. He proves in his research, substitution relation.

Prior empirical studies have investigated the relationship between dividend policy and (1) an individual component of corporate governance or (2) a corporate governance score (aggregate measure of governance quality). For instance Rozeff (1982) and Hu and Kumar (2004) report a negative relationship between dividend policy and the fraction of equity owned by managers. Short et al. (2002), Kouki & Guizani (2009) find a negative link between dividend payout ratio and institutional ownership.

Notably, the above studies have looked at only one aspect of the governance system, i.e. ownership structure. Subsequent studies have corrected for such shortcoming by relying on an aggregate corporate governance score which usually covers several aspects of the corporate governance practices, hence providing a more comprehensive analysis of corporate governance quality. For instance, Mitton (2004) shows a positive association between a governance score designed by the Crédit Lyonnais Securities Asia (CLSA) and dividend payouts in a sample of firms from emerging countries. Using a governance score based on the Institutional Shareholder Services (ISS) governance standards, Brown and Caylor (2004) report similar results in the United States. Furthermore, Farinha (2003) documents a positive association between firms' compliance with the Cadbury report 'best practices' governance guidelines and dividend payouts in the United Kingdom (UK). Although, these findings support the hypothesis of the outcome role of dividends, one could argue that corporate governance practices would suffice to protect investors against expropriation, hence reducing the need for dividend payments. Thus corporate governance mechanisms could substitute for dividend payments, and companies would set out the level of dividend payout based on how their corporate governance practices were: strong (weak) corporate governance would then induce low (high) dividend payouts.

The above argument is supported by John and Knyazeva (2006) who show that the level of dividend payouts decreases in well-governed firms since they are perceived to have lower agency conflicts. They also find that, in firms facing high agency costs, corporate governance plays a more crucial role than dividends. Taken together, their results suggest a negative relationship between dividend payout and certain (internal and external) aspects of corporate governance. Jiraporn and Ning (2006) also confirm the existence of a negative association between the strength of shareholder rights and dividend policy in the US. Their results confirmed the substitution hypothesis.

Abdelsalam *et al.* (2008) investigated the relationship between ownership structure and dividend policy in an emerging market, showed that between institutional ownership and dividend decisions and dividend payments, there is a direct relationship. Jiraporn *et al.* (2008) in another study, influence of the governance indicators in each category were analyzed separately and concluded that the inverse relation is established between two variables, while using a comprehensive index, they have verified the outcome hypothesis. The criteria that they were used to measure governance; encompassing eight corporate governance categories: audit, board of directors, charter/bylaws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation. This shows the criteria used in the governance index is very important. In the second article Jiraporn believe that the result of this is use of all-inclusive governance index.

In spite of many completed researches in other countries, similar researches haven't been completed in Iran; however, structures of corporate governance and dividend distribution have been inspected. For example about corporate governance and companies performance (Mashayekh 2006; Gaemi 2006; Namazi 2008) and about dividend distribution (Mehrani and Bahramfar, 2004; Mehrani and Talaneh, 2005; Jahankhahi and Gorbani, 2005). For this reason and modernity of the subject and necessity of corporate governance implementation in the country which the regulation has been prepared by stock exchange in 2006, this research tries to examine it about Iran capital market listed companies.

Research hypotheses

1. Controlling aspects of corporate governance quality affects dividend policy.
2. Board of director's aspect of corporate governance quality affects dividend policy.
3. Ownership aspect of corporate governance quality affects dividend policy.
4. Transparency of financial information aspect of corporate governance quality affects dividend policy.

MATERIALS AND METHODS

Statistic sample and data collection method

Term of our study begins from 2006 to 2010 for 5 years. We begin from 2006 because since then companies' transparency information is available.

