

Association between Ownership Structure and Accounting Conservatism

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Abstract

The current study aims to investigate the association between ownership structure (type of ownership and rank of ownership concentration) and accounting conservatism based on operating and book approaches. Four hypotheses were assumed to achieve this aim. First and second hypotheses assess the relation between type of ownership and rank of ownership concentration and accounting conservatism on the basis of operating and book approaches. Third and fourth hypotheses appraise the relation between type of ownership and rank of ownership concentration and accounting conservatism based on book approach. According to review of literature and theoretical background, regression model and descriptive and inferential statistics were applied to analyze the obtained data. Applying systematic deletion, a target population of 100 listed companies on Tehran Stock Exchange was utilized in this study during a period of two years from 2008 to 2009. The achieved results of analyzing data confirm first hypothesis and reject second, third and fourth hypotheses. Findings of the study indicate that there is a significant linear relationship between types of ownership and accounting conservatism based on operating approach; there is no significant relationship between type of ownership and rank of ownership concentration and accounting conservatism based on book approach.

Keywords: Type of ownership, rank of ownership concentration, operating conservatism, book conservatism

1. Introduction

Institutional investment is one of the effective elements of external control over corporate governance. According to Gillan and Starks (2003), institutional investors can drive corporate governance changes and due to the fact that institutional investors are the most significant group of investors, they have the potential to influence management's activities directly through their ownership or indirectly by trading their shares. They can also affect accounting procedures and financial statements. Conservatism is a long-lasting and influential concept in accounting and financial statements. Increasing the level of institutional ownership can enhance firms' tendency to apply accounting conservatism. Accounting conservatism can prevent managers from unethical opportunistic behaviours (Mehrani et al., 2010, p. 49).

The present study assesses the relationship between firms' ownership structure (type of ownership and rank of ownership concentration) and operating or book conservatism in financial statements. It intends to answer the main question of the research.

2. Statement of the problem

Different firms possess various types of investors. Some of the investors are true shareholders who mostly rely on accessible public information such as published financial statements to observe managers' activities. Some investors are primary professional investors who in opposition to the first group of investors can get access to valuable and internal information about future plans and prospects, business strategies and long-term investments. Moreover, they can directly make contact with the manager. Owing to the long-term or short term perspectives, some of the institutional investors are reluctant to apply accounting conservatism procedures, while utilizing conservatism is nowadays essential to be applied in accounting especially in the firms which have concentrated ownership. Considering the importance of accounting conservatism, this question can be asked, "Is there a significant relationship between ownership structure (type of ownership and rank of ownership concentration) and conservatism?" To answer this question, the current study investigates the association between conservatism and type of ownership and rank of ownership concentration based on operating and book approaches.

3. Review of literature

Many researches have been conducted both inside and outside the country in the field of the present study. The most important ones are explained in the following manner.

3.1. External researches

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OmneyaAbdelsalam, Ahmed El-Masry and SabriElsegini (2008) conducted a research and examined the effect of board of directors' composition and ownership structure on dividend policies in Egypt. They applied regression model and found that there is a significant positive association between institutional ownership and firm performance, and both dividend decision and payout ratio.

Tsai and GU did a study entitled "the relationship between institutional ownership and casino firm performance". They examined the association between institutional ownership and firm performance in the casino industry from 1999-2003. Based on the results of this study, institutional ownership was found to be a significant and positive determinant of casino firm performance as measured by a proxy for Tobin's Q in a simultaneous equations system.

LaFond and Watts (2008) argued that information asymmetry between firm insiders and outside equity investors generates conservatism in financial statements.

Elyasiani et al. (2007) conducted a research under the title of "institutional ownership stability and the cost of debt". Their study had three major results. First, there is a robust negative relationship between the cost of debt and institutional ownership stability. Second, institutional ownership stability plays a bigger role in determining the cost of debt, than the institutional ownership level commonly used in the literature. Third, institutional ownership stability affects the cost of debt to a greater extent for firms that are subject to more severe information asymmetry, greater agency cost of debt, and larger agency costs of equity.

LaFond and chowdhury (2008) appraised the effect of managerial ownership on financial reporting conservatism. They found that conservatism as measured by the asymmetric timeliness of earnings declines with managerial ownership, and there is a significant negative relationship between firm size and conservatism.

