

# The Survey of Relationship between Institutional Shareholders Percentage of Governmental Sector as One of Ownership Structure Criteria by Profit Smoothing in Accepted Companies in Tehran Stock Exchange

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## Abstract

Ownership structure in Iran is centralized and governmental ownership is more despite European and American zones that their ownership is usually separated. The purpose of this research is the relationship between ownership structures of governmental sector by profit smoothing in accepted companies in Tehran Stock Exchange in five-year period from 2008 to 2012 and it answers to this question whether there is significant relationship between institutional shareholders of governmental sector and profit smoothing or not? Accordingly, ownership percentage of governmental institutional shareholders as independent variable and profit smoothing as dependent variable are recognized. In this research statistical sample is including 75 companies that are used for hypotheses test of correlation coefficient by SPSS Software; the results of research show that there is a significant relationship between institutional shareholders of governmental sector and profit smoothing.

**Keywords:** Ownership structure, governmental institutional shareholders, profit smoothing.

## Introduction

Ownership structure in Iran is centralized and ownership is governmental despite European and American zones that their ownership is usually separated. Institutional owners based on Bush definition (1998) are included in large investors such as banks, insurance companies, investment companies, etc (Mehrani 2011).

According to Starks (2003) institutional owners have main role in most of organization changes. This group of shareholders has considerable influence in company according to significant ownership of company shares that their ownership percentage is usually more than 5 percent and they can affect on their procedures such as accounting procedures and financial reporting and also they have much motivation for supervision on financial reporting and financial statements especially income statement (Mehrani 2011).

Reported profit is such important financial information that are considered through decision making by people. Financial analysts generally emphasize reported profit as a significant factor in their investigations and judgments on financial information inserted in financial statements and economic units especially reported profit.

Investors believe that fixed profit in comparison to fluctuated profit guarantees higher divided profit payment. Furthermore profit fluctuations are considered as important criterion of general company risk and companies by smoother profit have less risk. Hence the companies which have smooth profit are considered more by investors and they are more suitable place for investment (Hendrickson 1992: 378).

Wild et al (2001) stated that investors generally have special attention to profit rate which they are considered as non-fluctuated or low fluctuated profit. Hence they are going to invest in companies in which profit process have more stability. Therefore reported profits always as one of financial decision making criteria have special credit and financial analysts often consider profit as a principal factor in their investigations and judgments. Managers have strong motivation to manage profit and try to interfere in the process of profit recognition to report profit rate through their favorite goals. Since job security of managers resulted in presenting desirable image of company performance in current and future periods, most of managers will be faced with the risk of dismissing because of failing in desirable performance of company in current period or forecasting for lack of success in future period and for this reason they consider profit smoothing. For example American Enron big company resulted to collapsing with this fraud (Yaqubi 2007).

Among ownership structure we can have more consideration on owners or institutional shareholders of governmental sector in Iran. Because most shares of company influences among management that it is a theory and in this research it is designed by the goal of investigation and finding answer of the question:

Is there any significant relationship between institutional shareholders of governmental sector and profit smoothing in accepted companies in Tehran Stock Exchange or not?

### Theoretical principles and research literature

Mashayekhi et al (2011) considered optional accrual items as a factor for the management of company profit especially during cash decline arising operations that shows weak performance of commercial unit. In other words cash arising operations and optional accrual items show inverse relationship as meaningful form.

Moradzadeh Fard et al (2012) concluded that there is negative relationship between institutional ownership levels of shares and profit management but institutional shareholders consider active monitoring role on company decisions about profit management. Also by increasing the percentage of institutional ownership of shares, the flexibility of company for profit management of accrual items will be declined and institutional shareholders improve the quality of company ownership in investment companies.

Mehrani & Qorbani (2012) investigated the effect of institutional shareholders on profit management among 90 accepted companies in Tehran stock exchange. The results showed that there is no significant relationship between profit management and institutional shareholders in the companies with free cash flows and low growth.

Ahmadpour et al (2011) by using the information of 185 accepted companies in Tehran stock exchange in the period from 2004 to 2007 concluded that when the motivation for manipulation of profit is high, non-bound managers and institutional investors have weak role in declining anomaly of unusual accruals.