Static society of our research involves all of Tehran stock exchange listed companies. To do the research a sample selected from Tehran stock exchange listed companies. The sample includes companies that contain bellow listed terms:

1. Companies must have been listed in Tehran Stock Exchange by the beginning of 2006.
2. In order to select active firms, the exchanges of these firms should have been active during the years between 2006 and 2010 and there should not be any stops more than 6 months in their activities.
3. In order to be compared properly and avoid divergences, the fiscal year should end on 29th of Esfand (March 21st.) and during the years between 2006 and 2010 they shouldn't have changed their fiscal year.
4. They must not have had any change and operation postponement in fiscal year during the years 2006 to 2010.
5. Financial statements and explanatory notes about them should be accessible.
6. Banks, financial institutes (investment firms, financial mediated), holdings, banks and leasing companies couldn't be involved since their financial disclosures and corporate governance structures are different.

Regarding the restrictions mentioned above, 81 companies were selected as our statistical sample for time period between 2006 and 2010.

The method to collect data has been documents' search method. To collect data needed, we have used financial statements and accompanying notes. For this, we have used Rahavard-e-Novin software and also the official site of Tehran Stock Exchange.

Research variables

Variables of the study consist of dependent, independent and controlling variables.

Independent variable: corporate governance.

Aspects of corporate governance quality and their measurements

Audit reference (Audit Quality): if basic financial statements of the firm audited by Audit organization the value would be 1 otherwise it would be 0. This variable is presented by (AUD).

The firm under examination is parent or subsidiary: if the firm is controlled by and depended to another one the value would be 1 otherwise 0. (PAR) represents this variable.

Legal inspector of the firm; if legal inspector is independent auditor the value will be 1 otherwise 0. LI shows this index.

Independence of board of directors; this variable represents ratio of non-duty members of the board to total members of it. Non-duty manager is part time member of the board directors without any executive responsibility. To measure this variable at first numbers of non-duty members of the board were assembled for all firms of survey then dividend to all members of the

board In order to calculate percent of non-duty members. Next total average of the variable is calculated annually for the survey term. Value is 1 for firms with higher percent of non-duty members to average and it is 0 for other firms. This index indicated by (IBOD). The variable is measured as:

$$IBOD_{i,t} = (OUTDIR_{i,t} / TOTALDIR_{i,t}) \times 100$$

In which:

OUTDIR: number of non-duty members of the board

TOTALDIR: number of total members of the board

Separation of chief executive officer (CEO) from chairman: if responsibility of CEO is separated from chairmen, the value will be 1 otherwise 0.

Timely annual general assembly : According to Tehran stock exchange organization regulation any firm is obliged to convene annual general assembly to disclosure information such as selection of the board of directors members, selection of auditor and dividend distribution in addition to savings and change of firm activity utmost by the end of July. It's to be mentioned that if the assembly convenes at least time (deadline determined by Tehran stock exchange organization) and above mentioned information disclosures, annual general assembly will convene timely. The relation of is used to calculate it.

$$TM_{i,t} = \left(1 - \frac{DS_{it}}{124} \right) \times 100$$

DSit : Number of days passed since the beginning of the year until the annual general assembly in the company i at time t.

Education: For companies with higher percentage of graduate board members compared to average, the value of 1, otherwise the value of 0 is given.

Profession: If the chief executive officer in the surveyed company has required proficiency in the industry, the value of 1, otherwise the value of 0 is given.

Level of stock under possession of institutional investors: It shows percent of stock under possession of institutional stockholders. In our research value for firms with 3 institutional stockholder that total percent of their stock is more than 50% is 1 and for others 0. INS presents this value.

Level of stock under possession of the major stockholder: it presents stock percent of the major stockholder. This variable considers ownership distribution. Total percent of stock under possession of the main stockholder and other stockholders with more than 5% in sequence is used to measure the above mentioned index.

$$O.Si,t = \sum POBH.UP.\%5i,t \times 100$$

In which:

POBH.UP5%: total percents of the main stockholder in addition to other stockholders with more than 5% in sequence

Level of ownership and government penetration in to the firm: The value for private companies is 1 and 0 for public ones. (GI) indicates this variable.

Financial Information Transparency: Information score of publishers is calculated based on two criteria, reliability and timeliness of information.

In transparency rating, transparency rankings released by analysts of company information committee, dependent on Association for Investment Management and Research (AIMR) are used.

