

RESEARCH ARTICLE

# The Effect of Defensive and Prospective Business Strategies on Cash Dividend Payments: The Moderating Role of Free Cash Flows and Financial Constraints

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ABSTRACT

Dividend policy is one of the most important financial decisions of firms, influenced by various factors such as financial conditions, growth opportunities, and strategic characteristics. Among these factors, a firm's business strategy can serve as a fundamental determinant that shapes managers' behavior in allocating cash resources and affects dividend payout decisions. This study examines the impact of defensive and prospecting business strategies on cash dividend payouts, considering the moderating roles of free cash flow and financial constraints. For this purpose, data from 145 firms listed on the Tehran Stock Exchange over the period 2013–2023 were analyzed. The hypotheses were tested using linear regression and panel data analysis while controlling for year and industry effects. The results indicate that the prospecting strategy has a negative and significant impact, whereas the defensive strategy has a positive and significant impact on the cash dividend payout ratio. Moreover, free cash flow weakens the negative relationship between prospecting strategy and cash dividend payout but has no significant moderating effect on the relationship between defensive strategy and dividend payout. Similarly, financial constraints reduce the negative effect of prospecting strategy on dividend payout but do not moderate the relationship between defensive strategy and dividend payout. Overall, the findings suggest that dividend policy is not only a function of firms' financial characteristics but also reflects their business strategy type and the normative pressures of the capital market.

## Introduction

In recent years, the role of business strategy in explaining corporate financial behavior—particularly dividend policy—has attracted considerable attention in the finance and strategic management literature. Dividend policy refers to the distribution of earnings to shareholders through cash dividends and share repurchases (Junior et al., 2024). Beyond serving as a mechanism for transferring wealth to shareholders, dividend policy is viewed, from the perspectives of agency and signaling theories, as an instrument for managing market expectations and mitigating conflicts between owners and managers (Bashirimanesh & Amiri, 2022; Sadeghi Sharif & Bahadori, 2009; DeAngelo et al., 2006; Farre-Mensa et al., 2014).

However, dividend policy decisions are not made in isolation. Rather, they are shaped by firms' strategic characteristics as well as institutional and market conditions. Although, in theory, an optimal financial policy suggests that dividends should be distributed only after financing all positive net present value investment opportunities, empirical evidence indicates that the residual dividend theory is rarely applied in practice. A range of factors—including business strategy—significantly influence managerial decisions regarding dividend payouts (Junior et al., 2024; Houqe et al., 2023).

Within this context, the Miles and Snow (1978) framework provides one of the most widely used frameworks for analyzing the relationship between business strategies and firms' financial behavior. This framework identifies four strategic types—prospecter, analyzer, defender, and reactor—that differ in their environmental orientation and resource allocation decisions. Prospector firms are characterized by continuous innovation, exploration of new markets, and a higher tolerance for risk, whereas defender firms emphasize operational efficiency, cost control, and the preservation of existing market share (Miles & Snow, 1978; Gu et al., 2025; Houqe et al., 2023).

The structural differences between these two strategic orientations entail significant financial implications. Prospector firms, due to their persistent need to invest in research and development, marketing, and adaptation to dynamic environments, tend to preserve financial flexibility and, consequently, distribute lower cash dividends. In contrast, defender firms—typically characterized by more stable cash flows and fewer growth opportunities—are more likely to adopt stable and predictable dividend policies (Safari Gerayyli & Rezaei Pitenoei, 2019; Akindayomi & Amin, 2022; Hoberg et al., 2014; Baker & Wurgler, 2004; Gu et al., 2025).

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In addition, free cash flow and financial constraints may influence both the magnitude and direction of the relationship between business strategy and dividend policy (Houque et al., 2023; Akindayomi & Amin, 2022; Junior et al., 2024). Free cash flow represents the cash remaining after covering operating expenses and necessary capital expenditures, which can either be distributed to shareholders or allocated to new investment projects (Jensen, 1986). Financial constraints, by contrast, refer to a firm's inability to undertake all profitable projects due to high external financing costs or limited access to credit markets (Whited & Wu, 2006; Hadlock & Pierce, 2010). From a moderating perspective, high levels of free cash flow may attenuate the negative effect of a prospector strategy on dividend payments and reinforce the positive effect of a defender strategy, as firms possess sufficient internal resources (Brav et al., 2005; Houque et al., 2023; Cao et al., 2022). Conversely, severe financial constraints—by increasing reliance on internal funds and raising the cost of external capital—are likely to strengthen the negative association between a prospector strategy and dividend payouts while weakening the positive association between a defender strategy and dividend payments (Akindayomi & Amin, 2022; Whited & Wu, 2006; Hadlock & Pierce, 2010; Houque et al., 2023).

Building on the Miles and Snow (1978) framework and prior empirical evidence (Akindayomi & Amin, 2022; Cao et al., 2022; Houque et al., 2023), the present study examines the impact of prospector and defender strategies on the cash dividend payout ratio, as well as the moderating roles of free cash flow and financial constraints. In terms of contribution, this study integrates two important domains—business strategy and dividend policy—thereby addressing a gap in the domestic literature. Prior domestic research has primarily focused on factors such as CEO turnover (Dana et al., 2025), managerial ability (Hejazi et al., 2017), customer concentration (Moradi et al., 2019), and intrinsic value in relation to dividend policy (Aghababaei et al., 2022), while the impact of firms' strategic differences on dividend policy has received comparatively limited attention.

This study not only fills this gap but also extends the literature by emphasizing the moderating roles of free cash flow and financial constraints, demonstrating how firms' internal financial conditions shape the strength and direction of the relationship between business strategy and dividend policy. Accordingly, the findings contribute to the academic literature and offer practical implications for managers and capital market policymakers, as they provide a basis for designing dividend policies aligned with firms' strategic orientations and financial characteristics. The remainder of the paper proceeds as follows: first, the theoretical foundations are reviewed, and hypotheses are developed; next, the research methodology is described; subsequently, the empirical findings are analyzed; and finally, conclusions and implications are presented.

