Relationship between Capital Increase from Earned Cash and Stock Return in Companies Listed in Tehran Stock Exchange

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ABSTRACT One of the main aims of business management is increasing the shareholders’ wealth and also increasing the value and return on stock. Several factors affect the companies’ stock return, and choosing a good financing method is one of these factors. The current research aim is surveying the relationship between capital increase from earned cash and stock return in companies listed in Tehran Stock Exchange. In order to reach the research aims, 21 companies from the active companies in Tehran Stock Exchange were chosen through random sampling from 2007 to 2012 as the sample. In this research, capital increase from earned cash is the independent variable and stock return is the dependent variable. Results showed a positive and significant relationship between capital increase from earned cash and stock return of the companies. It could be concluded that one of the effective ways that could increase the stock return is capital increase from earned cash.

Keywords: Capital increase, Return on common stock, Earned cash.

INTRODUCTION

During the recent years, a growing tendency toward capital increase by the companies listed in Tehran Stock Exchange has been observed. From the perspective of macroeconomic, great ownership division through sale of their shares in stock exchange helps the goal of a more equitable distribution of income and also a sense of participation in the whole population in production and commercial activities. Ownership of a large firm by one person or a few people who can finance it is not comparable to the benefits of collective ownership. In addition to that, if the possibility of funding the resources of large investments realizes through bank borrowings, however, publication and sale of the shares to the public for financing is preferable (Khosh Tinat, 2003). Investors as the providers of the required financial resources for the economic units, invest with different motivations including use of profit and cash benefits and also ownership in these units. On the other hand, other economic units need financial resources for different reasons; but what appears to be the most important for the investors and specific units is increasing the shareholders’ wealth (Islami Bigdeli and Sarenj, 2008). One of the main aims of business management is increasing the shareholders’ wealth and also increasing the value and return on stock. Several factors affect the companies’ stock return, and choosing an appropriate method of financing is one of these factors. Company management along with appropriate and optimal financing method and in order to maximize the stock return through implementing profitable projects should determine the cost of these financial resources and should create a balance between risk and stock return. Procurement of financial resources through sale of bonds and stocks is one of the safest ways for collecting the required funds for investment.

Instead of borrowing from the banking system, under some terms and conditions through selling stocks or bonds, the production and commercial units can provide their financial needs (Zhang, 2006). Based on the current research subject, one of the most important decisions of managers of a company is making a decision about the capital increase and use of the most effective ways for capital increase; because in addition to the quick effect on the stock price and shareholders’ return on stock, it may also affect other activities of the company. However, it must be stated that capital increase is one of the best methods for earning cash to expand activities and implement the future plans both in capital price and in ease of performing it. Different businesses can increase their capital through different ways, but the effect of each of these ways of increasing capital on the stock return is different. Companies can provide their required
financial resources both from the resources within the organization and outside the organization. But during the recent years most companies and businesses have turned toward external resources such as distribution of shares in stock market; and this method is only, one of the methods of financing. There is a possibility that different investment methods result in different stock returns. Thus the current research tries to answer this question that is there any relationship between capital increase from earned cash and stock return in companies listed in Tehran Stock Exchange or not?

**METHODOLOGY**

The current research method is correlative. In order to reach research aims, 21 companies from the active companies in Tehran Stock Exchange from 2007 to 2012 were chosen through random sampling as the research sample. In this research the capital increase from earned cash is the independent variable and return on common stock is the dependent variable. Stock return is calculated through the following formula:

\[
\text{Cash dividends} + \text{Priority benefits} + \text{Benefits of bonus shares (the share price differences at the beginning and end of period)}
\]

\[\text{The first share price at the beginning of fiscal year}\]

The total return on stock price to the initial price at the beginning of the period:

\[
\text{Cash dividends} + \text{Priority benefits} + \text{Benefits of bonus shares (the share price differences at the beginning and end of period)}
\]

In which the priority value and bonus shares value are calculated through the following formulas:

\[
\text{Priority value: (Nominal value per share – Latest share price at the end of the period) × Capital increase percentage}
\]

\[
\text{Bonus shares value: The latest price × Capital increase percentage}
\]

All the required financial information were extracted from the companies’ documents, they were categorized and analyzed. Pearson correlation coefficient was used for surveying the relationship between variables. Also the simple linear regression equation was used for surveying the causal relationship between independent and dependent variables. Furthermore, t and F tests were used for surveying the significance of the linear relationships. All the statistical analyses were conducted at level \(P \leq 0.05\).

