

Study of relationship between institutional ownership and accounting conservatism in accepted Companies in Tehran Stock Exchange

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Abstract: One of the more effective concepts in financial reporting of companies is conservatism, that its influence has longer history in accounting. Accounting trends of conservatism have been prevented managers from opportunistic behavior and excess optimistic in profitability. With regards to importance of accounting conservatism, aim of this study is reviewing relationship between institutional ownership and accounting conservatism in accepted companies in Tehran Stock Exchange. In order to do this study, it was selected and examined sample consists of 85 companies in Tehran Stock Exchange in 5 years (2007-2011). It was used linear regression model in 95% confidence level by using Excel and SPSS software to test hypothesis and review relationship between institutional ownership (independent variable) and accounting conservatism (dependent variable). Results indicated that there is direct (positive) relationship between institutional ownership level and accounting conservatism and there is reversed (negative) relationship between institutional ownership concentration and accounting conservatism.

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1. Introduction

Companies as economic units are seeking to obtain proficiency and wealth. Due to different reasons that their importance is separation ownership from management, companies' duty is to respond other people. Based on experimental evidences, financial reporting is the most effective responding form. Due to recent scandals and bankruptcy of great companies such as Anron, Worldcom, etc, validation of number and accounting figures (they are most important part of financial reporting) are under question so that investors haven't confidence to financial statements by manager. With regards to this, attention to leadership system of companies and quality of accounting reports are increasing more and more. Different countries have done many proceedings with regards to importance of leadership system. For example, Sabrina zaxlei rule was passed in United States that its duty is observer on leadership system of American companies.

One of the procedures in external control is institutional investors that they are effective in company governance and they are also important. With regards to ownership, these groups of stockholders have great influence in companies stocks, that they are influence their trends (accounting trends and financial reporting). Since institutional owners are great group of stockholders, then their role

is important in monitoring on trends by managers and it was expected that these owners have influenced on company trends. One of the most effective concepts in financial reporting of companies is conservatism that its influence has longer history in accounting. Accounting trends of conservatism have been prevented managers from opportunistic behavior and excess optimistic in profitability. Purpose of this study is reviewing relationship between institutional ownership in ownership structure of accepted companies in Tehran Stock Exchange and accounting conservatism.

2. Literature

The great financial scandals in worldwide, Anron and Worldcom in American to Parlamat in Europe, caused financial reporting have been charged. Financial statements are central core of financial reporting process. Financial statements and their gain and loss are in center of investors. In the recent years, reported profit quality is the most important issue for researchers. One of the profit qualities is conservatism; it means whatever profit conservatism is more; its quality is higher (Ball & Shivakumar, 2005).

The concept of conservatism has longer history in accounting, and Basso (1997) said that conservatism in accounting has history 500 years. Accountants have been introduced conservatism as

rule of loss achievement and without gains, traditionally. Basso defined conservatism as tendency of accountants to have been strong documents and higher degree of confirmed ability to recognize good news against bad news. Whenever difference of confirmation degree for gain is more than loss, then, conservatism is more (Basu, 1997).

One of the procedures in external control is institutional investors that they are effective in company governance and they are also important. According to Bosh (1998) definition, institutional investors are great investors such as banks, insurance companies, investing companies, etc. generally, it seems that institutional investors' maybe leads to change behavior and companies trends. This subject results from monitoring activities by investors (Bushee, 1998). Role of institutional owners and their relationship with gain quality of owning companies (gain conservatism) is unknown and ambiguous. Theoretically, institutions might have motivations for active monitoring on management, such they that due to invested wealth, institutions have been managed their investment actively (Shleifer & Vishny, 1986). Institutional owners have many motivations to monitor financial reporting. Financial statements, especially gain and loss, are important source of information about company. Experimental evidences indicated that institutional investors have positive relationship in market reaction related to gain spreading. As a result, gain has been provided suitable information in view of bonds pricing and it is the most important data source for institutions. Gain conservatism has been prevented managers in opportunistic behavior and excess optimistic in gain, so that effective conservatism gain was in high quality.

Therefore, it was expected institutions have been motivations in gain conservatism report (Jung & Kown, 2002). In contrast, many scientists believed that institutions didn't monitor on company, effectively, because they haven't enough experience, it might be conflict managers, politically (Admati et al, 1994). Also Kim (1993) stated that great institutional investors had access to secret information to extracted business purposes. Then, they had fewer tendencies to encourage management for gain reporting in high quality (Kim, 1993).