Yahya Hasas Yaganeh et al (2011) investigated the survey of relationship between institutional investors and company value. In this research multiple linear Regression is used for relation test between company and institutional ownership. In general research results show the presence of positive relationship between institutional investors and company value and approve effective monitoring hypothesis. Hence research results show no significant relationship between the focus of institutional ownership and company value and do not confirm convergence hypothesis of profits.

Taghavi and Ahadi Serkani (2008) investigated the survey of mutual relationship of economic growth or financial structure and governmental and non-governmental ownership structure of accepted companies in Tehran stock exchange. The results of their research show that companies by increasing financial preparation through making liability could not play an effective role in economic growth. These results show the importance of financial preparation of the companies through increasing capital and its effective role in development process. Furthermore there is no significant relationship between ownership structure and economic growth.

Gholam Reza Karami (2009) investigated the survey of relationship between institutional owners and informational contents of profit. In this research different attitude (the hypothesis of active supervision and the hypothesis of personal profits) about institutional investors tested. Two models of multiple linear Regression are used for test. Research results show that the number of institutional ownership does not cause improving informational contents of company profit and may decline it. Now institutional ownership level does not decrease informational contents of profit so that it may increase it.

Dr. Saber Sheri & Mohammad Marfou investigated the relationship of non-bound member percentage in the combination of board of directors and institutional investors to the forecasting of company profit. In this research the relationship of two procedures of company ownership as membership of non-bound members in the combination of board of directors and ownership of careful institutional investors, protection, being on time and review times in forecasting of company profit are investigated. Research findings show the low importance of non-bound managers and institutional investors in affecting on the features of forecasting of company profit.

Cheni & Jiner (2012) tested the effect of optional accrual items of company on profit smoothing and concluded that smoothing companies are higher than non-smoothing companies and they have more efficiency, higher voluntary commitments and higher debt ratio. Also the companies by weak performance have less consideration to profit smoothing because they have no suitable situation for smoothing.

Kont et al (2008) stated that institutional ownership of company that increases supervision on the company inhibits bold use of accounting freedom and also share ratio in institutional investor ownership, the number of institutional investors of the company and the ratio of board of directors that attributed by institutional investors cause to decline the average of optional accrual items and profit management meaningfully.

Navissi & Naiker (2006) in a research investigated the relationship between institutional ownership and company value. Research findings show that institutional investors have much motivation for supervision on management. Hence its presence has positive effect on company value but in the high levels of ownership, institutional investors may persuade board of director to make non-optimal decisions.

Research hypothesis based on theoretical principles can be expressed as follows:

**H<sub>0</sub>**: There is no significant relationship between institutional shareholders percentage of governmental sector and profit smoothing in accepted companies in Tehran Stock Exchange.

**H<sub>1</sub>**: There is significant relationship between institutional shareholders percentage of governmental sector and profit smoothing in accepted companies in Tehran Stock Exchange.

### Research method

Purpose of the present research is practical type and according to the nature of topic and in terms of research methodology it is classified in the field of descriptive and analytical researches. In descriptive researches we can evaluate society characteristics through measurement that including attitude evaluation towards studied phenomenon in which we used library and field method to collect needed information. In field studies the goal is discovering the relationship among studied variables that happen in real situations and researcher has no interference in variables and at first research data will be described and then explained (Khaki 2004, 216). Present research based on collected data from Tehran stock exchange investigates accuracy of their hypotheses and test and generalize results to the whole society (Inductive-deductive).

In this research the purpose is the recognition of relationship between profit smoothing as dependent variables and institutional shareholder percentage of governmental sector as independent variable. In this research we used combinative data and SPSS software for testing of hypotheses.

### Statistical population

Statistical population of the research is included in all accepted companies in Tehran stock exchange from 2007 to 2012.

### Research Sample

For selecting desired sample, following criteria are considered:

1. Companies which their reception date in stock exchange is before 2006.
2. Companies which are not in the group of investment companies and financial brokering (investment companies are not considered because of the difference between activity nature and other companies in statistical population).
3. For the purpose of comparison of data, 29 Esfand is the end of financial year.
4. For the homogeneity of data, the companies are productive type.
5. Needed information for company must be available in the period.
6. Needed data must be available.
7. Business pause does not exceed more than 90 days.

According to above limitations, the number of companies that were applied for performing this research of statistical population are 75 companies and all needed information were extracted through Tehran stock exchange sites and Rah Avard Novin software. Also time domain is the research from 2008 to 2012.

