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The Relationship Between Growth Opportunities and Leverage Ratio in the Companies Listed in Tehran Stock Exchange

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Abstract

This study examines the relationship between growth opportunities and leverage of firms listed in Tehran Stock Exchange and for the growth opportunities has used the ratio of market value of assets to book value of assets. In order to differentiate between corporates growth opportunities, the sample companies, based on their market value to book value, were divided into 3 groups: firms with High growth opportunities, firms with average growth opportunities and firms with low growth opportunities. The study used 65 firms data during the period 2005 to 2014. The results show that the low, medium and high growth opportunities are positively related with leverage ratios.

Keywords

Growth Opportunities, Capital Structure, Corporate Leverage, Profitability, Debt Ratio

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1. Introduction

In most cases, investors make decisions regarding their investments and intending to maximize their return. Therefore, any information that could be used to predict the level of growth of the company, take into consideration for them. The driving force of growth opportunities will motivate investors. However, the investors must consider risks to their investment decisions. Because what makes success, optimal use of available investment opportunities. For this, effective financial policies should be identified to create growth opportunities in the Businesses. On the other hands, Managers are also interested in increasing the value of the company and the level of debt and leverage in their company. Many companies face with issues such as financing funds, how to use the funds in order to maximize productivity, increasing the value and investment opportunities. In recent times, due to rapid changes in technology and the increasing expectations of shareholders, Financial decision making depends on the expertise of managers and also due to the importance of financial and accounting information in decision making and resource allocation, if proper market analysis and interpretation of the data to be done and companies long-term goals accurately to de determined, An optimum allocation of resources will be done from one side and the other side leads to the maximization of corporate value in the market. In this study we try to empirically study the relationship between growth opportunities and Leverage ratio in the companies listed in Tehran Stock Exchange with different growth opportunities.

Financial analysts examine the firm status by analyzing its financial statements. The profitability and the amount of firm earnings, are one of the important issues of today's discussion in the firms analysis of financial information. Debt amount

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and growth opportunities in the firm profitability are also a very important factor. Debt role in determining opportunities for growth and profitability is an important issue that should be considered in analyzing firms and evaluating firms' financial position and their flexibility. Growth Opportunity shows the firm's potential capacity in profitability and investing.

One of the methods of data analysis is the measurement of growth opportunities. In some cases the growth opportunities presented by a ratio of firm's value that is calculated by assets. Growth opportunities also represent a potential ability of investments. Investors require specific information for decision-making to invest in various areas such as growth opportunities and leverage ratios and etc. Financial analysts are comparing the ratio of financial leverage growth opportunities to the conclusion that in companies with different levels of debt, at what level their growth opportunities are. On the other hand, many other researchers believe that companies with high growth opportunities, faced with lower interest costs, so they have more financial leverage. In other words, growth opportunities and leverage ratio have positive relationships with each other.

1.1. Literature

Avaz zade (2004) in his master's thesis titled "the Analytical study of factors affecting the company's value in Tehran Stock Exchange" concludes that:

There is a significant relationship between firm value and leverage.

There is no significant relationship between dividend paid to dividend nonpaid and firm's value.

There is no significant relationship between capital expenditures and firm's value. [1]

Darabi (2007) in his master's thesis titled "The impact of capital structure (debt) on the value of companies with different growth opportunities in the companies listed in Tehran Stock Exchange" concludes that:

1. In firms with low growth, there is a significant positive relationship between firm value and capital structure and also in firms with high growth, there is a significant positive relationship between firm value and capital structure.
2. The relationship between short-term debt and firm value is positive and significant in firms with high growth and low growth, while the relationship between long-term debt and firm value in firms with high and low growth is positive but not significant. [5]

Kordestani and Najafi (2008) by surveying of 93 companies listed in Tehran Stock Exchange during the years 1999 and 2006 concluded that there is a significant and positive relationship between firm size and book value of debt and there is a significant negative correlation between the tax savings except for debt and debt ratio based on book value and market value. (That is according with the theory of static tradeoff). According to the Pecking-order theory there is a significant positive relationship between growth opportunities and debt ratio based on the book value. Contrary to the predictions of Static tradeoff and Pecking-order theory, there is a significant positive relationship between the volatility of earnings and debt ratio based on the book value and market-based and between dividend payout ratio and debt ratio based on the book value. According to the Pecking-order theory, there is a significant negative relationship between assets observability and debt ratio based on the book value and between the profitability of the company than debt ratio based on book value and market value. [6]

Noravesh and yazdani (2010) reviewed relationship between leverage and investment decisions of firms listed in Tehran Stock Exchange. For this purpose, they used two measures of the leverage and three empirical models. Their results showed a significant negative correlation between leverage and investment. The results also show that the relationship of investment leverage for firms with fewer growth opportunities, is stronger than firms with more growth opportunities. [11]