### Theoretical Foundations and Literature Review

In recent years, growing attention has been devoted to the role of business strategy in explaining corporate financial behavior, particularly dividend policy. Within the strategic management literature, the Miles and Snow (1978) typology represents one of the most established frameworks for understanding the link between business strategy and firms' financial decisions. This framework distinguishes among strategic types, notably identifying prospector firms as those characterized by continuous innovation and a high tolerance for uncertainty, whereas defender firms emphasize efficiency, standardization, and the preservation of existing market share (Miles & Snow, 1978; Hambrick, 1983).

These strategic distinctions are expected to give rise to systematic differences in dividend policy. Prospector firms, given their continuous need to preserve financial flexibility and their greater exposure to costly external financing, are generally less willing to commit to stable and predictable dividend payments. In contrast, defender firms, characterized by more stable profitability and cash flow patterns, possess stronger capacity and greater incentives to maintain regular and consistent dividend payouts (Houque et al., 2023; Cao et al., 2022; Higgins et al., 2015).

From a theoretical perspective, three major theories reinforce this prediction. First, agency theory conceptualizes dividend payments as a governance mechanism designed to mitigate managerial opportunism and reduce the potential misuse of excess cash flows. Under this view, firms with limited growth opportunities and more mature operating structures are expected to exhibit a stronger propensity to distribute dividends, as payout reduces free cash flow available for discretionary spending (Jensen, 1986; Easterbrook, 1984).

Second, dividend life-cycle theory posits that a firm's capacity and inclination to pay dividends depend on its stage of maturity and its reliance on retained earnings. Mature firms—strategically more comparable to defender-type firms—are therefore expected to demonstrate more stable and sustained dividend payments, reflecting accumulated earnings and fewer investment needs (DeAngelo et al., 2006). Third, according to the pecking order theory of financing, firms facing information asymmetry and high external financing costs prefer to rely primarily on internal funds, such as retained earnings, and turn to debt or equity issuance only when internal resources are insufficient (Myers & Majluf, 1984). Consequently, cash dividend payments—which reduce internally available funds—are less attractive for firms with substantial investment opportunities, high levels of innovation, and greater environmental uncertainty, such as prospector firms. In other words, due to their innovation intensity and heightened exposure to uncertainty, prospector firms are less inclined to commit to cash dividend payouts and typically adopt more conservative dividend policies (Akindayomi & Amin, 2022; Gu et al., 2025).

Empirical evidence indicates that defender or efficiency-oriented firms, compared to innovation-driven or prospector firms, are not only more likely to pay dividends but also tend to distribute higher amounts. These findings remain robust even after controlling for various firm-specific characteristics (Cao et al., 2022; Houque et al., 2023). Conversely, when competitive pressures and market threats intensify, firms generally reduce dividend payouts and prioritize maintaining financial flexibility. Accordingly, in industries or periods characterized by lower volatility in market conditions and profitability—environments in which defender firms typically perform better—dividend payments tend to be more stable (Hoberg et al., 2014). Furthermore, traditional perspectives on dividend policy emphasize dividend smoothing and managerial target payout ratios, which align closely with the stability-oriented characteristics of defender firms (Gu et al., 2025; Brav et al., 2005).

Domestic studies also demonstrate that business strategies significantly influence financial and managerial decisions. For instance, Tanani and Mohebkah (2014) found that a firm's strategic orientation affects both earnings quality and stock returns. Their results indicated that defender firms exhibit higher levels of earnings management compared to prospector firms, while the economic environment plays a significant moderating role in the relationship between strategy and earnings quality. However, no significant moderating effect of the economic environment was observed in the relationship between strategy and stock returns. Furthermore, accounting conservatism, in conjunction with strategic type, did not show a significant association with stock returns. These findings suggest that strategic differences among firms can shape earnings quality and financial reporting patterns, although their impact on stock returns may be less pronounced under varying environmental conditions.

Similarly, Vaghfi and Nilofari (2021) demonstrated that business strategy has a significant effect on firm performance, and managerial ability acts as a moderating factor that can either strengthen or weaken this relationship. This indicates that the financial consequences of strategic orientation depend not only on the nature of the strategy (prospector or defender) but also on managers' competence and capability to implement it effectively.

Furthermore, Bashirimanesh and Amiri (2022) show that adopting a prospector strategy during the COVID-19 period directly influenced the relationship between corporate social responsibility disclosure and investor reactions in the capital market, as well as long-term abnormal returns.

Building on these theoretical and empirical foundations, it is expected that a prospector orientation is associated with a lower cash dividend payout ratio, whereas a defender orientation is associated with a higher payout ratio. Accordingly, the first hypothesis of this study is formulated as follows:

**Hypothesis 1:** A prospector strategy has a negative effect on firms' cash dividend payout ratio.

According to the theoretical framework proposed by Miles and Snow (1978), defender firms focus on operational efficiency, process standardization, and the preservation of market share, typically operating in relatively stable environments (Miles & Snow, 1978; Gu et al., 2025). From the perspective of agency theory, dividend payments serve as a mechanism to reduce excess cash holdings and curb managerial opportunism; accordingly, mature firms with limited growth opportunities—strategically closer to defender firms—tend to exhibit higher dividend payout ratios (Jensen, 1986; Easterbrook, 1984).

Moreover, dividend life-cycle theory suggests that a firm's capacity and willingness to pay sustainable dividends increase with its reliance on retained earnings and its stage of maturity (DeAngelo et al., 2006). In addition, traditional views on dividend policy indicate that managers prefer not to reduce cash dividends and typically set payout ratios according to a firm's "sustainable payout capacity" (Brav et al., 2005). Sustainable payout capacity refers to a level of cash dividend that a firm can maintain consistently over time without imposing financial strain in future periods—a pattern that aligns closely with the stability-oriented and predictable characteristics of defender firms.

International evidence indicates that firms adopting a defender strategy exhibit a stronger propensity to pay dividends. Gu et al. (2025) show that prospector firms tend to pursue long-term managerial policies, whereas defender firms prioritize stability and short-term performance. This strategic distinction can extend to dividend policy as well: defender firms, characterized by more stable cash flows and lower risk, are more inclined to maintain higher cash dividend payouts. In contrast, innovative firms, which require internal financing for research and development projects, typically adopt more conservative dividend policies (Gu et al., 2025). Houqe et al. (2023) further demonstrate that efficiency-oriented or defender firms not only have a higher likelihood of paying dividends but also distribute larger amounts compared to innovation-driven or prospector firms, even after controlling for firm size, profitability, leverage, and lifecycle stage. Moreover, evidence from product market competition suggests that in relatively stable environments with lower competitive pressure, dividend payments tend to be more consistent and predictable (Hoberg et al., 2014). Theoretical perspectives such as the preference for payout and the investor sentiment view also support structural differences in dividend policies across firms, indicating that stability-oriented firms, like defenders, are more aligned with regular and predictable dividend payment patterns (Baker & Wurgler, 2004; Brav et al., 2005). More recent studies that directly examine the link between business strategy and dividend policy confirm significant differences between defender and prospector firms (Cao et al., 2022).