Chang et al. (2008) examined the effect of corporate governance and ownership structure on liquidity. They found that institutional investors are the reason of liquidity enhancement.

3.2. Internal researches

Mohammad Namazi and Kermani (2008) assessed the influence of ownership structure on the performance of listed companies on Tehran stock exchange. Their findings demonstrated that there is a significant negative relationship between institutional ownership and firm's performance; and there is a significant positive relationship between corporate ownership and firm's performance.

Sadidi, Saghafi and Ahmadi (2011) examined accounting conservatism and the effect of earnings' quality on return on assets and dividend yield. They found that based on the indicator of conservatism, the index of earning's quality can determine the difference between opening assets returns and current stock returns for the following year.

Kordestani and Khalili (2011) investigated the influence of conservatism on differential information content of cash flows and accruals. The obtained findings of their study indicated that the differential information content of cash flows and accruals is more in the firms with higher levels of conservatism than firms with lower levels of conservatism.

Nasrollahi and Arefmanesh (2010) studied the association between ownership and earnings' quality in the listed companies on Tehran stock exchange. They concluded that the level of ownership by institutional investors arises with the enhancement of earnings' quality.

4. Main research questions

This article intends to answer the following questions:

1. Is there a significant relationship between the type of firm's ownership and operating conservatism?
2. Is there a significant relationship between the rank of firm's ownership concentration and operating conservatism?
3. Is there a significant relationship between the type of firm's ownership and book conservatism?
4. Is there a significant relationship between the rank of firm's ownership concentration and book conservatism?

5. Research hypotheses

Four hypotheses are assumed in this article which can be explained in the following manner:

H1: There is a significant positive relationship between the type of firm's ownership and operating conservatism.

H2: There is a significant positive relationship between the rank of firm's ownership concentration and operating conservatism.

H3: There is a significant positive relationship between the type of firm's ownership and book conservatism.

H4: There is a significant positive relationship between the rank of firm's ownership concentration and book conservatism.

6. Data collection method

Needed data were assembled through audited financial statements, explanatory notes, annual financial reports, general meeting of shareholders accepted in Tehran stock exchange, Securities and Exchange Organization's website, database of listed companies on Tehran stock exchange, and library of Securities and Exchange Organization.

7. Research methodology

The applied method in this study is descriptive. Cross sectional analysis and correlation were utilized to assess the obtained data.

8. Target population and statistical sampling

Target population of this study is consisting of listed companies on Tehran stock exchange from 2008-2009. Statistical sampling was conducted through simple random sampling.

In this study, 'type of ownership' and 'rank of ownership concentration' are independent variables, and 'conservatism' is the dependent variable.

9. Research model

The analyzed model can be stated as follows:

$$CONS = \alpha_0 + \beta_2 Owne + \beta_3 Conc + \varepsilon$$

9.1. Independent variables

Independent variables in this study can be explained in the following manner:

Type of ownership: It refers to the matter of being public or private ownership. If it is under government control or governmental firms' control, it is considered as a public firm and number 1 will be regarded for it. But if it is not under government control, it is considered as a private firm and number 0 will be regarded for it.

Rank of ownership concentration: The Herfindahl-Hirschman index (HHI) was utilized to measure the ratio of ownership concentration. HHI is calculated by the sum of the squares of the market share of firms.

$$HHI = \sum (p_i / p * 100)^2$$

9.2. Dependent variable

'Conservatism' is the dependent variable of the present study. Givoly and Hayn (2000) model was applied to assess conservatism. Generally, the existing relationship between operating accruals and total assets of the beginning of each firm's period indicates the index of operating conservatism.

Operating conservatism = operating accruals \times (-1) / total assets of the beginning of each firm's period

Book conservatism = value of the firm's stock market / book value of shareholders' rights

10. The applied statistical models in the research

10.1. Hypothesis1: the relationship between type of ownership and operating conservatism Y1

There is no linear relationship between type of ownership and operating conservatism (linear regression model).

$$H_0: r = 0$$

There is a linear relationship between type of ownership and operating conservatism (non-linear regression model). $H_1: r \neq 0$

ANOVA b

MODEL	Sum squares	T	Variance	F	Sig.
Regression	69899.313	1	69899.313	6.276	0.014a
Remaining	913220.571	82	11136.83		
TOTAL	983119.883	83			

A-Predictors:Constant – Ownership type

B:Dependent Variable :Conservative clericalY2

In the above table, Significance equals 0.014 which is less than 0.05. So H0 and H1 are respectively rejected and confirmed with the confidence level of 95%.