Mahmmoudi et al (2013) in a study using data from 81 firms listed in Tehran Stock Exchange for the years 1384 to 1389, tried to examine the relationship between growth opportunities and debt at a low level of growth opportunities. Test results show that there is a significant negative relationship between growth opportunities and leverage level of debt in the firms with a low growth opportunity. [8]

Modigiliani and Miller (1958) accepted that the tax savings resulting from the debts interest increase firm value and suggested that firms use the maximum possible debt in their combining financial resources. [9]

Danielson (1996) studied the tax savings from the cost of leverage (debt) where cost of debt due to the firm's capital structure decisions is positively correlated with different growth opportunities. The results show that there is negative relationship between leverage and growth opportunities in companies with high growth opportunities. If growth opportunities and leverage have a negative relationship, so there is negative relationship between book value and market of debt and growth opportunities in the selected samples. Practical tests also show a positive relationship between taxable income and leverage in some specific periods for some firms with low growth opportunities. [4]

Long Chen (2006) investigated the relationship between growth opportunities and leverage ratio on the NYSE. The relationship between growth opportunities and leverage ratio

is a non-uniform relationship and for high growth opportunities this relationship is negative but this negative correlation is not robust. Firms with higher ratio of market value to book value in comparison with other companies, face lower borrowing costs. Generally, companies with high ratio of market value to book value, use less debt but those with low ratio, use high debt. [7]

Moon and Tandon (2007) survey the correlation between the equity and leverage types and the different growth opportunities. Findings show that correlation between equity and leverage for firms with low growth opportunities is important but for companies with high growth opportunities, is not important. According to the study, it was also found that in the firms with high growth opportunities, the relationship between capital structure and leverage is low. [10]

Billett et al (2007) studied the effect of growth opportunities on investment opportunities and selection of the type of security with respect to the composition of debt with maturities. The result in this case was: keeping commitment increases the leverage and the ratio of market value to book value, and decreases in short-term debt. The leverage also has a negative effect on growth opportunities and we can reduce the negative effect of growth opportunities by using commitments. [3]

Awan et al (2010): The purpose of their study is to find out how growth opportunities in Pakistan are related to leverage decisions for the listed manufacturing corporate concerns. They use financial data from a sample of 110 manufacturing companies listed on Karachi Stock Exchange for 15 years (1982-1997). They find a positive relationship between the growth opportunities and debt levels of the corporate firms. Another important finding of this study is that industry type is also a relevant variable which affects the relationship between growth opportunities and leverage. [2]

Ramezanalivaloujerdi et al (2015): This study examines corporate capital structure of listed construction companies in Malaysia from 2005-2009. The analysis revealed that profitability of the firm; growth opportunity and firm size had the significant relationship with dependent variable, leverage. Finally, there was no relationship between tangibility of assets and leverage for construction companies. [12]

1.2. Research Hypotheses

The main hypothesis: There is a positive relationship between leverage ratio and growth opportunities.

The first sub-hypothesis: There is a positive relationship between leverage ratio and growth opportunities, for companies with high growth opportunities.

The second sub-hypothesis: There is a positive relationship between leverage ratio and growth opportunities, for companies with average growth opportunities.

The third sub-hypothesis: There is a positive relationship between growth opportunities and leverage ratio, for companies with low growth opportunities.

1.3. Research Scope

Geographic scope: companies are listed in Tehran Stock Exchange.

The period scope: the period of investigation is from the beginning of 2005 until the end of 2014.

The subject scope: growth opportunities and financial leverage ratio in the companies listed in Tehran Stock Exchange.

1.4. The Population and Sample

The population of the study is companies listed in Tehran Stock Exchange. Based on calculation software PASS, for enough generalization to the population, the number of required samples, were selected for the sample of 65 companies.

1.5. Operational Definition of Variables

1.5.1. Growth Opportunities

Growth opportunity represents the potential ability of company investment. This variable is unobservable and the analysis needs to be a good indicator. Therefore, we used the market value to book value of assets ratio to measure and calculate growth opportunities. In this study, three groups of companies has used: companies with high, medium and low growth opportunities. So that "companies with low growth opportunities, their growth opportunities, ranging from zero to 1.25", and "companies with medium growth opportunities, their growth opportunities, ranging from 1.25 to 2", and "companies with high growth opportunities, their growth opportunities, ranging from 2 to 3.69"

1.5.2. Market Leverage Ratio

calculated by dividing the ratio of debt to market value of assets.

1.5.3. Book Leverage Ratio

calculated by dividing the ratio of debt to book value of assets.