Domestic research corroborates these findings. For instance, Ameri and Kamyabi (2025) show that defender firms, due to more efficient resource management and higher financial transparency, exhibit higher accounting information quality and lower cost of capital. Conversely, prospector firms face higher capital costs due to greater risk and uncertainty. Lower capital costs and improved information quality in defender firms facilitate higher and more stable dividend payouts, whereas prospector firms typically adopt more cautious dividend policies.

Based on these theoretical and empirical foundations, it is expected that firms with a defender strategy, due to their relative maturity, operational stability, and closer alignment with normative market expectations, exhibit higher cash dividend payout ratios. Accordingly, the second hypothesis of this study is formulated as follows:

**Hypothesis 2:** A defender strategy has a positive effect on firms' cash dividend payout ratio.

Within the Miles and Snow (1978) theoretical framework, prospector firms—characterized by continuous innovation, entry into new markets, and higher exposure to uncertainty—generally target lower dividend payout ratios. This is because they seek to preserve financial flexibility and mitigate the risks associated with growth projects, thereby limiting their commitment to stable dividend payments (Miles & Snow, 1978; Hambrick, 1983; Houqe et al., 2023). However, free cash flows can mitigate this baseline effect and enable prospector firms to distribute a portion of dividends. From an agency theory perspective, when cash is available beyond what is needed for positive net present value investment opportunities, dividend payments serve as an effective mechanism to constrain managerial opportunism (Jensen, 1986; Easterbrook, 1984). Likewise, according to dividend life-cycle theory, a firm's capacity to sustain dividend payments increases with its reliance on retained earnings and internal financing capabilities (DeAngelo et al., 2006). For prospector firms, this implies that as free cash flows increase, part of the need for financial flexibility can be satisfied from internal resources, allowing management to distribute a level of dividends that mitigates agency concerns and signals firm quality, without compromising growth investments (Brav et al., 2005; Farre-Mensa et al., 2014).

International empirical evidence indicates that agency motivations play a crucial role in shaping dividend policy, with firms balancing investment needs and shareholder commitments by adjusting target payout ratios. High free cash flows provide sufficient resources for investment while simultaneously enabling higher cash dividend payments by reducing conflicts of interest between managers and shareholders and lowering agency costs (Brav et al., 2005; Farre-Mensa et al., 2014). Recent studies show that although prospector firms typically pay lower dividends, their internal financing capacity—particularly free cash flows—can offset part of this reduction (Cao et al., 2022; Houqe et al., 2023; Akindayomi & Amin, 2022). Domestic research further supports this view. For example, Hasani et al. (2024) found that corporate governance mechanisms and agency costs did not significantly affect dividend policy; however, factors such as free cash flows, profitability

ratios, financial reporting quality, effective tax rates, capital structure, institutional ownership, information asymmetry, managerial ability, and ownership concentration all significantly influence dividend decisions.

Based on these arguments, the third hypothesis of the study is formulated as follows:

**Hypothesis 3:** Free cash flows attenuate the effect of a prospector strategy on firms' cash dividend payout ratio.

According to the Miles and Snow (1978) framework, defender firms—by emphasizing operational efficiency, process standardization, and market share preservation—generally operate with stable cash flows and lower operational risk. Under such conditions, cash dividend payments involve lower opportunity costs and serve both as a signal of firm quality and as a mechanism to align the interests of shareholders and managers (Miles & Snow, 1978; Gu et al., 2025). From an agency theory perspective, free cash flows can create opportunities for managerial opportunism. Therefore, dividend payments or share repurchases act as disciplinary tools, helping to control excess liquidity and mitigate agency problems (Jensen, 1986; Easterbrook, 1984). Moreover, according to dividend life-cycle theory, mature firms with substantial retained earnings possess both the capacity and willingness to distribute dividends. In this context, higher levels of free cash flow reinforce the firm's sustainable payout capacity and reduce the risk of being unable to maintain dividend payments over time (DeAngelo et al., 2006; Akindayomi & Amin, 2022; Brav et al., 2005; Farre-Mensa et al., 2014).

In defender firms, due to limited high-risk growth opportunities and the predictability of cash flows, free cash flows operate through two complementary channels. First, from an agency theory perspective, market pressure and corporate governance mechanisms direct excess cash toward dividend payments or share repurchases. Second, according to dividend life-cycle theory, greater reliance on retained earnings and internal resources enhances the firm's sustainable dividend-paying capacity. In contrast, in prospector firms, free cash flows are often allocated to support financial flexibility for high-risk projects, leaving a smaller portion available for dividend distribution (Jensen, 1986; Junior et al., 2024; DeAngelo et al., 2006). Empirical evidence further shows that efficiency-oriented or defender firms, even after controlling for factors such as firm size, profitability, leverage, lifecycle stage, and financial constraints, exhibit both a higher likelihood and greater magnitude of dividend payments compared to innovative or prospector firms (Cao et al., 2022; Houqe et al., 2023; Akindayomi & Amin, 2022). Overall, in defender firms, higher levels of free cash flow strengthen the positive effect of a defender strategy on the cash dividend payout ratio. Based on these arguments, the fourth hypothesis of this study is formulated as follows:

**Hypothesis 4:** Free cash flows strengthen the effect of a defender strategy on firms' cash dividend payout ratio.

Prospector firms focus on innovation, high-risk investments, and entry into new markets. Consequently, their cash flows tend to be less stable, they hold fewer tangible assets, and they face higher information asymmetry (Miles & Snow, 1978; Hambrick, 1983). These conditions increase the cost of external financing and push firms to rely more heavily on internal resources and cash retention (Myers & Majluf, 1984; Bates et al., 2009). When these firms encounter financial constraints—meaning that access to external funds is costly or difficult—the pressure to conserve liquidity intensifies. Innovative firms, which undertake high-risk projects and possess substantial intangible assets, are more dependent on internal financing due to the challenges of project valuation and consequently exhibit a lower propensity to distribute dividends (Almeida et al., 2004; Hall & Lerner, 2010; Akindayomi & Amin, 2022).

