American Journal of Business and Management
Vol. 3, No. 2, 2014, 117-125
DOI: 10.11634/216796061403539

Impact of Cash Flow on Capital Structure of Firms Listed in Tehran Stock Exchange

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This article examines the impact of cash flow on capital structure of firm and finance through debit and capital in future. In order to meet this goal, it is applied from multi variable regression statistical method and this article is carried out from 2006 until 2010 at Tehran stock exchange. In the way of carrying out this research the information related to dependent variable, independent variable and control variable through Tadbirpardaz database and Rahavard Novin database and through website and library affiliated to stock exchange organization and the sample was collected among 415 firms. Upon extracting information, the desired folders were designed and calculated by Excel and finally was analyzed by SPSS software. Results reveal that as it was expected there is significant relationship between operational cash flow with external financing, finance through stock, finance through debit for the firm listed at Tehran stock exchange.

Keywords: cash flow, capital structure, financing

Introduction

A company applies its assets in its business to generate a stream of operating cash flows. After paying taxes, the firm makes distributions to the providers of its capital and retains the balance for use in its business. If company is all equity financed, the entire after-tax operating cash flow each period accrues to the benefit of its shareholders (in the form of dividend and retained earnings). If instead the company has borrowed a portion of its capital, it must dedicate a portion of the cash flow stream to service this debt. Moreover, debt holders have the senior claim to a company's cash flow; shareholders are only entitled to the residual. The company's choice of capital structure determines the allocation of its operating cash flow each period between debt holders and shareholders (Chowdhury, 2010). Firm with informational and agency problems have limited access to external financing; therefore, they easy reject or withdraw profit-making investment opportunities. This issue in long term damages to profit-making ability, growth and financial status of firm and even many retard firm from competition and leading to elimination of firm from market. Such firms are called financially constraint firms. Capital structure is the means by which an organization is financed. It is the mix of debt and equity capital maintained by a firm. The extent literature is full of theories on capital structure since the seminal work of Modigliani and miller (1958). How an organization is financed is of paramount importance to both the managers of the firms and providers of funds. This is because if a wrong mix of finance is employed, the performance and survival of the business enterprise may be seriously affected (Chinaemerem, 2012). Thus, access to domestic funds for financially constraint firms is a vital issue and it is expected that in case of coping with serious fluctuation at cash flow the investment of financially constraint firms is faced with great fluctuation. This theory refers that existence of monotonous relationship between intensity of financially constraint and sensitivity of cash flow is not regarded as general conclusion for all of the firms. Such condition in long term damages to profit-making and competition ability of firms and lead firms toward financial crisis and bankruptcy. It is obvious that financial crisis and bankruptcy has serious negative impacts on macroeconomic indices such as: unemployment, national gross production. Having poor accounting standards lead to asymmetrical information and such relationship is clarified through offering report and poor obvious and clear information. Capital market system, creation of modern finance tools, improving governmental rules and regulations, promoting accounting and auditing standards certainly plays key role on reducing

deficiencies of capital market (Chinaemerem, 2012). Thus, it is necessary to deal with this issue that whether such theories are applicable within modern market of Iran or not

Literature Review

Almeida Campello Weisbach (2004) were among the first persons who announced that sensitivity of cash flow toward its miscellaneous applications is different based on whether firms have financial constraints for not. They stated that financially constraints firms in order to prevent from problems due to future finance have to save great portion of firm's capital. D Mello R et al (2008) studied effective factors on decision making for allocating cash while spin-off by using recommended variables through transaction theory and possible endogeneity and lever and cash ratios. They concluded that managers shall allocate higher cash ratios to smaller firms and other firms having high level of research and development cost and low net ratio of cash flow capital and also low lever. Thus, higher cash ratios are affiliated with external financing, reduced access to cash obtained from domestic resources. In addition, managers may allocate cash to the future growth opportunities instead of possible long term opportunities. Excess cash ratio analysis that are defined as difference between real and anticipated cash ratios show that firms allocate less average cash to the recommended level by transaction model and this diversion at allocated cash is described through simultaneous profit-making ability of firms (hierarchy theory justification). Gatchev et al (2010) concluded that the first reaction of firms toward cash flow is settlement of debits and increasing balance of bank accounts and they show minimum reaction toward long term investment.