Dependent variable: dividend policy

Consistent with prior research in finance (Holder et al., 1998; Farinha, 2003; Mitton, 2004; and John and Knyazeva, 2006), we use two alternative indicators as a proxy for corporate dividend policy.

a) ratio of cash dividend of a share to earning per share

b) Yield of cash dividend

with regard to studies and arguments, return of cash dividend represents cash dividend policy since return of cash dividend considers dividen distribution along with stock price. It means that cash dividend of a share divides to price of a share at the beginning of the year. Because of daily changes of stock price, average price is applied.

$$DY_t = \frac{Div_t}{\frac{P_{tH} + P_{tL}}{2}}$$

PtLandPtH: Represents respectively the lowest and highest stock price in any financial period.

Divt indicates cash dividend of per share.

Control Variables of Dividend Policy

PreDiv: indicates previous year's cash dividend. The number 1 represents dividend payments of last year and 0 means the opposite.

StockDiv: indicates the stock dividend. The number 1 represents the company has paid stock dividend in the same year and 0 does the opposite.

MTB: indicates investment opportunity. Ratio of market value to book value is used as representative of investment opportunity.

FCF: presents free cash flow. Lehn and Pulson model (1989) is applied for measuring free cash flows. According to this model free cash flow is calculated by deducting total of taxes, interest cost and dividend from operating income before depreciation and standardized by dividing it to assets as following:

$$FCF_{i,t} = (INC_{i,t} - TAX_{i,t} - INTEXP_{i,t} - PSDIV_{i,t} - CSDIV_{i,t}) / A_{i,t-1}$$

Where:

FCF_{i,t} is FCF of firm (i) in year (t)

INC_{i,t} is operating income after depreciation of firm (i) in year (t)

TAX_{i,t} is total taxes of firm (i) in year (t)

INTEP_{i,t} is interest expense of firm (i) in year (t)

PSDIV_{i,t} is preferred stockholders dividends of firm (i) in year (t)

CSDIV_{i,t} is common stockholders dividends of firm (i) in year (t)

A_{i,t-1} is total assets carrying value of firm (i) in year (t-1)

Profitability (ROE) presents profitability of the firm. In this research Returns on Equity used as profitability representative. The ratio is calculated by dividing net income after taxes by stockholders equity at the end of fiscal year.

Leverage: is measured as the ratio of long term debt to the total assets.

Size: indicates company size and is calculated by the natural logarithm of total par value of stock for one firm.

Research model

According to the stated explanations the model of the research is as follows:

$$\text{Dividend payout} = a + b1(\text{GQ}) + b2(\text{PreDiv}) + b3(\text{Stockdiv}) + b4(\text{MTB}) + b5(\text{FCF}) + b6(\text{Profit}) + b7(\text{LEV}) + b8(\text{Size}) + e$$

GQ indicates one defined aspect of corporate governance quality.

RESULTS

To test the normality of the data, Kolmogorov-Smirnov (K-S) test has been used. Regarding the results in table (1), by comparing the meaningfulness level of variables studied for our sample firms, and since the amount of meaningfulness level is more than 0/05 and there exists the assurance level of %95 (with %5 error level), the presupposition Ho is accepted and variables studied, benefit from a normal distribution.

Table 1: Kolmogorov-Smirnov Test

Variables	IBOD	TM	OS	TR	CD	DY	MTB	FCF	ROE	LEV	Size
Kolmogorov-Smirnov Z	1.762	2.840	3.361	1.326	1.189	2.307	4.472	1.404	0.661	4.133	1.674
Sig	0.007	0.000	0.000	0.060	0.068	0.056	0.000	0.039	0.775	0.000	0.007

The first hypothesis test results

First Hypothesis: control aspect of corporate governance quality has an impact on corporate dividend policy.