This reasoning is grounded in several theoretical perspectives. First, according to the pecking order theory, managers' reliance on internal resources increases, and dividend payments are relegated to a lower priority; this mechanism is particularly strong in firms that require higher financial flexibility from the outset—namely, prospector firms (Myers & Majluf, 1984). Second, under the precautionary motive for cash holdings, the more volatile a firm's cash flows and the more difficult access to external financing becomes, the more cash firms retain and the less they distribute as dividends. Consequently, firms facing financial constraints tend to pay lower dividends (Bates et al., 2009; Akindayomi & Amin, 2022). Third, according to real options theory, internal cash holds high option value in prospector firms because it allows them to wait and flexibly invest in uncertain projects. Financial constraints further amplify this option value, making dividend distribution under such conditions economically suboptimal (Almeida et al., 2004; Houqe et al., 2023). Accordingly, the more severe the financial constraints, the stronger the reduction in dividend payments among prospector firms. Based on this reasoning, the fifth hypothesis of this study is formulated as follows:

**Hypothesis 5:** Financial constraints strengthen the effect of a prospector strategy on firms' cash dividend payout ratio.

Within the Miles and Snow (1978) theoretical framework, defender firms—by emphasizing operational efficiency, process standardization, and market stability—typically exhibit more stable cash flows and lower operational risk. These characteristics reduce the opportunity cost of paying dividends from cash, resulting in a stronger propensity to distribute cash dividends. However, the presence of financial constraints can influence this relationship.

According to the pecking order theory, when external financing is more costly, managers prefer to rely on internal resources, and dividend payments are assigned a lower priority. In other words, financial constraints reduce a firm's capacity to pay dividends, leading even defender firms to delay or lower dividend distributions in order to preserve financial flexibility (Houqe et al., 2023; Gu et al., 2025). From an agency theory perspective, contractual covenants associated with debt financing can further restrict a firm's dividend policy. Stronger creditor rights and stricter contractual terms limit managerial discretion in distributing dividends, thereby indirectly weakening the positive effect of a defender strategy on dividend payments (Brockman & Unlu, 2009; Akindayomi & Amin, 2022).

Additionally, according to dividend life-cycle theory, mature and stable firms, such as defenders, generally have a stronger inclination to pay dividends under normal conditions. However, when facing financial constraints, both the capacity and willingness to distribute dividends decline, as external financing is costly and internal resources must be conserved to support ongoing operations and working capital requirements (DeAngelo et al., 2006; Denis & Osobov, 2008).

Existing empirical evidence supports this theoretical logic. Research findings indicate that efficiency-oriented or defender firms generally exhibit higher levels of cash dividend payments under normal conditions; however, in the presence of financial constraints, cash dividend distributions decline. This is because liquidity pressures and credit limitations impede the firm's ability to maintain stable dividend practices (Houqe et al., 2023; Cao et al., 2022; Akindayomi & Amin, 2022). Overall, financial constraints play a negative moderating role in the

relationship between a defender strategy and dividend policy: the more severe the financial constraints, the weaker the positive effect of a defender strategy on the cash dividend payout ratio. Based on this reasoning, the sixth hypothesis of the study is formulated as follows:

**Hypothesis 6:** Financial constraints weaken the effect of a defender strategy on firms' cash dividend payout ratio.

### Research Method

This study is applied in terms of its objective and employs a descriptive–correlational design with an ex post facto approach. The statistical population consists of all firms listed on the Tehran Stock Exchange (TSE) during the period 2013–2023 that meet the following criteria: First, the firm must have been listed on the TSE prior to 2013 and remained active through the end of 2023. Second, to enhance comparability, the firm's fiscal year must end in March (i.e., the end of the Iranian calendar year). Third, the firm must not have changed its fiscal year during the study period. Fourth, due to their distinct nature and financial structure, financial intermediaries and investment companies are excluded from the sample. Fifth, the firm must not have experienced a trading suspension exceeding six months. Finally, the required financial and accounting information must be available.

Based on these criteria, as illustrated in Table 1, a total of 145 firms were selected as the final sample.

**Table 1. Sample selection process**

| Description                                                                                                            | Number of Firms |
|------------------------------------------------------------------------------------------------------------------------|-----------------|
| Total number of firms listed on the Tehran Stock Exchange as of the end of 2023                                        | 393             |
| Number of firms that changed their fiscal year during the period 2013–2023 or whose fiscal year does not end in March. | 87              |
| Number of firms operating in the financial intermediation, banking, and insurance industries.                          | 95              |
| Firms excluded due to trading suspension exceeding six months                                                          | 28              |
| Firms excluded due to unavailability of financial information, delisting, or cessation of operations                   | 38              |
| <b>Final number of firms selected for the sample</b>                                                                   | <b>145</b>      |

### Research Models

To test the first and second hypotheses, following Houque et al. (2023), the following regression model is estimated:

$$DIVD_{it} = \beta_0 + \beta_1 PROSPECTOR_{it} + \beta_2 DEFENDER_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MB_{it} + \beta_6 WCAP_{it} + \beta_7 CFOVOL_{it} + \varepsilon_{it} \quad (1)$$

In model (1), DIVD represents the cash dividend payout ratio; PROSPECTOR denotes the prospector strategy; DEFENDER denotes the defender strategy; SIZE is firm size; LEV represents financial leverage; MB is the market-to-book ratio; WCAP denotes working capital; and CFOVOL is the standard deviation of operating cash flows.