Research Hypothesis

There is significant relationship between free cash flow with finance out of firm
Subsidiary Hypothesis 1: There is significant relationship between free cash flow with finance through debit in the fiscal year of firm
Subsidiary Hypothesis 1: There is significant relationship between free cash flow with finance through capital in the fiscal year of firm

Research Methodology

This research with respect to classification and based on objective is regarded as applied research. In this research it is applied from regression analysis in order to test the relationship between variables and significant model for describing dependant variable. Understanding this issue that how free cash flow is obtained from this research and desired analysis seems to be important. In order to meet this objective we attempt to introduce operational cash flow and method of obtaining it through equation No.1:

1) $\Delta CASHHOLDING+INVESTMENT-EXTERNALFINANCE=OCF$

2) $\Delta CASHHOLDING+INVESTMENT-EXTERNALFINANCE=OCF$

The left part of equation 1 consists of 3 main applications for applying cash in firm. Mainly cash is applied for investment, saving cash in bank and reducing external financing. OCF at right section of equation 1 shows operational cash flow and is regarded as cash fund (for examples refer to Bushman and et al 2011). In this research OCF is regarded as cash fund; since, one of our objectives is to find out an ordinary firm in order to allocate additional cash to its cash flow shall refer to which 3 items at left section of equation 1. In order to evaluate and estimate the relationship between cash and external finance (using debit finance and publishing stock) it is applied from model No.2 and in order to evaluate subsidiary hypothesis it is applied from models 3, 4.

3) $EXTERNALFINANCEi,t=y1,i+y2OCFi,t+y3SIZEi,t+y4LEVERAGEi,t+y5ZSCOREi,t+\varepsilon1,i,t,$

4) $EQUITYFINANCEi,t=y1,i+y2OCFi,t+y3SIZEi,t+y4LEVERAGEi,t+y5ZSCOREi,t+\varepsilon1,i,t,$

5) $DEBTFINANCEi,t=y1,i+y2OCFi,t+y3SIZEi,t+y4LEVERAGEi,t+y5ZSCOREi,t+\varepsilon1,i,t,$

OCF: It means operational cash flow that is regarded as cash fund; since, it is among our objectives to find out that an ordinary firm for allocating Rls additional cash refers to which 3 items at left section of equation 1.

External Finance: Each firm finances through 2 method i.e. it compensate it through borrowing or publishes stock; in which, in this research external finance is obtained through stock (increasing capital) and finance through debit (long term borrow)

Equity Finance: Finance through publishing stock; in which, firms finances through increasing capital and finance that is equal to increasing capital during specific t fiscal year

Debit Finance: finance through debit that firm by long term borrow increasing its capital and finances that this is equal to deducting long term debits f t year and fiscal year t-1

Agency theory contributes that leverage firms are better for shareholders as debt level can be used for monitoring the managers (Boodhoo, 2009). Thus, Higher leverage is expected to lower agency costs, reduce inefficiency and thereby lead to improvement in a firm's performance (Kochhar, 1996, Aghion, Dewatripont and Rey, 1999, Akintoye, 2008, Onaolapo and Kajola, 2010).

Financial disturbance index that firms facing with this problem are very sensitive for applying cash (Mozumdar 2004, Allayannis). By using Z-Altman grade at t time as control for finding out status of fiscal disturbance of firm

Size of Firm: It is referred to studies on factors determining cash assets from size of firm as agency for operation of firm (Opler Pinkowitz Stulz and Williams 1999, Elmida et al 2004. Size of firm introduces asymmetrical information; therefore, there is this probability that investment opportunities and insurance are influenced. We define size of firm as logarithm for book value of firm assets at the end of fiscal year.

Method of Data Collection

This research has been done in Tehran stock exchange organization from 2006 -2010. The related data to dependant variable and control variable was collected through Tadbirpardaz and Rahavard Novin database, website, library affiliated to stock exchange organization

Statistical Universe

Sum of objects and symbols having one or more properties in common that are considered together are regarded as statistical universe. In fact, statistical universe of this research is all firms listed at Tehran stock exchange

Statistical Sample

1) For homogeneity of statistical sample all firms listed at Tehran stock exchange before 2005 were considered
2) During aforesaid fiscal year the firm shall not change its activity or fiscal year
3) The firm shall not be among investment, financial dealer, holding, bank and leasing firm
Sampling method is based on targeted sampling by using elimination method.