Testing the significance of coefficients

Type of the ownership has no effect on operating conservatism.

$$H_0: \beta = 0$$

Type of the ownership is effective in operating conservatism.

$$H_1: \beta \neq 0$$

Coefficients^a

MODEL	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	STD. ERROR	BETA		
Constant	69.2	15.076		4.59	0.00
ownership type	58.512	23.355	0.267	2.505	0.014

A:Dependent Variable :Conservative clericalY2

According to the table, significance is 0.014 which is less than 0/05, so it can be regarded significant. Considering the amount of Beta which is 0.267, the variable of ‘the type of ownership’ was effective in operating conservatism. So, H0 is rejected and H1 is confirmed.

Regression model can be written in the following manner:

$$\text{Operating conservatism} = 69.200 + 58.512 (\text{type of ownership})$$

10.2. Hypothesis2: The relationship between ‘rank of ownership concentration’ and operating conservatism Y1

There is no linear relationship between rank of ownership concentration and operating conservatism (linear regression model).

$$H0: r = 0$$

There is a linear relationship between rank of ownership concentration and operating conservatism (non-linear regression model).

$$H1: r \neq 0$$

ANOVA^b

MODEL	Sum squares	T	Variance	F	Sig.
Regression	633.177	1	633.177	.0530	.819a
Remaining	982486.706	82	11981.545		
TOTAL	983119.883	83			

A- Constant - ownership concentration

According to the above table, Significance equals 0.819 which is more than 0/05, so H0 and H1 are respectively confirmed and rejected with the confidence level of 95%.

Testing the significance of coefficients

Statistical hypotheses are considered as follows:

Rank of ownership concentration has no effect on operating conservatism.

$$H0: \beta = 0$$

Rank of ownership concentration is effective in book conservatism.

$$H1: \beta \neq 0$$

Coefficients^a

MODEL	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	STD. ERROR	BETA		
Constant	97.14	19.583		4.961	0.000
ownership concentration	-0.001	0.005	0.025	-0.23	0.819

B:Dependent Variable :Conservative clericalY2

Owing to the fact that significance is 0.819 which is more than 0/05, it can be concluded that H0 is confirmed and H1 is rejected, and regression model can be written in the following manner:

$$\text{Operating conservatism} = 97.148 - 0.001 (\text{rank of ownership concentration})$$

10.3. Hypothesis3: the relationship between ‘type of ownership’ and ‘book conservatism’

There is no linear relationship between type of ownership and book conservatism (linear regression model).

$$H0: r = 0$$

There is a linear relationship between type of ownership and book conservatism (non-linear regression model).

$$H1: r \neq 0$$

ANOVA^b

MODEL	Sum squares	T	Variance	F	Sig.
Regression	0.361	1	0.361	0.659	0.419a
Remaining	48.264	88	0.548		
TOTAL	48.625	89			

A- Predictors:Constant - ownership type

B:Dependent Variable :Conservative clericalY2

Significance equals 0.419 which is more than 0/05. So H0 and H1 are respectively confirmed and rejected with the confidence level of 95%.

Testing the significance of coefficients

Statistical hypotheses can be organized as follows:

Type of ownership has no effect on book conservatism. H0: $\beta = 0$

Type of ownership is effective in book conservatism. H1: $\beta \neq 0$

Coefficients^a

MODEL	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	STD. ERROR	BETA		
Constant	1.222	0.103		11.899	0.000
ownership type	0.128		0.086	0.812	0.419

B:Dependent Variable :Conservative clericalY2

Due to the fact that significance is 0.419 which is more than 0/05, the variable of "type of ownership" cannot be considered significant. Considering the amount of Beta which is 0.086, the variable of "type of ownership" does not have much effect on book conservatism; therefore, H0 is confirmed and H1 is rejected. Regression model can be written in the following manner:

Book conservatism = 1.222 + 0.128 (type of ownership)

10.4. Hypothesis4: the relationship between 'rank of ownership concentration' and 'book conservatism'

There is no linear relationship between rank of ownership concentration and book conservatism (linear regression model). H0: $r = 0$

There is a linear relationship between rank of ownership concentration and book conservatism (non-linear regression model). H1: $r \neq 0$

ANOVA^b

MODEL	Sum squares	T	Variance	F	Sig.
Regression	0.141	1	0.141	0.256	0.614a
Remaining	48.484	88	0.551		
TOTAL	48.625	89			

A-Predictors:Constant - ownership concentration

B:Dependent Variable :Conservative clericalY2

Considering the amount of significance which equals 0.614 and is more than 0/05, H0 and H1 are respectively confirmed and rejected with the confidence level of 95%.