2. Results

2.1. 2010 Descriptive Statistics Results (Introducing Variables)

Since described before and as shown in Tab.1, 22 companies are in the low growth opportunities, 21 companies in the

medium, and 19 companies in the high position. As can be seen 35.5% of companies are in the low growth opportunities category, 33.9% of companies in the medium, and the others are (30.6%) in the high.

Table. 1. Simple frequency of growth opportunities levels.

growth opportunity position	frequency	Percent of relative frequency	Percent of cumulative relative frequency
low	22	35/5	35/5
medium	21	33/9	69/4
high	19	30/6	100
total	62	100	

2.1.1. Index of Companies Growth Opportunities

The amount of growth opportunities has been divided as growth opportunities for low, high and medium based on growth criteria. The distribution of growth opportunities in the Companies is presented in Tab.1. Tab.2 represents statistical indicators about the companies growth opportunities and Fig. 1 shows the distribution of the companies growth opportunities.

Table 2. Statistical indicators about the growth opportunities.

indicator	minimum	mean	maximum	Standard deviation
growth opportunity	0/89	1/72	3/69	0/686

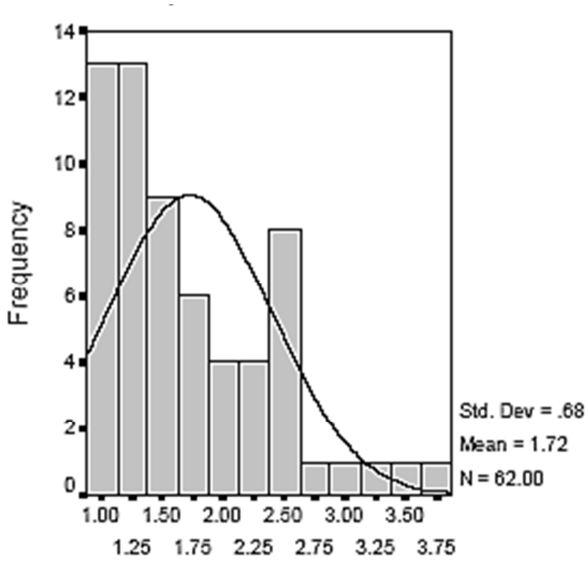

Fig. 1. Histogram of growth opportunities.

2.1.2. Index of Book Leverage

Figure 2 shows the distribution of the amount of book leverage ratio of companies and table 3 represents Statistical Indicators on the amount of book leverage ratio of companies. The table also shows that the mean amount of book leverage of companies is 0/68 and Standard deviation is 0/110 and the minimum and maximum of book leverage ratio are 0/41 and 0/9 respectively.

Table 3. Statistical Indicators on the amount of book leverage ratio of companies.

indicator	minimum	mean	maximum	Standard deviation
book leverage	0/41	0/9	0/68	0/110

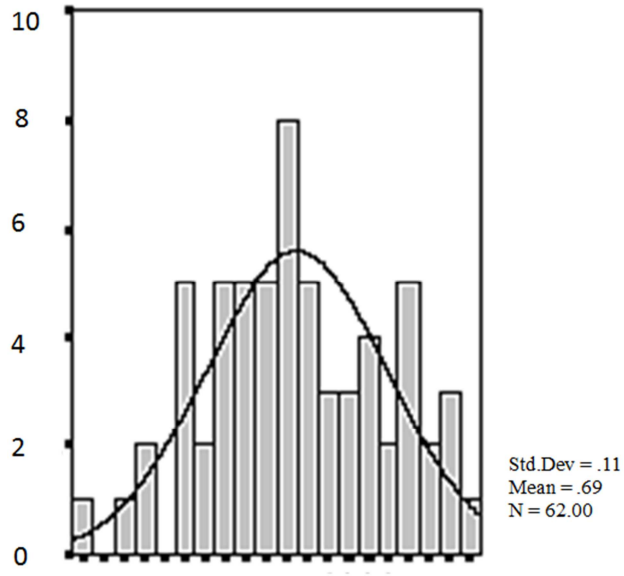

Fig. 2. Histogram of book leverage ratio.

2.1.3. Index of Market Leverage Ratio

Fig. 3 shows market leverage ratio and Tab.4 represents statistical indicators about the of market leverage ratio. The table also shows that the mean amount of market leverage ratio is 0/479 and Standard deviation is 0/174 and the minimum and maximum of market leverage ratio are 0/216 and 0/856 respectively.