Methods of analyzing data and hypothesis test

Upon extracting information the desired folders were designed by Excel software and finally data was processed by SPSS software. In addition by using statistical test we attempt to study the relationship between independent variables and dependant variables by using multi variable regression model. Upon calculating slope coefficients for research hypothesis and significant of this coefficient the regression model may be applied for t-student test

Results

Descriptive test and Pearson correlation coefficient Have been employed to data analysis. The findings indicated that except 2 variables as Lnsize and Z-score the remained variables are normal and in case of being true, the results obtained from analyzing these tests have minimum exactness. In order to find out whether these variables are not normal, it is applied from Kolmogorov-Smirnoff test that its results are offered in Table 2.

Table 1: Desriptive test for sample variables for the year 2006-2011

Table1: Desriptive test for sample variables for the year 2006-2011									
		OCF	Cash Holding	Long-term Investment	Debt Finance	Equity Finance	Z-Score	Size	Leverage
Mean		233609.79	137445.09	182079.79	25653.37	258270.94	.7038	13.1257	.4934
median		43565.00	21469.00	9000.00	589.00	60000.00	.6819	13.0429	.0556
Std. Deviation		9.50394E5	1.35271E6	6.03194E5	324553.576	5.75995E5	.71110	1.20395	1.91493
percentile	25	11052.00	-30975.00	1167.00	-6897.00	24150.00	.4019	12.2634	.0211
	50	43565.00	21469.00	9000.00	589.00	60000.00	.6819	13.0429	.0556
	75	123838.00	102956.00	54312.00	14254.00	188234.50	1.0157	13.9316	.1885

Table 2: One-Sample Kolmogorov-Smirnov Test

		OCF	Internal Finance	Cash Holding	Longterm Investment	External Finance	Debt Finance	Equity Finance	Z-Score	Size	leverage
Normal Parameters[a,b]	Mean	233609.7907	316014.9146	137445.0874	182079.7985	83530.954	25653.37	258270.9462	.7146	13.1257	.4934
	Std. Deviation	9.50394E5	1.22243E6	1.35271E6	6.03194E5	4.94045E5	324553.576	5.75995E5	.68738	1.203095	1.91493
Most Extreme Differences	Absolute	.382	.345	.322	.390	.339	.318	.344	.094	.044	.398
	Positive	.382	.345	.322	.390	.339	.316	.344	.089	.044	.346
	Negative	-.364	-.333	-.285	-.381	-.312	-.318	-.328	-.094	-.022	-.398
Kolmogorov-Smirnov Z		7.771	7.020	6.559	7.861	6.911	6.484	3.322	1.887	.899	8.116
Asymp. Sig.(2-tailed)		.000	.000	.000	.000	.000	.000	.000	.002	.394	.000

a. Test distribution is Normal.
b. Calculated from data.

Table 3: One-Sample Kolmogorov-Smirnov Test

		Ln Cash	Ln Cash Holding	Ln Investment	Ln External Finance	Ln Internal Finance	LnEquity Finance	Ln Leverage
Normal Parametersa,b	Mean	10.8862	11.3332	8.8949	83530.9542	11.2738	11.0998	-2.7772
	Std. Deviation	1.63794	1.73123	3.02662	4.94045E5	1.66824	1.61541	2.00583
Most Extreme Differences	Absolute	.056	.065	.054	.339	.065	.077	.062
	Positive	.056	.065	.054	.339	.065	.077	.062
	Negative	-.029	-.035	-.046	-.032	-.024	-.057	-.056
Kolmogorov-Smirnov Z		1.069	1.056	1.092	1.183	1.229	.746	1.261
Asymp. Sig.(2-tailed)		.203	.214	.184	.129	.098	.634	.083

a. Test distribution is Normal.
b. Calculated from data.

