



## Institutional Ownership Structure; Mediator Role in Related Party Transactions and Corporate Profit Management

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### A B S T R A C T

Institutional ownership is an important indicator of stock investment and can have a huge impact on the behavior and behavior of companies. In this study, the effect of institutional ownership structure on the relationship between Related Party Transactions and profit management of listed companies in Tehran Stock Exchange was investigated. The research sample was 87 companies that were selected in a systematic and purposive manner. The required data were collected from the MABNA software and analyzed using Eviews econometric software. The results indicated that the institutional ownership structure reduced the relationship between Related Party Transactions and management of profits, so that both of long-term institutional ownership and short-term institutional ownership reduced the forecast of profit management through Related Party Transactions.

**Keywords:** Institutional Ownership, Long-Term Institutional Ownership, Short-Term Institutional Ownership, Related Party Transactions, Profit Management.

### INTRODUCTION

Ownership of corporate resources through related party transactions is common in developed countries, but due to lack of foreign markets and corporate governance weaknesses, this phenomenon is more evident in emerging economies (Berglöf & Von Thadden, 1999; Lin, Ming, & Xu, 2006). In many cases, related party transactions are inevitable and beneficial and repeated throughout the company's business cycle (Alves, 2012; C.-W. Chen & Wu, 2010; Huang, 2015; Xianhui & Liansheng, 2009); but in certain circumstances, major shareholders (majority shareholders) or corporate directors will be allowed, at the expense of minority shareholders, personal interests Self-financing (de Jong, Röell, & Westerhuis, 2014; Kim & Woo, 2008). A global theory is that related party transactions can be used in group companies as a way to optimize the allocation of domestic resources, reduce transaction costs, and improve returns on assets (Y. Chen, Chen, & Chen, 2009; Ge, Drury, Fortin, Liu, & Tsang, 2010; Habib, Muhammadi, & Jiang, 2017; Hennart, 2015). On the other hand, these transactions are used opportunistically by managers or other major shareholders, which can mislead the results of the operation or may have

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an adverse effect on the interest of minority shareholders (Hasnan, Daie, & Hussain, 2016; Huang, 2015; Minggui & Xinping, 2004; Tong, Wang, & Xu, 2014). Also, shareholders (directors) who have more incentive to own a property may acquire their personal interests through transactions involving affiliated assets with the diversion of assets and the transfer of the price; therefore, the need for the supervisory board to control the ownership and management of the transaction Firms require more research in this field so investors and stockholders use the results (Enriques, 2015; Haji-Abdullah & Wan-Hussin, 2015; Lu, 2017).

Ownership in terms of ownership structure is classified into short-term and long-term groups. Short-term institutional shareholders, due to extreme and excessive focusing on current income, can create incentives for corporate executives to run a larger income management to better reflect the current state of affairs (Kang, Lee, Lee, & Park, 2014; Latif, Latif, & Abdullah, 2017). In contrast, long-term institutional shareholders have a long-term investment horizon and value intrinsic value versus current income, which is why it prevents executives from managing increased profit management (Koh, 2003; Noori, Turabi, & Ajdar, 2017; Zhang & Gimeno, 2016).

Supervising the owners as one of the corporate governance structures can have a special impact on different aspects of the company, such as profitability. Because of they are more active in directing (supervising) the performance of corporate executives and being more aware of their ability to access different information resources. Institutional monitors have a key role in supervising companies over the salaries of their shareholders, which are held by them (Ajinkya, Bhojraj, & Sengupta, 2005; Bhojraj & Sengupta, 2003). The supervision of the performance of managers involves deciding whether or not to related party transactions, and how the ownership structure of the companies may lead to an increase or decrease in the carrying out of transactions with related parties (Y. Chen et al., 2009). According to Xianhui and Liansheng (2009), among eight corporate governance factors, institutional ownership and board independence, they have the greatest impact on reducing profit management as well as improving the information content of profits.

## **METHODOLOGY**

This research is based on the purpose is application study, because its purpose is to develop knowledge in a particular domain, which is guided by the scientific application of the results of that knowledge. The information and data required for the research have been extracted from the financial statements, the Tehran Stock Exchange and the Tehran Stock Exchange database, as well as from the TADBIRPARDAZ database.

Independent variable of research is related party transactions. According to Standard No. 12 of Iran, the related party transactions is defined as follows: the transfer of resources, services or obligations between affiliated entities, regardless of whether the request is due or not to the price. To measure this variable, the total amount of related party transactions disclosed in the notes accompanying the annual financial statements of the companies admitted to the Tehran Stock Exchange, divided by the total assets of the company's period, has been used.