A negative and statistically significant coefficient on PROSPECTOR ( $\beta_1$ ) and a positive and statistically significant coefficient on DEFENDER ( $\beta_2$ ) at the 95% confidence level provide support for the first and second hypotheses, respectively. To test the third and fourth hypotheses, the following model is estimated:

$$DIVD_{it} = \beta_0 + \beta_1 PROSPECTOR_{it} + \beta_2 DEFENDER_{it} + \beta_3 FCF_{it} + \beta_4 PROSPECTOR_{it} \times FCF_{it} + \beta_5 DEFENDER_{it} \times FCF_{it} + \beta_6 SIZE_{it} + \beta_7 LEV_{it} + \beta_8 MB_{it} + \beta_9 WCAP_{it} + \beta_{10} CFOVOL_{it} + \varepsilon_{it} \quad (2)$$

FCF represents free cash flow. A positive and statistically significant coefficient on the interaction terms ( $\beta_4$ ) and ( $\beta_5$ ) at the 95% confidence level provides support for the third and fourth hypotheses.

$$DIVD_{it} = \beta_0 + \beta_1 PROSPECTOR_{it} + \beta_2 DEFENDER_{it} + \beta_3 Fin-Cons_{it} + \beta_4 PROSPECTOR_{it} \times Fin-Cons_{it} + \beta_5 DEFENDER_{it} \times Fin-Cons_{it} + \beta_6 SIZE_{it} + \beta_7 LEV_{it} + \beta_8 MB_{it} + \beta_9 WCAP_{it} + \beta_{10} CFOVOL_{it} + \varepsilon_{it} \quad (3)$$

FINCONS represents financial constraints. Negative and statistically significant coefficients on the interaction terms ( $\beta_4$ ) and ( $\beta_5$ ) at the 95% confidence level provide support for the fifth and sixth hypotheses.

### Variables

The variables used in this study consist of dependent, independent, moderating, and control variables, which are selected following Houque et al. (2023). The dependent variable is the cash dividend payout ratio (DIVD), measured as cash dividends paid divided by beginning total assets. Consistent with Houque et al. (2023), firms' strategic orientation—specifically *Defender* and *Prospector* strategies—is used as the main independent variable.

To classify firms' strategic type, following Houque et al. (2023) and Safari Gerayyli and Rezaei Pitenoei (2019), five criteria are employed: Sales growth ratio, Employees-to-sales ratio, SG&A expenses-to-sales ratio, Standard deviation of the employees-to-sales ratio over a three-year period, and Fixed assets-to-total assets ratio.

After computing these ratios, firms are independently ranked into quintiles for each of the first four measures, from highest to lowest. Firms in the highest quintile receive a score of 5, whereas firms in the lowest quintile receive a score of 1. For the fifth measure (fixed assets to total assets), the scoring procedure is reversed to reflect the conceptual distinction between defender and prospector strategies. Firms in the highest quintile receive a score of 1, and those in the lowest quintile receive a score of 5. The total strategic score for each firm is obtained by



summing the five component scores, resulting in a composite score ranging from 5 to 25. Firms with total scores between 5 and 10 are classified as Defender firms, whereas firms with scores between 20 and 25 are classified as Prospector firms. After determining strategic orientation, dummy variables are constructed as follows: *Defender* equals 1 if the firm is classified as a defender firm, and 0 otherwise. *Prospector* equals 1 if the firm is classified as a prospector firm, and 0 otherwise.

The moderating variables in this study include free cash flow (*FCF*) and financial constraints (*FINCONS*).

To measure free cash flow (*FCF*), following Hosseini et al. (2021), the model proposed by Lehn and Poulsen (1989) is employed, as specified in Equation (4):

$$FCF_{it} = INC_{it} - TAX_{it} - INTEP_{it} - CSDIV_{it} \quad (4)$$

*FCF* denotes free cash flow; *INC* represents operating income; *TAX* is income tax paid; *INTEP* refers to interest expenses paid; and *CSDIV* denotes cash dividends paid to common shareholders. To measure financial constraints (*FINCONS*), this study employs the Kaplan and Zingales (1997) index, as operationalized by Tehrani and Hesarszadeh (2009), as specified in Equation (5):

$$KZ = 17.33 - 37.486 C - 15.216 DIV + 3.39 LEV - 1.402 MTB \quad (5)$$

In Equation (5), *C* represents the ratio of cash holdings to total assets; *DIV* denotes the dividend payout ratio scaled by total assets; *LEV* is the ratio of total debt to total assets; and *MTB* represents the market-to-book ratio of shareholders' equity.

The control variables used in this study include firm size (*Size*), measured as the natural logarithm of total assets; financial leverage (*LEV*), calculated as total debt divided by total assets; the market-to-book ratio (*M/B*), measured as the market value of equity divided by the book value of shareholders' equity; working capital (*WCAP*), defined as current assets minus current liabilities scaled by lagged total assets; and operating cash flow volatility (*CFOVOL*), measured as the standard deviation of operating cash flows scaled by mean total assets over the preceding three years.

## Results

This section first presents the descriptive statistics of the study variables in Table 2, followed by the results of the hypothesis tests.

**Table 2. Descriptive statistics of variables**

| Variable                                       | Mean          | Median | Std. Dev.                        | Skewness | Kurtosis | Min     | Max   |
|------------------------------------------------|---------------|--------|----------------------------------|----------|----------|---------|-------|
| DIV                                            | 0.043         | 0.016  | 0.059                            | 1.874    | 6.084    | 0.00002 | 0.283 |
| FCF                                            | 0.091         | 0.072  | 0.181                            | -0.694   | 9.003    | -1.399  | 0.813 |
| FIN_CONS                                       | 10.19         | 12.35  | 7.29                             | -2.679   | 8.076    | -35.95  | 22.75 |
| SIZE                                           | 15.23         | 14.98  | 1.657                            | 0.759    | 3.911    | 11.15   | 21.89 |
| LEV                                            | 0.520         | 0.522  | 0.212                            | 0.222    | 3.788    | 0.012   | 0.953 |
| MB                                             | 4.368         | 3.145  | 3.519                            | 1.601    | 4.902    | 1.004   | 14.74 |
| WCAP                                           | 0.301         | 0.274  | 0.320                            | 0.401    | 3.613    | -0.558  | 1.252 |
| CFOVOL                                         | 0.067         | 0.056  | 0.049                            | 1.669    | 8.968    | 0.0005  | 0.333 |
| Distribution of Firms by Strategic Orientation |               |        |                                  |          |          |         |       |
| Strategic Score                                | Strategy Type |        | Number of Firm-Year Observations |          |          |         |       |
| 5–10                                           | Defender      |        | 174                              |          |          |         |       |
| 20–25                                          | Prospector    |        | 195                              |          |          |         |       |