As it is obvious from the aforesaid table, the value of logarithm for all of these variables is more than sig level 0.05 i.e. logarithm distribution of variables is normal.

Table 4. Correlation

		Ln Cash	Ln Cash Holding	Ln Investment	Ln External Finance	Ln Internal Finance	Ln Equity Finance	Z-Score	Size	Ln Leverage
Ln Cash	Pearson Correlation	1	.811**	.056	.357**	.853**	.639**	.086	.024	.444**
	Sig.(2-tailed)		.000	.288	.000	.000	.000	.107	.642	.000
	N	364	254	355	364	334	81	354	364	364
Ln Cash Holding	Pearson Correlation	.811**	1	.027	.535**	.966**	.799**	.058	.057	.590**
	Sig.(2-tailed)	.000		.667	.000	.000	.000	.351	.354	.000
	N	254	266	256	266	266	70	257	266	266
Ln Investment	Pearson Correlation	.056	.027	1	-.070	-.004	-.084	-.042	-.121*	.055
	Sig.(2-tailed)	.288	.667		.162	.944	.426	.406	.015	.267
	N	355	256	405	405	345	92	394	405	405
Ln External Finance	Pearson Correlation	.357**	.535**	-.070	1	.523**	.721**	-.003	.087	.300**
	Sig.(2-tailed)	.000	.000	.162		.000	.000	.953	.077	.000
	N	364	266	405	415	355	93	403	415	415
Ln Internal Finance	Pearson Correlation	.853**	.966**	-.004	.523**	1	.840**	.041	.002	.611**
	Sig.(2-tailed)	.000	.000	.944	.000		.000	.453	.967	.000
	N	334	266	345	355	355	92	345	355	355
LnEquityFinance	Pearson Correlation	.639**	.799**	-.084	.721**	.840**	1	-.002	.191	.583**
	Sig.(2-tailed)	.000	.000	.426	.000	.000		.986	.067	.000
	N	81	70	92	93	92	93	88	93	93
Z-Score	Pearson Correlation	.086	.058	-.042	-.003	.041	-.002	1	-.008	-.124*
	Sig.(2-tailed)	.107	.351	.406	.953	.453	.986		.873	.013
	N	354	257	394	403	345	88	403	403	403
Size	Pearson Correlation	.024	.057	-.121*	.087	.002	.191	-.008	1	-.555**
	Sig.(2-tailed)	.642	.354	.015	.077	.967	.067	.873		.000
	N	364	266	405	415	355	93	403	415	415
LnLeverage	Pearson Correlation	.444**	.590**	.055	.300**	.611**	.583**	-.124*	-.555**	1
	Sig.(2-tailed)	.000	.000	.267	.000	.000	.000	.013	.000	
	N	364	266	405	415	355	93	403	415	415

**. Correlation is significant at the 0.01 level(2-tailed).
*. Correlation is significant at the 0.05 level(2-tailed).

Sig Test for Regression Equation 2:

Whereas sig level for all variables from the year 2006 until 2010 was 0.000 that is less than 0.05; therefore, research hypothesis i.e. normal data for this hypothesis is rejected i.e. distribution of variable during aforesaid years is not normal. In order to solve this problem it is applied from normal logarithm as variables of this research that for eliminating normal status the Kolmogorov-Smirnoff test is again tested for normal logarithm of variables and its results is offered in Table 3.

According to the following table, whereas at sig level of 95% (α=5%) the F statistics is larger than regression 2, the H0 hypothesis (regression equation is not significant) is rejected. It is obvious that in case of rejecting H0, the regression equation is significant

Table 5. ANOVA

ANOVA[b]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.506E13	4	3.764E12	29.033	.000a
	Residual	4.525E13	349	1.297E11		
	Total	6.031E13	353			

a. Predictors:(Constant), LnLeverage, Z-Score, Ln Cash, Size
b. Dependent Variable: Ln External Finance

Absence of Self-Correlation: Dorbin-Watson statistics is applied for estimating either existence of non-existence of self-correlation at remained sentences and is followed by test on this basis that zero hypothesis is stated as:

H0: In the remained sentence there is self-correlation

H1: In the remained sentence there is no self-correlation

If according to the research literature the value of statistics is between 1.5% to 2.5%, the H0 hypothesis is rejected and H1 hypothesis is confirmed. According to the following table, the Dorbin-Watson statistics is equal to 1.801; therefore, H0 hypothesis is rejected and H1 hypothesis concerning that there is no self-correlation between sentences is confirmed. The determining coefficient shows that 25% of changes for dependant variable of research is explained by independent variables

Table 6. Model Summary

Model Summary[b]						
Model		R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
dimension0	1	.500a	.250	.241	3.60085E5	1.801

a. Predictors:(Constant), LnLeverage, Z-Score, Ln Cash, Size
b. Dependent Variable: Ln External Finance

Table 7. ANOVA

ANOVA[b]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	127.799	4	31.950	42.030	.000a
	Residual	54.732	72	.760		
	Total	182.531	76			

a. Predictors:(Constant), LnLeverage, Z-Score, Ln Cash, Size
b. Dependent Variable: LnEquityFinance

Determining coefficient shows that 70% changes of dependant variable is explained by independent variables

Table 8. Model Summary

Model Summary[b]						
Model		R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
dimension0	1	.837a	.700	.683	.87187	1.896

a. Predictors:(Constant), LnLeverage, Z-Score, Ln Cash, Size
b. Dependent Variable: LnEquityFinance

Table 9. Significant test of regression equation 4

ANOVA[b]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	864.589	4	216.147	178.856	.000a
	Residual	224.780	186	1.208		
	Total	1089.369	190			

a. Predictors:(Constant), LnLeverage, Z-Score, Ln Cash, Size
b. Dependent Variable: LnDebtFinance

Absence of Self-Correlation

According to the following table, the level of Dorbin-Watson statistics is 1.660; therefore, H0 is rejected and H1 concerning for absence of self-correlation at remained sentences is confirmed. The determining coefficient shows that 79% of changes of dependant variable is explained by independent variables.

Table 10. Model Summary[b]

Model		R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
dimension0	1	.891a	.794	.789	1.099	1.660

a. Predictors:(Constant), LnLeverage, Z-Score, Ln Cash, Size
b. Dependent Variable: LnDebtFinance

Principal hypothesis test: Principal Hypothesis: There is significant relationship between operational free cash flow with finance out of firm

Model 2:

$$EXTERNALFINANCE_{i,t}=y1,i+y2OCF_{i,t}+y3SIZE_{i,t}+y4LEVERAGE_{i,t}+y5ZSCORE_{i,t}+\varepsilon 1,i,t,$$

Table 11. Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1667248.954	246301.083		-6.769	.000
	Ln Cash	28934.119	14524.616	.114	1.992	.047
	Z-Score	8649.571	28737.558	.014	.301	.764
	Size	130144.160	20514.140	.385	6.344	.000
	LnLeverage	101182.109	13953.808	.502	7.251	.000

a. Dependent Variable: Ln External Finance

Results show that as it was expected, the operational cash flow has positive significant relationship with external finance for the firms listed at Tehran stock exchange (with coefficient of 28934.119 and sig coefficient of 0.407). Therefore, the principal research hypothesis concerning that Operational cash flow has significant relationship with external finance is confirmed. In addition to variable of size of firm, the financial leverage has strong significant positive relationship with external financing; since, at sig level of 95% their coefficients was obtained as 101182.109 and 130144.160 is significant with 0.000. However, Z-score variable is significant since it is over accepted by 0.05 (0.746); consequently, its relationship with external finance is not statistically confirmed.

Subsidiary research hypothesis test 1: Subsidiary hypothesis 1: There is significant relationship between operational cash flow with finance through firm capital during fiscal year

Model3:EQUITYFINANCEi,t=y1,i+y2OCFi,t+y3SIZEi,t+y4LEVERAGEi,t+y5ZSCOREi,t+ε1,i,t,