For the first hypothesis test, two models were used as follows:

$$CD_{i,t} = \alpha + \beta_1(Audit_{i,t}) + \beta_2(Parent_{i,t}) + \beta_3(LI_{i,t}) + \beta_4(Pr eDiv_{i,t}) + \beta_5(StockDiv_{i,t}) + \beta_6(MTB_{i,t}) + \beta_7(FCF_{i,t}) + \beta_8(ROE_{i,t}) + \beta_9(Lev_{i,t}) + \beta_{10}(Size_{i,t}) + \epsilon_{i,t}$$

$$DY_{i,t} = \alpha + \beta_1(Audit_{i,t}) + \beta_2(Parent_{i,t}) + \beta_3(LI_{i,t}) + \beta_4(Pr eDiv_{i,t}) + \beta_5(StockDiv_{i,t}) + \beta_6(MTB_{i,t}) + \beta_7(FCF_{i,t}) + \beta_8(ROE_{i,t}) + \beta_9(Lev_{i,t}) + \beta_{10}(Size_{i,t}) + \epsilon_{i,t}$$

Table 2: Model Summaryb

Model	Dependent Variable	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	CD	0.640a	0.409	0.393	0.27759	2.061
2	DY	0.581a	0.337	0.319	0.07947	1.725

a. Predictors: (Constant), Size, Parent, ROE, LI, PreDiv, StockDiv, LEV, Audit, FCF, MTB

b. Dependent Variable: CD and DY

Table 3: Independent variables’ coefficients, and significance levels

Variables	Model 1			Model 2		
	Beta	t	Sig.	Beta	t	Sig.
(Constant)	-0.252	-2.086	0.038	-0.079	-2.289	0.023
Audit	0.033	1.026	0.305	0.021	2.292	0.022
Parent	0.004	.122	0.903	0-.012	-1.374	0.170
LI	-0.077	-.276	0.783	-0.028	-.352	0.725
PreDiv	0.492	10.124	0.000	0.085	6.072	0.000
StockDiv	-0.005	-0.100	0.920	-0.027	-2.024	0.044
MTB	0.005	1.232	0.219	-0.003	-2.615	0.009
FCF	0.275	1.955	0.051	0.122	3.023	0.003
ROE	0.462	6.060	0.000	0.165	7.627	0.000
LEV	-0.281	-1.798	0.073	-0.081	-1.815	0.070
Size	0.026	2.637	0.009	0.008	2.773	0.006

As it is shown in the following figure (Tables 2, 3), in model 1 (p-value>0.05), that shows the variables of AUDIT, PARENT and LI, there was not a meaningful relationship with the company's ratio of cash dividends. Thus, there is no relationship between the ratio of cash dividends and control aspect of corporate governance. Also, test results show that, there is a significant and positive relationship between ratio of cash dividends and control variables such as cash dividends of last year, leverage, companies’ profitability and size. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %40 of changes in Dividend policy.

As it is shown in the following figure (Table 2, 3), in model 2 (p-value>0.05), that show the variables of PARENT and LI, have not a meaningful relationship with the company's cash dividends yield. But, result show that there is significant and positive relationship between the cash dividends yield and AUDIT quality (p-value<0.05). Also, test results show that, there is a significant and positive relationship between cash dividends yield and control variables such as cash dividends of last year, investment opportunity (MTB), FCF, companies’ profitability and size, and significant and negative relationship by stock dividend. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %32 of changes in Dividend policy.

The second hypothesis test results

Second Hypothesis: board of director’s aspect of corporate governance quality has an impact on corporate dividend policy. For the second hypothesis test, two models are used as follows:

$$\begin{aligned}
 CD_{i,t} &= \alpha + \beta_1(IBOD_{i,t}) + \beta_2(DUAL_{i,t}) + \beta_3(TM_{i,t}) + \beta_4(ED_{i,t}) + \beta_5(PROF_{i,t}) + \beta_6(PreDiv_{i,t}) \\
 &+ \beta_7(StockDiv_{i,t}) + \beta_8(MTB_{i,t}) + \beta_9(FCF_{i,t}) + \beta_{10}(ROE_{i,t}) + \beta_{11}(Lev_{i,t}) + \beta_{12}(Size_{i,t}) + \varepsilon_{i,t} \\
 DY_{i,t} &= \alpha + \beta_1(IBOD_{i,t}) + \beta_2(DUAL_{i,t}) + \beta_3(TM_{i,t}) + \beta_4(ED_{i,t}) + \beta_5(PROF_{i,t}) + \beta_6(PreDiv_{i,t}) \\
 &+ \beta_7(StockDiv_{i,t}) + \beta_8(MTB_{i,t}) + \beta_9(FCF_{i,t}) + \beta_{10}(ROE_{i,t}) + \beta_{11}(Lev_{i,t}) + \beta_{12}(Size_{i,t}) + \varepsilon_{i,t}
 \end{aligned}$$