The dependent variable, cash dividend payout ratio (*DIV*), has a mean of 0.043, as reported in Table 2, indicating a relatively low level of dividend payments among the sample firms. The standard deviation of this variable (0.059) suggests a relatively limited dispersion around the mean. *DIV* exhibits a high positive skewness (1.874) and extreme kurtosis (6.084), indicating that most firms have low to moderate dividend payouts, while a few firms with very high dividend payments create a long right tail in the distribution. Free cash flow (*FCF*) has a mean of 0.091 and a standard deviation of 0.181, reflecting substantial variability in free cash flow across firms. In contrast, the financial constraints index (*FINCONS*) shows a mean of 10.19 and a standard deviation of 7.29, highlighting considerable differences in the level of financial constraints among firms. To mitigate the potential influence of extreme outliers, observations below the 1<sup>st</sup> percentile and above the 99<sup>th</sup> percentile were excluded from the analysis. As shown in Table 2, out of all firm-year observations, 195 observations have a strategic score between 20 and 25 and are classified as Prospector firms, while 174 observations have a score between 5 and 10 and are classified as Defender firms.

The regression models in this study were estimated using panel data with year and industry fixed effects. To examine heteroskedasticity and autocorrelation, the Likelihood Ratio (LR) test and the Breusch-Godfrey test were conducted, respectively. The p-values of both tests were below 0.05, indicating the presence of heteroskedasticity and autocorrelation. To address these issues, the regression models were estimated using the Generalized Least Squares (GLS) method with robust standard errors clustered at the firm level. Multicollinearity among explanatory variables was assessed using the Variance Inflation Factor (VIF) test, and the results showed that VIF values for all variables were below 10, indicating that multicollinearity is not a concern in the regression models.

## Results of Hypotheses 1 and 2

According to the first hypothesis, a prospector strategy negatively affects the cash dividend payout ratio, while the second hypothesis posits that a defender strategy has a positive impact on the cash dividend payout ratio. To test these hypotheses, regression model (1) was employed. The estimation results of this model are presented in Table 3.

**Table 3. Regression results for hypotheses 1 and 2**

| $DIVD_{it} = \beta_0 + \beta_1 PROSPECTOR_{it} + \beta_2 DEFENDER_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \beta_5 MB_{it} + \beta_6 WCAP_{it} + \beta_7 CFOVOL_{it} + \varepsilon_{it}$ |                        |            |             |         |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|------------|-------------|---------|
| Variable                                                                                                                                                                                      | Coefficient            | Std. Error | t-Statistic | p-Value |
| $\beta_0$                                                                                                                                                                                     | 0.023                  | 0.012      | 1.863       | 0.091   |
| PROSPECTOR                                                                                                                                                                                    | -0.007                 | 0.003      | -2.471      | 0.033   |
| DEFENDER                                                                                                                                                                                      | 0.012                  | 0.004      | 2.819       | 0.018   |
| SIZE                                                                                                                                                                                          | 0.000                  | 0.0008     | 0.344       | 0.737   |
| LEV                                                                                                                                                                                           | 0.037                  | 0.004      | 7.637       | 0.000   |
| MB                                                                                                                                                                                            | 0.0008                 | 0.0003     | 2.045       | 0.068   |
| WCAP                                                                                                                                                                                          | 0.005                  | 0.002      | 2.055       | 0.066   |
| CFOVOL                                                                                                                                                                                        | 0.009                  | 0.031      | 0.284       | 0.782   |
| Year and industry effects                                                                                                                                                                     | are controlled         |            |             |         |
| F-statistic                                                                                                                                                                                   | 16.730 ( $p < 0.001$ ) |            |             |         |
| Adjusted R <sup>2</sup>                                                                                                                                                                       | 0.24                   |            |             |         |

According to Table 3, the F-statistic is significant at the 5% level, indicating that the regression model is statistically significant at the 95% confidence level. The adjusted R<sup>2</sup> is 0.241, suggesting that approximately 24% of the variation in the cash dividend payout ratio is explained by the explanatory variables included in the model. The coefficient for the prospector strategy (PROSPECTOR) is -0.007 with a p-value of 0.033, which is below the 5% significance level. This provides support for Hypothesis 1, indicating that firms adopting a prospector strategy tend to have a lower propensity to pay cash dividends. Similarly, the coefficient for the defender strategy (DEFENDER) is 0.012 with a p-value of 0.018, also below the 5% significance threshold. This supports Hypothesis 2, suggesting that firms with a defender strategy are more likely to pay higher cash dividends.

#### Results of Hypotheses 3 and 4

According to the third hypothesis, free cash flow (FCF) weakens the effect of a prospector strategy on the cash dividend payout ratio, while the fourth hypothesis posits that FCF strengthens the effect of a defender strategy on the cash dividend payout ratio. To test these hypotheses, regression model (2) was employed. The estimation results of this model are presented in Table 4.

**Table 4. Regression results for hypotheses 3 and 4**

| $DIVD_{it} = \beta_0 + \beta_1 PROSPECTOR_{it} + \beta_2 DEFENDER_{it} + \beta_3 FCF_{it} + \beta_4 PROSPECTOR_{it} \times FCF_{it} + \beta_5 DEFENDER_{it} \times FCF_{it} + \beta_6 SIZE_{it} + \beta_7 LEV_{it} + \beta_8 MB_{it} + \beta_9 WCAP_{it} + \beta_{10} CFOVOL_{it} + \varepsilon_{it}$ |                        |            |             |         |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|------------|-------------|---------|
| Variable                                                                                                                                                                                                                                                                                              | Coefficient            | Std. Error | t-Statistic | p-Value |
| $\beta_0$                                                                                                                                                                                                                                                                                             | 0.012                  | 0.011      | 1.045       | 0.320   |
| PROSPECTOR                                                                                                                                                                                                                                                                                            | -0.004                 | 0.001      | -3.650      | 0.004   |
| DEFENDER                                                                                                                                                                                                                                                                                              | 0.011                  | 0.004      | 2.943       | 0.014   |
| FCF                                                                                                                                                                                                                                                                                                   | -0.119                 | 0.017      | -6.804      | 0.000   |
| PROSPECTOR × FCF                                                                                                                                                                                                                                                                                      | 0.075                  | 0.013      | 5.571       | 0.000   |
| DEFENDER × FCF                                                                                                                                                                                                                                                                                        | -0.023                 | 0.021      | -1.107      | 0.293   |
| SIZE                                                                                                                                                                                                                                                                                                  | 0.002                  | 0.001      | 2.825       | 0.018   |
| LEV                                                                                                                                                                                                                                                                                                   | 0.005                  | 0.004      | 1.371       | 0.200   |
| MB                                                                                                                                                                                                                                                                                                    | 0.001                  | 0.000      | 4.290       | 0.001   |
| WCAP                                                                                                                                                                                                                                                                                                  | 0.027                  | 0.002      | 9.704       | 0.000   |
| CFOVOL                                                                                                                                                                                                                                                                                                | 0.009                  | 0.013      | 0.701       | 0.499   |
| Year and industry effects                                                                                                                                                                                                                                                                             | are controlled         |            |             |         |
| F-statistic                                                                                                                                                                                                                                                                                           | 32.238 ( $p < 0.001$ ) |            |             |         |
| Adjusted R <sup>2</sup>                                                                                                                                                                                                                                                                               | 0.408                  |            |             |         |