Testing the significance of coefficients

Statistical hypotheses are assumed as following:

Rank of ownership concentration has no effect on book conservatism. H0: $\beta = 0$

Rank of ownership concentration is effective in book conservatism. H1: $\beta \neq 0$

Coefficients^a

MODEL	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	STD. ERROR	BETA		
Constant	1.328	0.129		10.287	0.000
ownership concentration	-1.715E-5	0.000	-0.054	-0.506	0.614

B:Dependent Variable :Conservative clericalY2

Owing to the fact that significance is 0.614 which is more than 0/05, the variable of ‘rank of ownership concentration’ cannot be significant. Regarding the amount of Beta which is 0.054, ‘rank of ownership concentration’ does not have much effect on book conservatism. So, H0 is confirmed and H1 is rejected. Regression model can be written in the following manner:

$$\text{Book conservatism} = 1.328 - 1.715E - 5 (\text{rank of ownership concentration})$$

11. Conclusion

11.1.Results of the first hypothesis

The first hypothesis assumed that the type of firm’s ownership affects operating accounting conservatism. Owing to the fact that correlation coefficient between operating accounting conservatism and type of ownership was about -0.031, and significance level equalled 0.386 which is more than 0/05, there is no significant correlation between these variables. On the other hand, the results of testing coefficients and regression significance showed 0.014 for the level of significance which is less than 0/05, so linearity of regression model was confirmed, and with the confidence level of 95% this conclusion could be drawn that there was a significant positive linear relationship between type of ownership and operating conservatism.

11.2. Results of the second hypothesis

In this hypothesis, the amount of correlation coefficient was calculated about 0.118, and significance level equalled 0.133 which is more than 0/05; therefore, there is no significant correlation between these variables. On the other hand, the results of testing coefficients and regression significance indicated 0.819 for the level of significance which is more than 0/05, so linearity of regression model was rejected, and with the confidence level of 95% it could be alleged that there was no significant linear relationship between rank of ownership concentration and operating conservatism.

11.3. Results of the third hypothesis

The third hypothesis assumed that the type of firm’s ownership affects book accounting conservatism. Considering the amount of correlation coefficient between book accounting conservatism and type of ownership which was -0.093 and significance level that was 0.186 and more than 5%, it can be concluded that there is no significant correlation between these two variables. Moreover, the results of testing coefficients and regression significance showed 0.419 for the level of significance which is more than 0/05; therefore, linearity of regression model was not confirmed. It was also proved that type of ownership did not have any significant effects on book conservatism.

11.4. Results of the fourth hypothesis

In this hypothesis, the amount of correlation coefficient between book accounting conservatism and rank of ownership concentration was calculated about 0.016, and significance level was 0.440 which is more than 0/05; therefore, there is no significant correlation between these two variables. Furthermore, the results of testing coefficients and regression significance demonstrated 0.614 for the level of significance which is more than 0/05, so linearity of regression model was rejected, and with the confidence level of 95% it could be concluded that there was no significant linear relationship between rank of ownership concentration and book conservatism. And rank of ownership concentration does not have any effect on operating accounting conservatism.

12.Applicable suggestion

It is suggested that:

1. While delivering firms’ shares to institutional investors, Analysts should avoid ownership concentration in the firms and encourage owners to compete with each other.
2. Considering the importance of ownership structure, the effect of institutional ownership on firms’ performance should be assessed both on institutional owners who have business association with the firm and those who do not.

13. Suggestions for further researches

1. Investigating the influence of the type of industry on relations between ownership structure and operating and book accounting conservatism
2. Examining the association between different types of ownership (such as external and managerial ownership) and operating and book accounting conservatism in the firms
3. Assessing the association between ownership structure and profitability management in different industries

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