### Research variables

The variables of this research are divided in two groups of dependent and independent variables for the purpose of hypotheses test.

### Dependent Variable

In the present research dependent variable is profit smoothing that Eckel Index is used for measuring profit smoothing and after measurement, the companies are divided into the companies with smooth profit and the companies with non- smooth profit.

### Profit smoothing

In accounting literature the action of approximating reported profit to the level of target profit is performed by manipulation that profit smoothing is one of manipulation goals. Hence profit smoothing is known as part of profit management. Profit smoothing is defined as deliberate action for declining changes and periodical fluctuations of reported profit or predicted profit through using of accounting methods in the framework of general accepted principles of accounting.

In this research Eckel index as following is used for the calculation of profit smoothing:

$$\text{Eckel index} = \frac{CV\Delta I}{CV\Delta S}$$

In this model:  $\Delta I$  changes of profit in a period,  $\Delta S$  changes of sale in a period and CV are change coefficient for desired variable that calculated as following by dividing standard deviation of desired variable on mean of the same variable:

$$CV\Delta I = \frac{\sqrt{\frac{\sum(\Delta I_i - \Delta \bar{I})^2}{n-1}}}{\Delta \bar{I}}$$

$$\frac{\sqrt{\frac{\sum(\Delta S_i - \Delta \bar{S})^2}{n-1}}}{\Delta \bar{S}}$$

In this model:

CV: Change Coefficient

$\bar{I}$ : Profit Mean

$\bar{S}$ : Sale Mean

When Eckel index is less than one, profit manipulation or profit smoothing is happened:

$$\frac{CV\Delta I}{CV\Delta S} < 1$$

Eckel index compares profit variability with sale variability. The main logic in this formula turns to the behavior of fixed expenditure. In other words the presence of fixed expenditure causes profit variability will be more than sale variability in usual situation (Kucheki 1995).

### Independent variable

#### Institutional Shareholder Ownership Rate

Institutional shareholders of this research are legal people that consider investment in the shares of other companies in Tehran stock exchange and they are the owner of more than 5 percent of the shares of Investee Company. According to present literature of investment companies, it is included in insurance companies, banks and pension funds. The ownership rate of institutional shareholders in each company is calculated through survey of ownership structure of companies and adding up the ownership percentage of institutional shareholders that are present in each company (Izadi nia & Rasaeen 2011).

For calculating institutional shareholder percentage in each company, the number of shares of institutional shareholders is divided by the total number of ordinary shares in the end of period that institutional shareholders are divided in two parts of ownership percentage of governmental institutional shareholders and ownership percentage of non-governmental (private) institutional shareholders. In this research the main focus is on ownership percentage of governmental institutional shareholders. In Iran despite of American and European areas that their ownership is separated, the ownership structure is concentrated and governmental ownership is more.

### Applied Statistical Methods

In this research at first statistical sample among statistical population of accepted companies in Tehran stock exchange are selected based on special conditions which noted in population part and statistical sample and then correlation coefficient used for the purpose of hypotheses test. Furthermore SPSS software will be used for analysis and test of statistical hypotheses of the research.

### Frequency Statistical Analysis of Research Qualitative Variables

This research has two qualitative variables (smoothing and non-smoothing profit) that we are going to test hypotheses by using them. At last list of statistical sample recognized by using Eckel index that profit of the company is smooth or not.

Table 1: Frequency Table of smoothing and non-smoothing companies

Percentage	Frequency	Company Type in Terms of Profit
%72	54	Smoothing Profit
%28	21	Non-Smoothing Profit
1	75	All Statistical Companies

Pie Chart, Company Type in terms of smoothing or non-smoothing

Blue Color: Smoothing Profit

Green Color: Non-Smoothing Profit

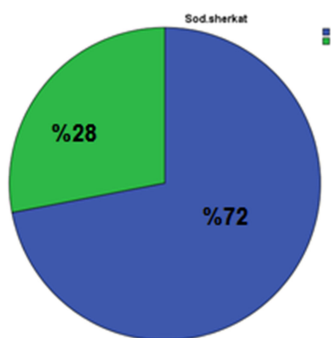


Figure 1: Pie Chart of Smoothing and Non-Smoothing Profit of Companies

### Descriptive Analysis of Quantitative Variables of the Research Institutional Ownership of Governmental Sector

This variable plays as quantitative variable of the research that we consider the mean of governmental ownership rate through study interval from early 2008 to late 2012 (List of Companies is in appendix).