Table 4: Model Summaryb

Model	Dependent Variable	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	CD	.660a	.435	.416	.27297	2.053
2	DY	.580a	.336	.314	.07901	1.699

a. Predictors: (Constant), Size, ROE, DUAL, PreDiv, PROF, StockDiv, IBOD, TM, LEV, ED, FCF, MTB

b. Dependent Variable: CD and DY

As it is shown in the following figure (Table 4, 5), in model 1 (p-value>0.05), that show the variables of IBOD, DUAL and ED, does not have not a meaningful relationship with the company's ratio of cash dividends. But, result show that there is significant and positive relationship between the ratio of cash dividends and TM (p-value<0.05), and negative relationship between the ratio of cash dividends and PROF. Also, test results show that, there is a significant and positive relationship

between ratio of cash dividends and control variables such as cash dividends of last year, leverage, companies' profitability and size. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %42 of changes in Dividend policy.

As it is shown in the following figure (Table 4, 5), in model 2 (p-value>0.05), that show the variables of IBOD, DUAL, ED, TM and PROF have not a meaningful relationship with the company's cash dividends yield. Also, test results show that, there is a significant relationship between cash dividends yield and all control variables of model 2. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %32 of changes in Dividend policy.

Table 5. Independent variables' coefficients and significance levels

Variables	Model 1			Model 2		
	Beta	t	Sig.	Beta	t	Sig.
(Constant)	-.275	-2.235	.026	-.091	-2.575	.010
IBOD	.001	1.178	.240	.000	1.142	.254
DUAL	-.012	-.348	.728	-.004	-.403	.687
TM	.002	3.234	.001	-1.886E-5	-.086	.931
ED	.027	.845	.399	.000	-.061	.952
PROF	-.090	-2.124	.034	-.018	-1.475	.141
PreDiv	.476	9.462	.000	.095	6.441	.000
StockDiv	.000	-.007	.994	-.026	-1.989	.048
MTB	.002	.520	.604	-.003	-2.692	.007
FCF	.184	1.315	.189	.092	2.276	.023
ROE	.420	5.442	.000	.163	7.384	.000
LEV	-.437	-2.704	.007	-.101	-2.163	.031
Size	.030	3.126	.002	.009	3.298	.001

The third hypothesis test results

Third Hypothesis: ownership aspect of corporate governance quality has an impact on corporate dividend policy. For the third hypothesis test, two models are used as follows:

$$CD_{i,t} = \alpha + \beta_1(INS_{i,t}) + \beta_2(OS_{i,t}) + \beta_3(GI_{i,t}) + \beta_4(PreDiv_{i,t}) + \beta_5(StockDiv_{i,t}) + \beta_6(MTB_{i,t}) + \beta_7(FCF_{i,t}) + \beta_8(ROE_{i,t}) + \beta_9(Lev_{i,t}) + \beta_{10}(Size_{i,t}) + \varepsilon_{i,t}$$

$$DY_{i,t} = \alpha + \beta_1(INS_{i,t}) + \beta_2(OS_{i,t}) + \beta_3(GI_{i,t}) + \beta_4(PreDiv_{i,t}) + \beta_5(StockDiv_{i,t}) + \beta_6(MTB_{i,t}) + \beta_7(FCF_{i,t}) + \beta_8(ROE_{i,t}) + \beta_9(Lev_{i,t}) + \beta_{10}(Size_{i,t}) + \varepsilon_{i,t}$$