3. Literature Review

Wuchun Chi et al (2009) concluded that higher rate of stocks by institutional stockholders lead to reduce demand for conservatism and on the other hand, distinction of director and manager cause to reduce demand for conservatism (Wuchun et al, 2009). Chi, Liu and Wang found that there is meaningful and positive relationship between institutional ownership and conservatism. Based on

their findings, companies in less institutional ownership had less demand for conservatism accounting. Also they have been understood that due to lack of distinction between role of manager and director, there are more tendencies in conservatism (Chi et al, 2007).

Results of Akinkya et al (2005) indicated that whenever institutions ownership was more in each company, conservatism in gain prediction increased. Also, based on their findings, whenever percentage of undue manager is more, this prediction is more conservatism (Ajinkya et al, 2005).

Nekoonam et al (2012) stated in his research as "examination of relationship between ownership structure and information unsymmetrical that it explained differences in ownership structure of information unsymmetrical. They concluded that increasing in institutional ownership level, managerial ownership and ownership concentration cause to increase information unsymmetrical but increase in company ownership level cause to decrease information asymmetry (Nekounam et al, 2012).

Chi et al (2009) have been used Khan and Watts model to measure accounting conservatism in study as relationship between company governance and conservatism. They found that in companies such as Taiwan that their stock is available institutional stockholder; it needs to less conservatism accounting in 1996-2004 (Chi et al, 2009). Yuma and Jenkins (2006) concluded that concentrative institutional ownership has negative relationship of many criteria in gain quality (Velury & Jenkins, 2006).

Astami and Tower (2006) examined company features and selection of accounting methods in Pacific Asia (consists of Australia, Hong Kong, Indonesia, Singapore and Malaysia). Their findings indicated that lower financial leverage, less ownership concentration and opportunities set of more investor lead to more conservatism in financial statements. Of course, these findings were obtained when they didn't consider two variables, industry and country. In the other hand, above relationship was true if there isn't control on industry and country variable. If two variables were considered, control variable related to country is more deterministic related to above variables. Their findings show that Malaysian companies interested in conservatism (Astami & Tower, 2006).

Beeks et al (2004) conservatism and profitable considered as quality criteria in accountings in study as relationship among profitability, gain conservatism and board combination. They concluded that companies that they have more independency in board membership; they are more conservatism, by sample in England and by using asymmetry model in gain by Basso (1997). Therefore, they concluded that

status of board members is main factor in gain quality determination of England companies (Beekes et al, 2004).

Ahmed and Duellman (2008) found that accounting conservatism is obstacle of invested managers in project by negative yield. Also he found that there is direct relationship between stock percentage belongs to board members and conservatism (Ahmed & Duellman, 2008).

Givoly and Hay (2000) indicated that profitability in past decades was decreased. But this reduction didn't cause to decrease cash flows. Their findings refer that loss recognition was done related to gain and rate of unconditional conservatism and loss report will be increased 35% in financial reporting of American (Givoly & Hayn, 2000).

Klein and Marquardt (2006) shown that there is direct relationship among maximization of unconditional conservatism and enhancing companies losses. They have found direct relationship among conservatism and companies losses in American companies during 50 years, and they confirmed results of Givoly and Hayn studies (Klein & Marquardt 2006).

In other study, Reza zadeh and Azad (2009) examined relationship between accounting conservatism and information asymmetry during 1381-1385. Their findings indicated that there is positive and meaningful relationship between information asymmetry among investors and accounting conservatism. Also, according to their conclusion, change in information asymmetry among investors cause changing in conservatism level (Reza zadeh & Azad 2009).

Sasan Mehrani et al (2011) examined relation between institutional ownership and conservatism accounting and they concluded that by increasing institutional ownership level, companies' tendency in using conservatism trend was more (Mehran et al 2011).

Mehdi Moradzade et al (2010) examined relationship between institutional ownership and gain management. In this study, relationship between institutional investors and also their concentration on gain management was examined, and they found that there is negative and meaningful relationship between stock institutional ownership and gain management (Moradzade et al 2010).

Sohrab Asta (2012) in study as examination relationship between ownership structure and gain management, stated that differences in ownership structure explained gain management. Their results indicated that there is negative and meaningful relationship between institutional ownership and managerial ownership with gain management, but there is positive and meaningful relationship between

company ownership and gain management (Asta 2012).

4. Hypothesis

In order to obtain aim of study, the following hypotheses were designed that it will be tested:

First hypothesis: there is relationship between institutional ownership level and accounting conservatism.