According to Table 4, the F-statistic is significant at the 5% level, indicating that the regression model is statistically significant at the 95% confidence level. The adjusted R<sup>2</sup> is 0.408, suggesting that approximately 41% of the variation in the cash dividend payout ratio is explained by the explanatory variables included in the model.

The coefficient of the interaction term between free cash flow and prospector strategy (PROSPECTOR × FCF) is positive (0.075) and significant with a p-value of 0.002, which is below the 5% significance threshold. The positive sign of this interaction term indicates that free cash flow weakens the negative effect of a prospector strategy on the cash dividend payout ratio, providing support for Hypothesis 3. In contrast, the coefficient of the interaction term between free cash flow and defender strategy (DEFENDER × FCF) is negative (-0.023) but not statistically significant ( $p = 0.293$ ). Therefore, Hypothesis 4 is not supported, suggesting that free cash flow does not significantly strengthen the positive effect of a defender strategy on the cash dividend payout ratio.

#### Results of Hypotheses 5 and 6

According to the fifth hypothesis, financial constraints (FINCONS) strengthen the effect of a prospector strategy on the cash dividend payout ratio, while the sixth hypothesis posits that FINCONS weakens the effect of a defender strategy on the cash dividend payout ratio. To test these hypotheses, the regression model (3) was employed. The estimation results of this model are presented in Table 5.

Table 5. Regression results for hypotheses 5 and 6

| $DIVD_{it} = \beta_0 + \beta_1 PROSPECTOR_{it} + \beta_2 DEFENDER_{it} + \beta_3 Fin-Cons + \beta_4 PROSPECTOR_{it} \times Fin-Cons + \beta_5 DEFENDER_{it} \times Fin-Cons + \beta_6 SIZE_{it} + \beta_7 LEV_{it} + \beta_8 MB_{it} + \beta_9 WCAP_{it} + \beta_{10} CFOVOL_{it} + \epsilon_{it}$ |                    |            |             |         |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|------------|-------------|---------|
| Variable                                                                                                                                                                                                                                                                                           | Coefficient        | Std. Error | t-Statistic | p-Value |
| $\beta_0$                                                                                                                                                                                                                                                                                          | 0.156              | 0.013      | 11.891      | 0.000   |
| PROSPECTOR                                                                                                                                                                                                                                                                                         | -0.006             | 0.002      | -2.324      | 0.020   |
| DEFENDER                                                                                                                                                                                                                                                                                           | 0.002              | 0.003      | 0.606       | 0.544   |
| FINCONS                                                                                                                                                                                                                                                                                            | -0.008             | 0.0006     | -13.530     | 0.000   |
| PROSPECTOR $\times$ FINCONS                                                                                                                                                                                                                                                                        | 0.0006             | 0.0001     | 3.712       | 0.000   |
| DEFENDER $\times$ FINCONS                                                                                                                                                                                                                                                                          | 0.002              | 0.002      | 0.927       | 0.353   |
| SIZE                                                                                                                                                                                                                                                                                               | 0.001              | 0.0005     | 3.192       | 0.001   |
| LEV                                                                                                                                                                                                                                                                                                | 0.045              | 0.004      | 9.859       | 0.000   |
| MB                                                                                                                                                                                                                                                                                                 | -0.011             | 0.0008     | -13.323     | 0.000   |
| WCAP                                                                                                                                                                                                                                                                                               | -0.004             | 0.002      | -1.528      | 0.126   |
| CFOVOL                                                                                                                                                                                                                                                                                             | -0.048             | 0.014      | -3.479      | 0.000   |
| Year and industry effects                                                                                                                                                                                                                                                                          | are controlled     |            |             |         |
| F-statistic                                                                                                                                                                                                                                                                                        | 33.437 (p < 0.001) |            |             |         |
| Adjusted R <sup>2</sup>                                                                                                                                                                                                                                                                            | 0.422              |            |             |         |

According to Table 5, the F-statistic is significant at the 5% level, indicating that the regression model is statistically significant at the 95% confidence level. The adjusted R<sup>2</sup> is 0.422, suggesting that approximately 42% of the variation in the cash dividend payout ratio is explained by the explanatory variables included in the model. The coefficient of the interaction term between prospector strategy and financial constraints (PROSPECTOR  $\times$  FINCONS) is positive (0.0006) and statistically significant (p = 0.000), which is below the 5% significance threshold. Contrary to expectations, the positive sign of this interaction term indicates that financial constraints weaken the negative effect of a prospector strategy on the cash dividend payout ratio. Therefore, Hypothesis 5 is not supported. In contrast, the coefficient of the interaction term between defender strategy and financial constraints (DEFENDER  $\times$  FINCONS) is positive but not statistically significant (p = 0.353). This suggests that financial constraints do not significantly moderate the effect of a defender strategy on the cash dividend payout ratio, and Hypothesis 6 is also not supported.

## Discussion and Conclusion

In recent years, the role of business strategy in shaping corporate financial behavior, particularly cash dividend policy, has received increasing attention. Firms with different strategic characteristics distribute profits differently. For instance, prospector firms, due to their focus on innovation and exposure to uncertainty, generally pay lower dividends, whereas defender firms, with stable operations and consistent cash flows, exhibit a higher tendency to distribute dividends. This study examined the relationship between business strategy type, free cash flow, financial constraints, and the cash dividend payout ratio.