Table 4. Statistical indicators about the amount of market leverage ratio.

indicator	minimum	mean	maximum	Standard deviation
market leverage	0/216	0/479	0/856	0/174

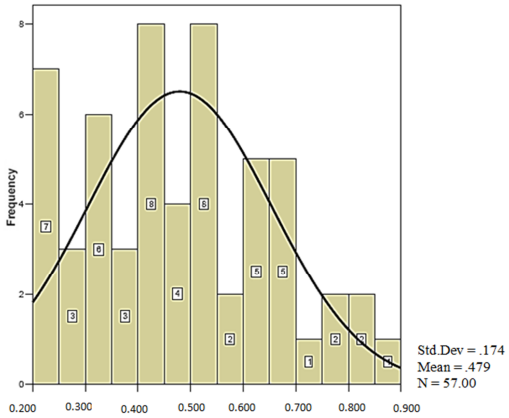

Fig. 3. Histogram of the amount of market leverage ratio.

2.1.4. Index of Profitability Ratio

Tab.5 represents statistical indicators and Fig. (4) shows the distribution of profitability ratio of the companies. The table

also shows that the mean amount of profitability ratio is 0/179 and Standard deviation is ±0/08and the minimum and maximum of profitability ratio are 0/0073 and 0/372 respectively.

Table 5. Statistical indicators about the amount of profitability ratio.

indicator	minimum	mean	maximum	Standard deviation
profitability	0/0073	0/179	0/372	0/08

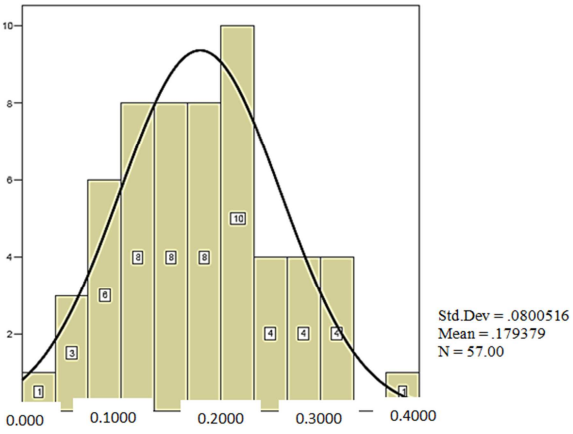

Fig. 4. Histogram of the amount of profitability ratio.

2.1.5. Index of the Company Size

Tab. 6 represents statistical indicators and Fig. (5) shows the distribution of the size of companies.

Table 6. Statistical indicators about the amount of the size of companies.

indicator	minimum	mean	maximum	Standard deviation
size of company	3/88	5/47	7/67	0/614

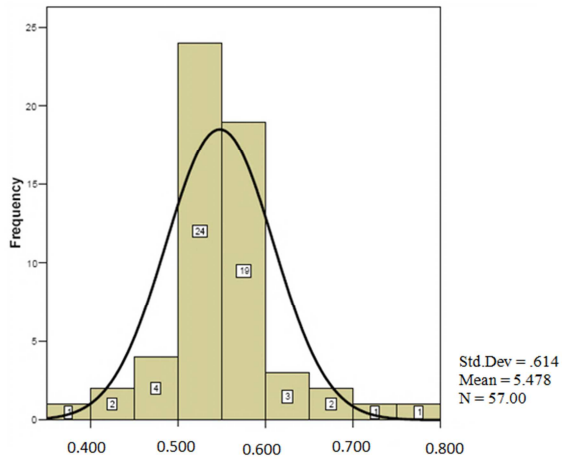

Fig. 5. Histogram of the amount of the size of companies.

2.2. Hypothesis Testing and Inferential Statistics Results

The main hypothesis testing: there is a positive relationship between growth opportunity index and market leverage ratio. Fig.6. shows the relationship distribution between the market leverage and growth opportunities and Tab.7 represents Pearson correlation coefficient and significance test of the relationship between growth opportunities index and market leverage ratio. The table also shows that by increasing growth opportunities of companies, market leverage ratio reduces 0/84 and this relationship is significant (p=0/0001).

Table 7. The significance test result of Pearson linear correlation coefficient.

variable	explanation	market leverage ratio	growth opportunity
growth opportunity	Pearson correlation coefficient	-0/840	1
	Significance level	0/0001	0
market leverage ratio	Pearson correlation coefficient	1	-0/840
	Significance level	0	0/0001

The first sub-hypothesis test: there is positive relationship between the index of growth opportunity and the market leverage ratio in companies with high growth opportunities.

Tab.8 shows the Pearson linear correlation coefficient and significance test regarding to the relationship between the index of growth opportunity and market leverage ratio in companies with high growth opportunities. The table also shows that by increasing growth opportunities, the market leverage ratio reduces 0/678 and this relationship is significant (p=0/003).