**RESULTS**

Table 1 shows the companies’ stock return based on capital increase from earned cash.

<table>
<thead>
<tr>
<th>No.</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return</td>
<td>21</td>
<td>25.81</td>
<td>245.8</td>
<td>99.21</td>
</tr>
</tbody>
</table>

Pearson correlation coefficient was used for surveying the relationship between variables. Results indicate a positive relationship between capital increase from earned cash and stock return (\(P \leq 0.05\)). Statistical results are shown in table 2.

**Table 2. Summary of statistical results.**

<table>
<thead>
<tr>
<th>Pearson</th>
<th>Capital increase from earned cash</th>
<th>Return on common stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Correlation coefficient</td>
<td>1.000</td>
<td>0.792*</td>
</tr>
<tr>
<td>Significance level (P-Value)</td>
<td>.</td>
<td>0.000</td>
</tr>
<tr>
<td>No.</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>Return on common stock</td>
<td>Correlation coefficient</td>
<td>0.792</td>
</tr>
<tr>
<td>Significance level (P-Value)</td>
<td>0.000</td>
<td>-</td>
</tr>
<tr>
<td>No.</td>
<td>21</td>
<td>21</td>
</tr>
</tbody>
</table>

*Correlation at error level 0.01 is significant (one-way)

Correlation coefficient between capital increase from earned cash and return on common stock equals 0.792; thus after the confirmation of the relationship between these two variables, the causal relationship between them was surveyed. Tables 3 and 4 show a summary of statistical analysis.
Table 3. The causal relationship between capital increase from earned cash and return on common stock.

<table>
<thead>
<tr>
<th></th>
<th>Sum of scores</th>
<th>df</th>
<th>Mean of scores</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>34137.34</td>
<td>1</td>
<td>34137.34</td>
<td>31.9</td>
<td>0.00</td>
</tr>
<tr>
<td>Residual</td>
<td>20334.09</td>
<td>19</td>
<td>1070.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>54471.43</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4. Coefficients of causal relationship between capital increase from earned cash and return on common stock.

<table>
<thead>
<tr>
<th>Model</th>
<th>Non-standardized coefficients</th>
<th>Standardized coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>Capital increase from earned cash</td>
<td>1.041</td>
<td>0.184</td>
<td>0.792</td>
<td>5.648</td>
</tr>
</tbody>
</table>

α: Dependent variable: return on common stock

Achieved results show that the achieved t amount is equal to 5.648 which is more than 2.57; thus with 99% confidence it could be claimed that capital increase from earned cash has a positive and significant effect on return on common stock. Also the achieved F amount is significant too. This shows that the achieved Beta coefficient is the actual effect of independent variable on the dependent variable and it is not caused by error.

CONCLUSION

The aim of conducting the current research is surveying the correlation between capital increase from earned cash and stock return of companies listed in Tehran Stock Exchange. Results showed a positive and significant correlation between these two variables. The achieved correlation coefficient was 0.792 and the revised coefficient of determination was 0.607. Thus it could be said that capital increase from earned cash has a share in 0.607 of the changes of stock return. Based on Sharp’s opinion and CAPM theory, if the market portfolio is efficient then there is a linear relationship between capital increase index from earned cash and the expected return, and it is expected from the capital increase from earned cash to solely explain the difference between the expected return of different assets. The current research results are inconsistent with the researches by Noravesh et al (2005), and Bahar Moghaddam (2008). They showed that the capital increase does not have any effect on stock return. On the other hand, this research is consistent with research results of Fakhari (2009) and Ibrahimi Kordeli (2006). They concluded that capital increase results in increase of price and stock return. In total, the return on equity and as a result the set of corporate assets increases through capital increase. On the other hand, it is also possible to change the combination of shareholders’ ownership. Additionally, companies have different reasons and motivations for capital increase from deposits. This type of capital increase could include aims such as company development, purchase of new assets or replacement of new assets, facilitating resources to enter foreign markets, solvency of the company, and facilitating the required working capital for the company. It could be concluded that one of the effective ways for increasing the stock return is through capital increase from earned cash.

REFERENCES