Table 4: Model Summaryb

Model	Dependent Variable	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	CD	0.641a	0.411	0.395	0.27715	2.095
2	DY	0.577a	0.333	0.315	0.07963	1.738

a. Predictors: (Constant), Size, OS, LEV, GI, PreDiv, FCF, StockDiv, MTB, ROE, INS

b. Dependent Variable: CD and DY

As it is shown in the following figure (Table 6, 7), in model 1 (p-value>0.05), that show the variables of INS, OS and GI, have not a meaningful relationship with the company's ratio of cash dividends. Thus, there is no relationship between the ratio of cash dividends and ownership aspect of corporate governance. Also, test results show that, there is a significant and positive relationship between ratio of cash dividends and control variables such as cash dividends of last year, FCF, leverage, companies' profitability and size. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %40 of changes in Dividend policy.

Table 7. Independent variables’ coefficients and significance levels.

Variables	Model 1			Model 2		
	Beta	t	Sig.	Beta	t	Sig.
(Constant)	-.312	-2.419	.016	-.082	-2.225	.027
INS	.050	.754	.451	-.024	-1.269	.205
OS	.000	.270	.787	.000	.474	.636
GI	-.021	-.681	.496	-.012	-1.288	.198
PreDiv	.494	10.201	.000	.086	6.111	.000
StockDiv	.005	.099	.921	-.029	-2.138	.033
MTB	.004	1.071	.285	-.003	-2.511	.012
FCF	.260	1.856	.064	.117	2.913	.004
ROE	.456	5.984	.000	.167	7.666	.000
LEV	-.303	-1.942	.053	-.079	-1.771	.077
Size	.028	3.014	.003	.010	3.660	.000

As it is shown in the following figure (Table 6, 7), in model 2 (p-value>0.05), that show the variables of INS, OS and GI, have not a meaningful relationship with the company's cash dividends yield. Also, test results show that, there is a significant relationship between cash dividends yield and all control variables of model 2, except leverage. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %32 of changes in Dividend policy.

The fourth hypothesis test results

Fourth Hypothesis: financial information transparency aspect of corporate governance quality has an impact on corporate dividend policy. For the fourth hypothesis test, two models are used as follows:

$$CD_{i,t} = \alpha + \beta_1(TR_{i,t}) + \beta_2(PreDiv_{i,t}) + \beta_3(StockDiv_{i,t}) + \beta_4(MTB_{i,t}) + \beta_5(FCF_{i,t}) + \beta_6(ROE_{i,t}) + \beta_7(Lev_{i,t}) + \beta_8(Size_{i,t}) + \varepsilon_{i,t}$$

$$DY_{i,t} = \alpha + \beta_1(TR_{i,t}) + \beta_2(PreDiv_{i,t}) + \beta_3(StockDiv_{i,t}) + \beta_4(MTB_{i,t}) + \beta_5(FCF_{i,t}) + \beta_6(ROE_{i,t}) + \beta_7(Lev_{i,t}) + \beta_8(Size_{i,t}) + \varepsilon_{i,t}$$

Table 8: Model Summaryb

Model	Dependent Variable	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	CD	.666a	.444	.432	.26835	2.140
2	DY	.584a	.341	.327	.07888	1.717

a. Predictors: (Constant), Size, ROE, PreDiv, StockDiv, LEV, FCF, TR, MTB
 b. Dependent Variable: CD and DY

Table 9. Independent variables’ coefficients and significance levels.

Variables	Model 1			Model 2		
	Beta	t	Sig.	Beta	t	Sig.
(Constant)	-.383	-3.298	.001	-.116	-3.416	.001
TR	.003	4.965	.000	.001	3.009	.003
PreDiv	.430	8.876	.000	.075	5.230	.000
StockDiv	.012	.273	.785	-.025	-1.933	.054
MTB	.002	.636	.525	-.003	-3.019	.003
FCF	.165	1.213	.226	.094	2.342	.020
ROE	.395	5.308	.000	.154	7.091	.000
LEV	-.324	-2.142	.033	-.085	-1.920	.056
Size	.032	3.527	.000	.010	3.794	.000

As it is shown in the following figure (Table 8, 9), in model 1 (p -value <0.05), that show the variable of TR has a meaningful and positive relationship with the company's ratio of cash dividends. Thus, there is a relationship between dividend policy and financial information transparency (TR) aspect of corporate governance. Also, test results show that, there is a significant and positive relationship between ratio of cash dividends and control variables such as cash dividends of last year, FCF, companies' profitability and size, and significant and negative relationship by Leverage. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %43 of changes in Dividend policy.