Following table including descriptive statistics is related to governmental ownership data through desired time return that is calculated by using SPSS software.

Table 2: Descriptive Analysis of Institutional Ownership Variable of Governmental Sector

Kurtosis	Skewness	Range	Variance	Standard Deviation	Mean	Variable Name
-1.020	0.450	0.92	0.079	0.28164	0.3260	Governmental Ownership

### Normality Test of Variables

For normality of variables of this research, Kolmogorov-Smirnov Test is used. This test is used for investigating the normality of data distribution of a quantitative variable that is performed by SPSS software. We proceed for investigation of normality of a special variable as follows:

- { H0: Distribution of selective variable is normal.
- { H1 : Distribution of selective variable is not normal.

Now according to the output arising SPSS software, we can recognize normality of selective variable distribution. If sig is less than %5, H0 is refused and the claim of normality of selective variable will not be accepted.

While data distribution of a variable is normal, we use Pearson Correlation Coefficient for correlation test between two quantitative variables and in abnormal state of variables, we use Spearman Correlation Coefficient (Azar & Momeni 2005).

Table 3: Results of normality test of variables

Inferential statistics	Normality	(Sig) Significant level	Test Type	Variables	Rank
Pearson Correlation Coefficient	abnormal	0.759	Test K-S	Company Profit	1
Pearson Correlation Coefficient	abnormal	0.203	Test K-S	Governmental Ownership	2

### Hypotheses Test

To test the variables in this research, correlation analysis is used because we follow proving the relationship between two variables in this research. Correlation analysis is statistical instrument for recognizing type and degree of relationship of two variables through which we can recognize intensity and relationship type (direct or inverse) which this coefficient is between +1 and -1 and in the absence of relationship between two variables is zero.

Results arising hypotheses of this research are calculated by SPSS software.

There is significant relationship between institutional ownership of governmental sector and smoothing of profit.

According to variable scale and the type of their distribution, Pearson Correlation Coefficient is used for testing this hypothesis. Results arising Pearson Test is calculated by SPSS software which presented in table 4.

Table 4: Pearson Correlation Test for Research Hypothesis

Profit Smoothing	Variable Type	
0.162	Pearson Correlation Significant level Number	Institutional Ownership of governmental Sector
0.000		
75		

As table shows there is relationship between institutional ownership of governmental sector and profit smoothing in the level  $\alpha = 0.05$  because significant level is  $\text{sig} < \%5$ . Hence institutional ownership of governmental sector is affected by profit smoothing.

### Conclusion

In this research the relationship between institutional ownership of governmental sector and profit smoothing in accepted companies in Tehran Stock Exchange in five-year period from 2008 to 2012 is investigated.

Profit smoothing can be defined as deliberate action for declining profit fluctuations which reported through financial periods about level of profit that is named usual profit (normal) of company. One of the forms of profit management is profit smoothing that is attracted much attention in accounting literature. In this research Eckel index is used for calculation of profit smoothing.

Ownership structure in Iran is centralized and governmental ownership is more despite European and American zones that their ownership is usually separated.

In this research institutional investors (shareholder more than 5 percent of all shares) is divided in two groups of institutional shareholders of governmental sector and institutional shareholders of private sector.

Institutional investors are large investors as banks, financial institutions and investment companies.

Governmental ownership is considered about companies through which social agreement allows government to use them or government is made it through sources.

The purpose of governmental companies in institutional ownership of governmental sector is banks and governmental insurances, or non-governmental institution that put in a group entitled by governmental companies. In fact governmental ownership is the companies which Governmental ownership is considered about companies through which social agreement allows government to use them or government is made it through sources.

According to topic literature it was expected that there is positive and strong relationship between institutional investors of governmental sector and profit smoothing but according to performed tests, a significant relationship was observed among them and there is significant relationship in hypotheses test by using Pearson correlation coefficient between institutional investors of governmental sector and profit smoothing because significant level is  $\text{sig} < \%5$ . The results of hypotheses test of this research is consistent with the studies of Denis and Denis (1994), Murali and Welch (1989), Morad Zadeh Fard et al (2012) and Ahmad Pour et al (2011).

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