Table 12.Model 3; Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.711	1.307		.544	.588
	Ln Cash	.254	.072	.288	3.546	.001
	Z-Score	-.076	.158	-.032	-.483	.630
	Size	.670	.114	.488	5.866	.000
	LnLeverage	.527	.069	.708	7.593	.000

a. Dependent Variable: LnEquityFinance

Results show that as it was expected, there is positive significant relationship between finance through stock and operational cash flow for the firms listed at Tehran stock exchange (with coefficient of 0.254) and significant coefficient of 0.001 that leads to this fact that subsidiary hypothesis 1 of research concerning Operational cash flow has significant relationship with finance through debit during fiscal year, is confirmed. In addition, the variable of size of firm has strong positive relationship with dependant variable i.e. external finance and at sig level of 95% their coefficients are 0.670 and 0.527 with sig level of 0.000; nevertheless, Z-score is over significant than 0.05 (0.630) thus, its relationship with finance through stock is not statistically confirmed.

Subsidiary research hypothesis test 2: Subsidiary research hypothesis: There is significant relationship with operational cash flow with finance through debit.

Model 4:

DEBTFINANCEi,t=y1,i+y2OCFi,t+y3SIZEi,t+y4LEVERAGEi,t+y5ZSCOREi,t+ε1,i,t,

Table 13. Coefficients[a], model 4

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-301930.093	182188.550		-1.657	.098
	Ln Cash	.054	.017	.158	3.160	.002
	Z-Score	-33771.275	23222.749	-.070	-1.454	.147
	Size	24495.550	13696.256	.090	1.788	.074
	LnLeverage	31945.536	8631.435	.189	3.701	.000

a. Dependent Variable: Ln Debt Finance

Results show that there is positive significant relationship between finance through debit and operational cash flow for the firms listed at Tehran stock exchange (with coefficient of 0.054) and sig coefficient of 0.002 and sig level of 0.05 that leads to this fact that subsidiary research hypothesis 2 concerning that Operational cash flow has significant relationship with finance through debit in fiscal year,

is confirmed. In addition, financial leverage has strong positive significant relationship with dependant variable i.e. finance through debit; since, at sig level of 95% their coefficients are 31945.536 with sig level of 0.000; nevertheless, variable as size of firm and Z-score because of being over significant than 0.05 (0.074 and 0.147); thus, its relationship with finance through debit is not statistically confirmed.

Conclusion

This paper has identified the impact of cash flow on capital structure in the context of Iranian economy or industrial sector. In order to achieve the goal this paper gathered secondary data of publicly listed companies traded in Tehran Stock Exchange (TSE) and used some statistical tools to analyze all the financial information. To see the relationship between capital structure and cash flow in Iranian, this paper considered cash flow and different ratios for capital structure decision.

Whereas one of the assumptions of regression is ordinary remained pattern, in order to estimate final pattern of research, it is applied from information related to independent variables and then to estimate the final regression. Table 1 shows that author concluded that except 2 variables of Lnsize and Z-score the remained variables are normal, the answer of this ambiguity is offered at Kolmogorov-Smirnov test that results of this table reveal that assumption of author about abnormal variables was correct and in order to solve this problem, it was applied from normal logarithm. It is to be noted that Kolmogorov-Smirnov test was again retested for normal logarithm of this variable that its results are shown in table 3; in which, all of these variables after taking normal logarithm have normal distribution and it is possible to apply them for analysis. Table 4 shows Pearson correlation coefficient for sample variables. Table for regression results obtained from model 2 shows that as it was expected, the operational cash flow has significant relationship external finance for the firms listed at Tehran stock exchange (with coefficient of 28934.119) and sig coefficient of 0.047; therefore, principal hypothesis 1 concerning that Operational cash flow has significant relationship with external financing.

Table 12 showed that as it was expected, there is positive significant relationship between finance through stock and operational cash flow for the firms listed at Tehran stock exchange (with coefficient of 0.254) and sig coefficient of 0.001 that leads to this issue that subsidiary hypothesis 1 concerning that There is positive relationship between operational cash flow with finance through during fiscal year, is confirmed. Finally the results obtained from regression table and research model No.4 shows that there is positive significant relationship between finance through debit and operational cash flow for the firms listed at Tehran stock exchange (with coefficient of 0.54) and sig coefficient of 0.002 and sig level of 0.05 that leads to this event that subsidiary research hypothesis 2 as “There is significant relationship between operational cash flow and finance through debit in fiscal year, is confirmed.

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