The results of Hypotheses 1 and 2, consistent with theoretical expectations, showed that a prospector strategy has a significant negative effect on the cash dividend payout ratio, while a defender strategy has a significant positive effect. These findings align with the studies of Houque et al. (2023) and Cao et al. (2022), indicating that prospector firms—focused on innovation, market development, and dealing with high uncertainty—tend to retain liquidity to maintain financial flexibility, leading to lower dividend payments. In contrast, defender firms—emphasizing operational stability, efficiency, and market share maintenance—have more stable cash flows, making dividend payments less costly and resulting in a positive and significant impact on the dividend payout ratio. These findings are also consistent with agency theory, which views dividend payments as a mechanism to mitigate excess free cash flow and control managerial opportunism (Jensen, 1986; Easterbrook, 1984), and with the life-cycle theory of dividends (DeAngelo et al., 2006).

The results of Hypothesis 3 indicated that free cash flow weakens the negative effect of a prospector strategy on the cash dividend payout ratio, consistent with the findings of Houque et al. (2023). This suggests that while prospector firms generally retain earnings to fund high-risk investments and growth projects due to their focus on innovation and risk-taking, the availability of free cash flow provides sufficient internal resources to pay a portion of dividends without compromising financial flexibility or investment capacity. In this sense, free cash flow acts as an “internal financial support”, aligning with agency theory and the dividend life-cycle logic, as dividend payments can be made while preserving investment resources, also signaling financial discipline and quality (Jensen, 1986; DeAngelo et al., 2006; Brav et al., 2005; Farre-Mensa et al., 2014).

On the other hand, the results of Hypothesis 4 showed that free cash flow does not significantly moderate the effect of a defender strategy on dividend payout, which is inconsistent with the findings of Houque et al. (2023). This may be attributed to the inherent ability of defender firms to pay dividends due to their stable cash flows and limited high-risk growth opportunities, so additional cash does not substantially alter dividend payouts. Furthermore, defender firms may employ alternative policies, such as share repurchases, or respond to market norms emphasizing payment stability. This observation aligns with previous studies (Baker & Wurgler, 2004; Hoberg et al., 2014), suggesting that alternative policies and normative pressures can shape dividend behavior.

The results of Hypotheses 5 and 6 provide further insights into the moderating role of financial constraints in the relationship between business strategy and dividend payout. Contrary to expectations, Hypothesis 5 indicated that financial constraints weaken the negative effect of a prospector strategy on the cash dividend payout ratio. One plausible interpretation is that even under financial constraints, prospector firms may still distribute part of their earnings due to agency pressures, signaling high quality, and maintaining shareholder trust. In other words, while financial constraints may make firms more cautious, this cautiousness does not necessarily reduce dividend payments further. Instead, available cash flow and the priority of maintaining corporate credibility can mitigate the negative impact of a prospector strategy. This



interpretation aligns with agency theory and precautionary motives for cash holdings, as dividend commitments under financial constraints can serve as a mechanism to reduce conflicts of interest between managers and shareholders.

Regarding Hypothesis 6, it was expected that financial constraints would moderate the effect of a defender strategy on dividend payout. However, the results indicated no significant moderation. This may be due to the fact that dividend decisions in defender firms are primarily driven by the goal of maintaining stability and market credibility rather than current financial conditions. In other words, even under financial constraints, managers of defender firms tend to maintain their dividend policy to avoid negative market perceptions (Denis & Osobov, 2008). Furthermore, in the context of the Iranian capital market, relatively easy access to informal financing, bank facilities, or support from major shareholders may reduce the observable impact of financial constraints on dividend behavior. These findings are inconsistent with Houque et al. (2023).

Based on the findings of Hypotheses 1 and 2, it is recommended that firms design their dividend policies in alignment with their business strategy. Prospector firms, focusing on innovation, market development, and high-risk projects, should adopt flexible dividend policies that preserve liquidity while allowing investment in growth opportunities. In contrast, defender firms with stable operations and cash flows can continue consistent and regular dividend payments to maintain shareholder trust and market credibility. Overall, aligning dividend policy with strategy enhances coordination between growth objectives, liquidity management, and market expectations.

According to Hypothesis 3, managers of prospector firms are advised to actively manage free cash flow as an internal resource to balance investment and dividend policies. The results suggest that higher free cash flow can mitigate the negative effect of a prospector strategy on dividend payouts, allowing these firms to distribute part of the earnings during periods of high liquidity to reinforce shareholder confidence and send positive market signals. In contrast, consistent with Hypothesis 4, free cash flow does not significantly affect dividend payments in defender firms. Therefore, these firms are recommended to maintain stable dividend policies while utilizing excess cash for share repurchases or low-risk investments to balance shareholder returns and liquidity preservation.

Consistent with the findings of Hypothesis 5, it is suggested that managers consider both the intensity of financial constraints and the firm's business strategy simultaneously when designing dividend policies. Even under financial constraints, prospector firms may distribute dividends to maintain market credibility and mitigate agency conflicts. Hence, it is recommended that prospector firms carefully assess their liquidity and financial obligations and maintain a certain level of dividend payments as a signaling and trust-building tool. For defender firms, given that financial constraints do not significantly influence dividend policy, maintaining stable dividend payments is advisable to meet shareholder expectations and uphold market norms.

Future research could explore the role of organizational factors such as ownership structure, firm size, and board composition in the relationship between corporate strategy and dividend policy, providing deeper insights into the internal determinants of dividend management. Additionally, share repurchase policies could be examined alongside cash dividends as an alternative or complementary payout mechanism.

This study has several limitations. First, the sample is limited to firms listed on the Tehran Stock Exchange between 2013 and 2023, which restricts the generalizability of the findings to other periods or the broader Iranian capital market. Second, some variables, such as financial constraints, free cash flow, and business strategy type, are measured using proxies, which may not fully capture the underlying concepts. In particular, the measures used to classify firms as defender or prospector primarily rely on financial and accounting characteristics and do not reflect qualitative or behavioral aspects of strategy. Third, external factors such as regulatory changes, institutional pressures, inflation, and macroeconomic policy volatility were not included in this study. Considering these factors could influence the magnitude or direction of the relationships between strategy, free cash flow, financial constraints, and dividend policy.

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