As it is shown in the following figure (Table 8, 9), in model 2 (p -value <0.05), that show the variable of TR has a meaningful and positive relationship with the company's cash dividends yield. Also, test results show that, with assuming the acceptable error level is increased to 6% there is a significant relationship between cash dividends yield and all control variables of model 2. The determination coefficient and adjusted determination coefficient demonstrate that, these variables explain %33 of changes in Dividend policy.

DISCUSSION

The first hypothesis test results show that, the ratio of cash dividends has no relation with control aspect of corporate governance. The results of this study are in alignment with the results of other studies conducted by Jiraporn & Ning (2006), Mitton (2004) and John & Knyazeva (2006), Kouki & Guizani (2009), Short *et al.* (2002), Abdelsalam & *et al.* (2008). Their results confirm the Substitution relation of cash dividends and corporate governance index. It means that, companies with weaker governance pay more dividends to be a substitute for poor management.

In the present study, the relation between the control aspect of corporate governance (be parent or subsidiary company, the audit authority [quality], and legal inspector) in the first model was not confirmed. But in second model of first hypothesis, the existence of relation between audit authority (audit quality) and dividend policy was confirmed, that the results are in alignment with the results of other studies conducted by Gompers *et al.* (2003), Vein Drobtz (2004), Mitton (2004), Durnev and Kim (2005), Brown & Kaylor (2005), and Black *et al.* (2006).

Our result confirms the outcome Hypothesis. This hypothesis is largely based on the free cash flow hypothesis (Jensen, 1986). Managers of firms with weak governance are more likely to retain cash within the firm as it allows them to consume perquisites, engage in empire building, and invest in projects and acquisitions that may enhance their personal prestige but not necessarily provide stockholder's with adequate returns. By contrast, in firms with strong governance, managers are less likely to abuse the free cash flow, thus raising the attractiveness of paying out cash to stockholders. The expected dividend policy is thus the outcome of the governance regime in this view. The empirical prediction of this hypothesis is that firms with strong governance should pay larger dividends. In other words, there is expected to be a positive association between corporate governance quality and dividend payouts (Jiraporn *et al.*, 2008). Therefore, in this study, audit quality has an impact on corporate dividend policy. In other words, the companies that are audited by the audit organization, owner's rights are more respected.

The results of the second hypothesis show that; the ratio of cash dividends doesn't contain relation with board independence, separation of CEO and education. This result, confirms the end result of Abdelsalam & *et al.* (2008). That study was not found any significant relationship between board composition and dividend policy. But, our research shows that, the ratio of cash dividends positively associated with Timely Annual General assembly, and negatively associated with board of director's proficiency. Also, test results show that, there is a significant relationship between ratio of cash dividends and control variables such as cash dividends of last year, leverage, companies' profitability and size.

Among the components of the board of director's aspect, being of positive relationship between dividend policy and Timely Annual General assembly, confirm the outcome hypothesis and are in alignment with the results of other studies conducted by Gompers *et al.* (2003), Vein Drobtz (2004), Mitton (2004), Durnev and Kim (2005), Brown & Kaylor (2005), Black *et al.* (2006), and Jiraporn, Kim and kim (2008). Mitton by using an agency model showed that, companies with higher corporate governance score pay higher dividends.

Negative relationship between dividend policy and the board of director's proficiency is confirmed substitution hypothesis, and supported by studies of Liu (2002), Jiraporn & Ning (2006) and John & Knyazeva (2006).

According to this theory, owner's right can be replaced by dividend payment; i.e. companies with weaker governance pay greater dividend to be a substitute for their poor management.