Second hypothesis: there is relationship between institutional ownership concentration and accounting conservatism.

5. Methodology

This study is applied and it is descriptive – correlative. The aim is to review relationship between institutional ownership (independent variable) and accounting conservatism (dependent variable) that it was used linear regression mode to review relationship among these variables. Hypothesis was reviewed in confidence level 95%. It was noted that nonlinear relation test was done among study variables, and with regards to F statistics and meaningful level, it was clear that linear regression have shown the best way from variables.

5.1. Data collection

In this study, it was done librarian method and refer to archives to collect data. Study tool consists of financial statements, notes and financial reports of studied companies that they are collected via Rahavard Novin software and formal website of Tehran Stock Exchange, and after categorization and calculation of variables in Excel software, data were analyzed by using SPSS software, finally.

5.2. Research model and variables measurement

The present model was used to review relationship between ownership structure and accounting conservatism. Model adjustment of Astami & Tower (2006) is the following:

$$\text{CONSER}_{it} = \alpha + \beta_1 \text{INS}_{it} + \beta_2 \text{CONC}_{it} + \beta_3 \text{SIZE}_{it} + \beta_4 \text{LEV}_{it} + \beta_5 \text{GROWTH}_{it} + \beta_6 \text{MBV}_{it} + \varepsilon_{it}$$

CONSER_{it} : index of accounting conservatism for i company in t period

INS_{it} : institutional ownership level for i company in t period

CONC_{it} : institutional ownership concentration for i company in t period

SIZE_{it} : i company size in t period

LEV_{it} : i company leverage in t period

GROWTH_{it} : i company growth index in t period

MBV_{it} : market value to book value of yield fluctuation in i company in t period

ε_{it} : error state for i company in t period

5.3.1. Independent variables

a) Institutional ownership level: it's equal to percentage of kept stocks by great investors such as banks, insurance companies, investor's companies, etc. (Bushee, 1998).

b) Institutional ownership concentration: it was used Herfindal Hirschman index to calculate institutional ownership concentration. This index is an economical index that it was used to measure monopoly rate in market. If percentage stock of each provider became twice in market, and then it added together, its result was 0-1, and whenever it close to 1, it will be stated concentration and whenever it close to 0, it will be stated non concentration. In this study, it was use the following equation to measure institutional ownership concentration:

$$CONC = \sum_{i=1}^n (INS)^2$$

5.3.2 Dependent variable

In the present study, it was use Givoly and Hayn model to measure accounting conservatism index. Conservatism index was calculated based on above model in the following:

$$CONSER = \frac{OACC}{TA_{t-1}} * (-1)$$

CONSER: Accounting conservatism index

OACC: Operational obligated items

TA_{t-1}: Total assets in first period

5.3.3 Control Variables

Company size: In this study, company size is equal to natural logarithm of total assets in end period.

Financial leverage: This variable is defined as total debts to total assets in end period.

Growth index: This variable is defined as assets changes to assets in first period.

Market value to book value: This variable according to literature is defined as market valued of company stoke in year ending to book value of stockholders rights.

6. Community and statistics sample

Sample of study consists of accepted companies in Tehran Stock Exchange in time period in 2007-2011, that they are in the followings:

- 1- Company has been accepted in Tehran Exchange Stock since 2007.
- 2- End of financial year of each company is March 20.
- 3- Number of trading days in companies isn't less than 70 days in each fiscal year.
- 4- It didn't belong to financial and investing companies.
- 5- Required financial data is available.

With regards to above limitations, 85 companies were selected as statistical sample by using systematic deletion and then they were studied.

7. Findings and data analysis:

Data about 85 Member Company derived from resources such as Rahavard Novin, Bourse Site during 2007-2011 and after classification and

calculation variables in Excel software, data were analyzed by using SPSS software, finally.

7.1. Descriptive statistics

Table 1 has descriptive statistics of tested variables. In this diagram, there are statistical index, number of observations, average and standard deviation.

7.2. normal test of dependent variable:

Being normal in distribution of dependent variable is one of the basic assumptions in correlation method. Then, normal of dependent variable was reviewed by using Kolmogorov – Simonov test. Results were in table 2. Since, importance level of dependent variable, 19/8% is more than 5%, but dependent variable has normal distribution. Hence, it can be concluded that other variables in regression line have also normal distribution and possibly, it hasn't variance incompatible.