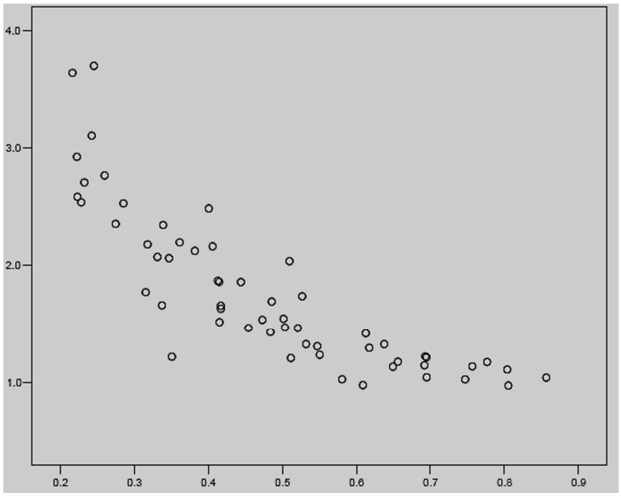

Fig. 6. Scatter plot of market leverage ratio against the Companies growth opportunities.

Table 8. The result of significance test of Pearson correlation coefficient.

market leverage	growth opportunity	explanation	variable	The growth opportunity position
-0/678	1	Pearson correlation coefficient	growth opportunity	
0/003	0	Significance level		High growth opportunity
1	-0/678	Pearson correlation coefficient	market leverage	
0	0/003	Significance level		

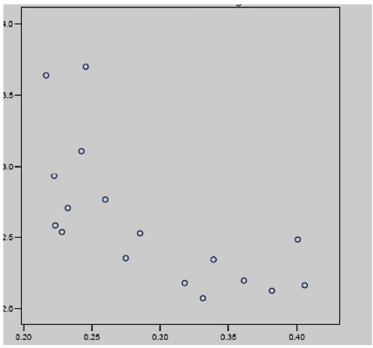

Fig. 7. The scatter plot of market leverage ratio against the amount of growth opportunity in companies with high growth opportunities.

The second sub-hypothesis test: there is a positive relationship between the growth opportunities index and the market leverage ratio in companies with average growth opportunities.

Tab. 9 shows the Pearson Linear correlation coefficient and significance test regarding to the relationship between the growth opportunity index and the market leverage ratio in companies with average growth opportunities. The table also shows that by increasing growth opportunities, the market leverage ratio decreases 0/566 and this relationship is significant (p=0/007).

Table 9. The result of significance test of Pearson correlation coefficient.

market leverage	growth opportunity	explanation	variable	The growth opportunity position
-0/566	1	Pearson correlation coefficient	growth opportunity	average growth opportunity
0/007	0	Significance level		
1	-0/566	Pearson correlation coefficient	market leverage	
0	0/007	Significance level		