Moreover, dividend paying firms also incur the cost of forgone positive-NPV projects or the additional cost of external financing to fund them when internal cash flow is inadequate. Since dividends are costly, firms that are less vulnerable to managerial entrenchment (i.e. firms with strong governance) should be less inclined to pay dividends and should pay lower dividends on average. Conversely, firms more susceptible to agency costs (i.e. those with weak governance) are expected to show a stronger propensity to pay dividends and should pay larger dividends on average. In other words, larger dividends substitute for weaker governance (Jiraporn, Kim and kim, 2008).

The third hypothesis models test shows that there isn't a relationship between the ratio of cash dividends, cash dividends yield and ownership aspect of corporate governance. The present results differ from the findings of Kouki

&Guizani(2009), Short & et al.(2002), Abdelsalam& et al.(2008). These results agreed with a substitution hypothesis. That, by increasing the quality of corporate governance, the amount of dividend decreases.

On the other hand, Wiberg (2008) results showed that institutional ownership and dividend payments are positively related. Our study also is not consistent with the findings of this researcher. Therefore, one can infer that in Iran with regard to outcome hypothesis and rely on agency theory, institutional investors, major stockholder's and the government has failed, as a controlling agent and to reduce agency costs, increase dividends. In that case, based on the agency theory the relationship between dividend policy and institutional ownership is found.

Further, it is argued that institutional stockholder's and dividends may be considered as a substitute signaling means. The presence of major stockholder's, ownership and power of government and institutional stockholder's may reduce the need to use dividends as a message of good performance; because, this stockholder's can act as a more valid message. The presence of these owners may be communicate to the market that agency costs due to monitoring activities of this group of stockholder's has been reduced(Bichara, 2008). Our results not consistent with Bichara view. This means that, this type of company owners have not been able to play a role in the form of two hypotheses.

The fourth hypothesis models test shows that there is a significant and positive relationship between the ratio of cash dividends, cash dividends yield and financial information transparency aspect of corporate governance. The result supported by outcome hypothesis and confirmed the agency theory. Also, our result is in line with Mitton (2004), and Jiraporn, Kim and kim(2008).

CONCLUSION

The hypothesis models test results using information contained in Tehran Stock Exchange Companies during the period 2006-2010 shows that there is a significant and positive relationship between audit quality, Timely Annual General assembly, financial information transparency and dividend policy.

There is evidence of the outcome relationship between these variables and the dividend policy and support agency theory, and confirms the free cash flow hypothesis that is base on that theory. That is, companies that have stronger corporate governance quality, to reduce agency costs greater dividends are distributed. On the other hand, Negative relationship between dividend policy and the board of director's proficiency is confirmed that corroborate substitution hypothesis of dividend policy. It can be argued that opportunistic managers use dividends as a means to cover their weaknesses and weaknesses in aspects of corporate governance quality, in general.

Also, the results of this study indicates significant and positive relationship between dividend policy and control variables such as cash dividends of last year, free cash flow, corporate profitability, and firm size in all models. In addition, between dividend policy and control variables such as leverage with assuming the acceptable error level is increased to 10% (on some models) a significant positive or negative relationship exists. Less impact of leverage on corporate dividend policy in some models may be related to corporate financing structure, in Iran is often done through the banks and with no related to dividend distribution.

Relationship between firm size and dividend policy, confirming the idea that larger firms have greater ability to pay dividends and significant and positive relationship between free cash flow, corporate profitability, leverage and dividend policy also largely consistent with previous research regarding the impact of these variables on the dividend policy. But, the existence of negative relationship between leverage and dividend policy which has been approved in previous research shows that, companies with high debt ratios due to restrictions on debt and capital rationing, less cash dividends are paid.

Based on the findings can be recommended to investors in its portfolio comprises, in addition to dividends are paid, have sufficient attention to the dimensions of corporate governance; According to the findings of this research is necessary to exchange officials to develop regulations and legal requirements for implementing the principles of corporate governance in exchange companies. Finally, the organizations are able to calculate the score of corporate governance is essential; because, the existence of such an indicator in addition to ranking companies can also effective for auditors, policy makers and the public to participate in the judgment about firms. The final point is that the findings with regard to access data about stock companies have been doing so, the generalization of the findings for other companies should be carefully observed.

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