7.3. Test results of first hypothesis

Findings derived from tests and statistics analysis in table 3 indicated that independent variable coefficient of institutional ownership level in regression pattern is positive and meaningful. With regards to (sig meaningful level) T and F statistics in mode is smaller than 5%, this information stated that H₀ isn't confirmed and H₁ is accepted and it was stated that the first hypothesis is accepted. Therefore, there is direct (positive) relationship between institutional ownership level and accounting conservatism. That is, whenever institutional ownership level increased, accounting conservatism increased meaningfully. Therefore, first hypothesis was confirmed. Results of this hypothesis was contradicted to results of other studies; such as chi et al (2009), voochan chi et al (2009), Yooma Jenkiz (2006), Nekoonam et al (2012), Moradzadeh et al (2010) and Esta (2012), but it was confirmed to results of studies; such as Chi et al (2007), Ajinika et al (2005) and Mehrani et al (2011).

7.4. Test results of second hypothesis

Findings derived from tests and statistics analysis in table 4 indicated that independent variable coefficient of institutional ownership concentration in regression pattern is negative and meaningful. With regards to (sig meaningful level) T and F statistics in mode is smaller than 5%, this information stated that H₀ isn't confirmed and H₁ is accepted and it was stated that the second hypothesis is accepted. Therefore, there is reverse (negative) relationship between institutional ownership concentration and accounting conservatism. That is, whenever institutional ownership concentration increased, accounting conservatism decreased meaningfully. Therefore, second hypothesis was confirmed. Results of this hypothesis were confirmed to results of other

studies; such as Yooma & Jenkiz (2006) and Astami & Taver (2006).

8. Discussion and conclusions

In this study, effect of the most effective factors in company governance was tested in 5 years, i. e. institutional ownership on obligation items management and accounting conservatism by accepted companies in Tehran Stock Exchange. Generally, evidences stated that about institutional ownership, as stated in first hypothesis test, there is meaningful and positive relationship between stock institutional ownership level and accounting conservatism in confidence level, 95%; according to active monitoring assumption of advocates. This hypothesis, it was stated that institutional owners are investors in long term perspective that they had more ability and motivation to control managers, actively. Therefore, institutional investors have been revised managers' behavior related to reports about inequality gains and finally, it used to increase conservatism in financial reporting. Results of second hypothesis testing indicated that there is negative and meaningful relationship between stock institutional ownership concentrations and accounting conservatism in confidence level, 95%; great institutional investors

have access to secret data that they derived from trade aims. In these conditions, they have fewer tendencies to encourage management to report gain in high quality. In other words, according to personal benefit hypothesis great institutional investors have great influence on company reporting due to have many stocks and they will be revised effect on rate of conservatism by pressure on manager to increase gain and increase stock price.

Table 1. Descriptive statistics of variables

Variable	Observations	Average	SD
Ownership concentration level	425	0.60	0.37
Firm size	425	4.563	0.762
Financial lever	425	0.128	0.155
Growth index	425	1.526	0.152
Market value to book value	425	1.635	0.234
Accounting conservatism index	425	0.68	0.133

Table 2. Kolmogorov- Smirnov Test

Accounting conservatism index	Description
Number of observations	425
Kolmogorov-Smirnov statistic	1.075
Significance level	0.198

Table 3. Findings derived from tests and statistics analysis in

CONSER _{it} = α + β ₁ CONC _{it} + β ₂ SIZE _{it} + β ₃ LEV _{it} + β ₄ GROWTH _{it} + β ₅ MBV _{it} + ε _{it}								
Dependent variable (Accounting conservatism)	Dependent variable (Ownership concentration)		Variance analysis	Determination power			Durbin-Watson statistic	Result
	Coef.	T (sig)	F (sig)	R	R ²	Adjusted R ²		
CONSER	-2.048	-6.805 (0.000)	44.674 (0.000)	0.617	0.380	0.372	1.968	Confirmed

Table 4. The results of Second hypothesis test

CONSER _{it} = α + β ₁ INS _{it} + β ₂ SIZE _{it} + β ₃ LEV _{it} + β ₄ GROWTH _{it} + β ₅ MBV _{it} + ε _{it}								
Dependent variable (Accounting conservatism)	Dependent variable (Institutional Ownership)		Variance analysis	Determination power			Durbin-Watson statistic	Result
	Coef.	T (sig)	F (sig)	R	R ²	Adjusted R ²		
CONSER	0.547	8.972 (0.000)	54.464 (0.000)	0.654	0.428	0.420	1.971	Confirmed

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