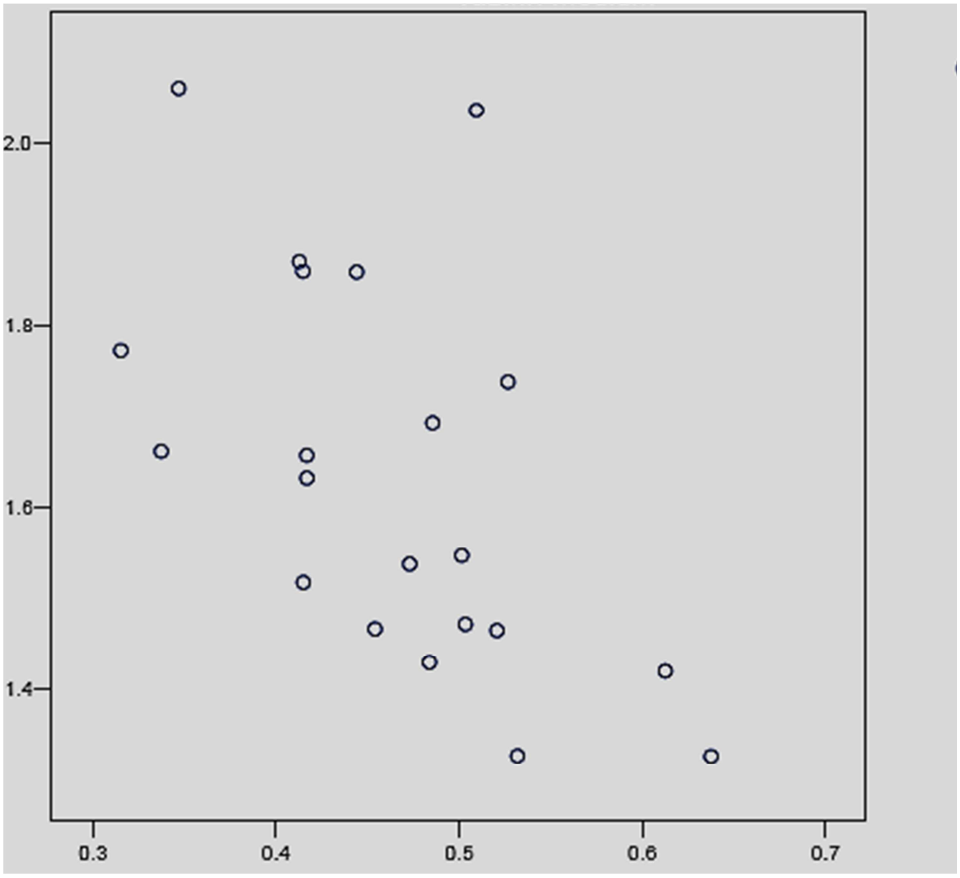

Fig. 8. The scatter plot of market leverage ratio against the amount of growth opportunity in companies with average growth opportunities.

The third sub-hypothesis test: there is a positive relationship between the growth opportunity index and market leverage ratio in companies with low growth opportunities.

Tab.10 shows the Pearson Linear correlation coefficient and significance test regarding to the relationship between the growth opportunity index and the market leverage ratio in companies with low growth opportunities. The table also shows that by increasing growth opportunities, the market leverage ratio decreases 0/471 and this relationship is significant (p=0/042).

Table 10. The result of significance test of Pearson correlation coefficient.

market leverage	growth opportunity	explanation	variable	The growth opportunity position
-0/471	1	Pearson correlation coefficient	growth opportunity	low growth opportunity
0/042	0	Significance level		
1	-0/471	Pearson correlation coefficient	market leverage	
0	0/042	Significance level		

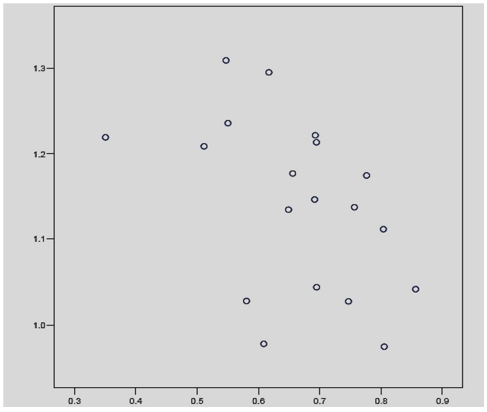

Fig. 9. The scatter plot of market leverage ratio against the amount of growth opportunity in companies with low growth opportunities.

In short we can say that there is a negative and significant relationship between growth opportunity and market leverage ratio in the tested sample. The results are given in Tab.11:

Table 11. The results of between growth opportunity and market leverage ratio.

Result of test	test	hypothesis Description	Hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio	The main hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio in companies with high growth opportunities	The first sub-hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio in companies with average growth opportunities	The second sub-hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio in companies with low growth opportunities	The third sub-hypothesis

3. Discussion

3.1. The main Hypothesis Test

There is a positive relationship between growth opportunities and book leverage ratio.

Fig.10 shows the distribution of communication between the book leverage ratio and the growth opportunity and Tab.12 depicts the Pearson correlation coefficient and significant test of the relationship between growth opportunities and book leverage ratio. The table also shows the weak relationship between growth opportunities and book leverage ratio (0/194) and this relationship is not statistically significant (p=0/131).

Table 12. Significant test result of Pearson linear correlation coefficient.

book leverage	growth opportunity	Explanation	variable	The growth opportunity position
-0/194	1	Pearson correlation coefficient	growth opportunity	total
0/131	0	Significance level		
1	-0/194	Pearson correlation coefficient	book leverage	
0	0/131	Significance level		

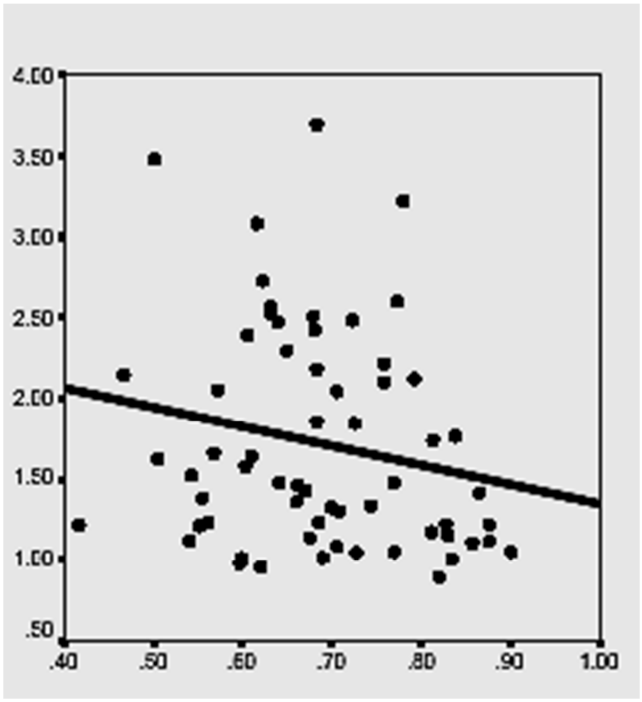

Fig. 10. The scatter of book leverage against the market leverage.

3.2. The First Sub-hypothesis Test

There is a positive relationship between the growth opportunities index and the book leverage ratio in companies with high growth opportunities.

Table 13. Significant test result of Pearson linear correlation coefficient.

book leverage	growth opportunity	Explanation	variable	The growth opportunity position
0/745	1	Pearson correlation coefficient	growth opportunity	high growth opportunity
0/01	0	Significance level		
1	-0/745	Pearson correlation coefficient	book leverage	
0	0/01	Significance level		

Fig.11 shows the distribution of communication between the book leverage ratio and the growth opportunity and Tab.13 depicts the Pearson correlation coefficient and significant test in the relationship between the growth opportunities index and the book leverage ratio in companies with high growth opportunities. The table also shows that by increasing growth opportunities, book leverage ratio reduced (745/0) and this relationship is statistically significant (p=0/01).

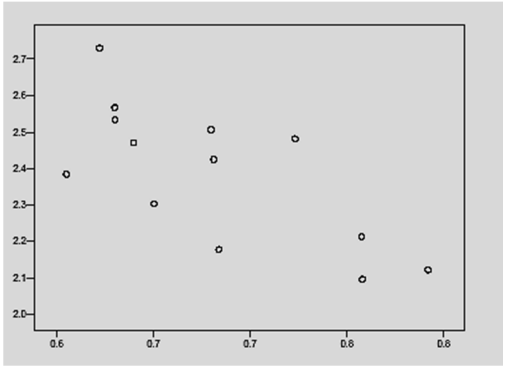

Fig. 11. The scatter plot of book leverage against the growth opportunity.

3.3. The Second Sub-hypothesis Test

There is a positive relationship between the growth opportunities index and the book leverage ratio in companies with average growth opportunities.

Tab.14 depicts the Pearson correlation coefficient and significant test in the relationship between the growth opportunities index and the book leverage ratio in companies with average growth opportunities. The table also shows that there is a very weak significant relationship between opportunity and book leverage ratio that is not statistically significant (p=0/86).

Table 14. Significant test result of Pearson linear correlation coefficient.

book leverage	growth opportunity	Explanation	variable	The growth opportunity position
-0/041	1	Pearson correlation coefficient	growth opportunity	average growth opportunity
0/86	0	Significance level		
1	-0/041	Pearson correlation coefficient	book leverage	
0	0/86	Significance level		

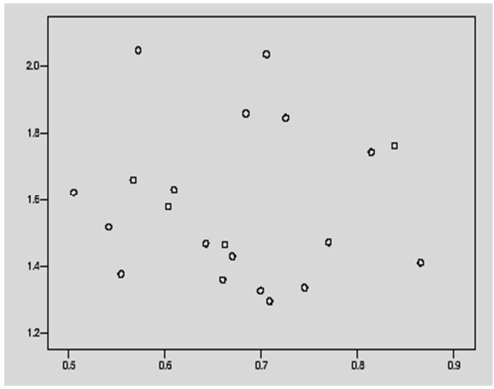

Fig. 12. The scatter plot of book leverage ratio against the growth opportunity amount.

3.4. The Third Sub-hypothesis Test

There is a positive relationship between the growth opportunities index and the book leverage ratio in companies with low growth opportunities.

Tab. 15 depicts the Pearson correlation coefficient and significant test in the relationship between the growth opportunities index and the book leverage ratio in companies with low growth opportunities. The table also shows that there is a weak significant relationship between opportunity and book leverage ratio that is not statistically significant (p=0/517).

Table 15. Significant test result of Pearson linear correlation coefficient.

book leverage	growth opportunity	Explanation	variable	The growth opportunity position
-0/148	1	Pearson correlation coefficient	growth opportunity	low growth opportunity
0/517	0	Significance level		
1	-0/148	Pearson correlation coefficient	book leverage	
0	0/517	Significance level		

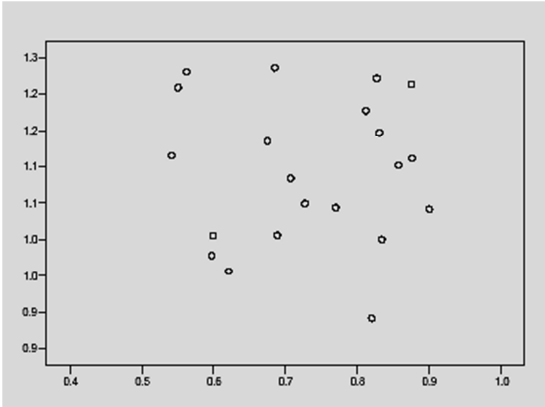

Fig. 13. The scatter plot of book leverage ratio against the growth opportunity amount.

At the end, according to the statistical results of testing various hypotheses and sub-hypotheses, we can say “There is a significant relationship between growth opportunities and

leverage ratio in companies with high growth opportunities". Test results are given in Tab.16:

Table 16. The results of between growth opportunity and book leverage ratio.

Result of test	test	hypothesis Description	Hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio	The main hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio in companies with high growth opportunities	The first sub-hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio in companies with average growth opportunities	The second sub-hypothesis
H_0 is confirmed	Pearson correlation	There is a positive relationship between the growth opportunities and leverage ratio in companies with low growth opportunities	The third sub-hypothesis

4. Conclusions

4.1. The Results of the Test Hypotheses Using Variables of Growth Opportunity and Market Leverage Ratio

1. The main hypothesis test results:

We use Pearson correlation test for finding the correlation between growth opportunities index and market leverage. The results show that there is strong negative significant relationship between growth opportunities and leverage ratio.

2. The first sub-hypothesis test:

In this test the relationship between growth opportunities and market leverage ratio in companies with high growth were examined. The results show that there is strong negative significant relationship between growth opportunities and market leverage ratio in high growth opportunities.

3. The second sub-hypothesis test:

In this test the relationship between growth opportunities and market leverage ratio opportunities in companies with average growth were examined. The results show that there is significant relationship between growth opportunities and market leverage ratio.

4. The third sub-hypothesis test:

In this test the relationship between growth opportunities and market leverage ratio in companies with low growth were examined. The results show that there is significant relationship between growth opportunities and market leverage ratio.

4.2. The Results of the Test Hypotheses Using Variables of Growth Opportunity and Book Leverage Ratio

1. The main hypothesis test results:

We use Pearson correlation test for finding the correlation between growth opportunities index and book leverage. The results show that there is weak significant relationship between growth opportunities and book leverage ratio.

2. The first sub-hypothesis test:

In this test the relationship between growth opportunities and book leverage ratio in companies with high growth were examined. The results show that there is strong negative significant relationship between growth opportunities and book leverage ratio in high growth opportunities.

3. The second sub-hypothesis test:

In this test the relationship between growth opportunities and book leverage ratio opportunities in companies with average growth were examined. The results show that there is no significant relationship between growth opportunities and book leverage ratio in companies with average growth.

4. The third sub-hypothesis test:

In this test the relationship between growth opportunities and book leverage ratio in companies with low growth were examined. The results show that there is significant relationship between growth opportunities and book leverage ratio.

4.3. Other Findings

We used regression test to acheive a relationship between growth opportunity as a dependent variable and four independent variables such as corporate profitability, market leverage ratio, profitability ratio and corporate size. To determine the association between growth opportunities and other variables, stepwise multiple linear regression analysis was used. Multiple linear regression analysis was obtained after iteration as follows:

$$\text{Growth Opportunity}=0.672+(4.527\times \text{ profitability})-(3.4\times \text{ market leverage})+(2.8\times \text{ book leverage})$$

Table 17. Report of confirmed model with linear regression method.

Model	R (determination coefficient)
Profitability	0/828
market leverage and profitability	0/852
market leverage, profitability and book leverage	0/877

As you can see, with the variables such as profitability, market leverage and book leverage, the final model shows that about 87/7percent of the companies growth opportunities changes can be explained only by variables such as profitability,

market leverage ratio and book leverage ratio. The final model is statistically valid on the level of 5 percent.

Underlying assumptions of the multiple linear regression model such as normal distribution of residuals, hemoskedasticity, zero being of errors mean and lack of autocorrelation were investigated and establishing these hypotheses is ensured.

5. Research Recommendations

In this study, factors and variables such as interest rates, tax rates, inflation, and economic conditions are assumed to be constant. Therefore, users of this study should consider these factors in their own decisions.

Since, this study was done for all kinds of industries, therefore because of corporate diversification, industries diversification, different capital structure and market conditions, it is advisable that industry characteristics is considered for decision making.

Since, the results of the study showed that there is a negative relationship between growth opportunities and leverage ratio, it is recommended that firms with high growth opportunities to further consider the use of credit resources. Because, cost of capital of these resources may be cheaper than the internal financing.

According to the results of research, it is recommended to investors that Carefully consider the relationship between growth opportunities and leverage ratio. Because most of investors interested to invest in companies that have a lower risk and long-term interests as well. Therefore, investors try to invest in companies with higher growth opportunities.

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