The dependent variable is profit management, which is measured by the DAC (optional accruals) indicator. Since profit management cannot be measured directly, the profit management literature has several methods for calculating profit management: the method of accruals, total of accruals, accounting changes, and distributive methods. The most commonly used method is the accruals method that assumes that managers rely on their accrual accounting accruals to manage their profits. Accruals are optional and non-existent. Optional accruals are determined by management, but non-controlling accruals are affected by the business unit's operating cycle and are not managed. Therefore, in this research, optional accruals are used to measure profit

management. Before dividing accruals voluntarily and non-controlling, total accruals are obtained from the following equation:

Relation 1):

$$TAC_{i,t} = (\Delta CA_{i,t} - \Delta Cash_{i,t}) - (\Delta CL_{i,t} - \Delta LTD_{i,t} - \Delta ITP_{i,t}) - DPA_{i,t}$$

$TAC_{i,t}$  = Total accruals of company  $i$  in year  $t$

$\Delta CA_{i,t}$  = change in current assets of company  $i$  in years  $t$  and  $t-1$

$\Delta Cash_{i,t}$  = change in company's cash balance in year  $t$  and  $t-1$

$\Delta CL_{i,t}$  = change in current debt of company  $i$  in years  $t$  and  $t-1$

$\Delta LTD_{i,t}$  = change in current debt ratio of company  $i$  in years  $t$  and  $t-1$

$\Delta ITP_{i,t}$  = change in payable income tax between  $t$  and  $t-1$  years

$DPA_{i,t}$  = cost of depreciation of fixed and intangible assets of company  $i$  in year  $t$

Non-adherent accruals are obtained from the following equation:

Relation 2):

$TAC_{i,t}$  = Total accruals of company  $i$  in year  $t$

$TA_{i,t-1}$  = Total company's assets at the end of year  $t-1$

$\Delta REV_{i,t}$  = Net sales of company  $i$  in year  $t$

$PPE_{i,t}$  = Gross assets of machinery and equipment company  $i$  in year  $t$

Now, we can acquire the volumes of discretionary accruals by deducting non-contingent accruals from total accruals (Equation 3): Relationship 3):  $DAC = TAC - NDAC$

Another variable that plays the role of mediating variable in this study is ownership. Since the ownership structure is considered to be research, in terms of structure, property ownership is classified into a long-term and short-term property domain. Short-term shareholders are temporary investors who primarily focus on determining the stock price on a net profit rather than on long-term gains; on the other hand, short-term institutional shareholders focus on short-term profitability goals, while the goals of institutional shareholders Long-term focus is on maximizing the value of the company in the long run.

The statistical population consists of all companies accepted in Tehran Stock Exchange. A screening method has been used to select the sample. Thus, first all companies were selected during the period from 2012 to 2016, then from among existing companies, companies that did not meet any of the following conditions were excluded:

- 1- At least since the beginning of 2011, they have joined the Tehran Stock Exchange.
2. The financial information for the period from 2012 to 2016 is specific and accessible.
- 2- The financial period of the companies will be completed by the end of March.
3. During the research period, their shares did not have a trading interruption for more than 6 months.
4. The investigated companies do not include insurers, banks and investment funds (due to the different nature of their profit).

Taking into account these limitations, the list of 87 companies listed in the Tehran Stock Exchange was selected as the sample.

In this research, one-variable regression has been used to test the research hypotheses. Accordingly, the research hypotheses were examined according to the following models:

**Model 1:** Long-term ownership of the relationship between related party transactions and management of listed companies affects the stock market.

$$DAC_{i,t} = \beta_0 + \beta_1 RPT_{i,t} + \beta_2 LONGDP_{i,t} + \beta_3 (RPT_{i,t} + LONGDP_{i,t}) + \beta_4 CFO_{i,t} + \beta_5 Leverage_{i,t} + \beta_6 ROA_{i,t} + \beta_7 Firm\ Size_{i,t} + \epsilon_i$$

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$DAC_{i,t}$  = Optional accruals index (for measuring profit management).

$RPT_{i,t}$  = total sum of transactions with affiliated entities disclosed in the notes accompanying the annual financial statements of the companies admitted to the stock exchange divided by the total assets of the company at the beginning of the year (transactions with affiliated entities).

$LONGDPI_{i,t}$  = Percentage ownership of long-term investment horizon in company  $i$  at the end of year  $t$ .

$CFO_{i,t}$  = cash flows from operations of company  $i$  during year  $t$  divided by total assets of company  $i$  in year  $t$  (operating cash flows).

$Leverage_{i,t}$  = is more valuable than total debt of company  $i$  in year  $t$  divided by the book value of company's assets in year  $t$  (leverage).

$ROA_{i,t}$  = ratio of net profit of company  $i$  in year  $t$  is divided by the value of total assets of company  $i$  at the beginning of year  $t$  (return on assets).

$Frim\ Size_{i,t}$  = Natural logarithm of the total value of company's assets in year  $t$  (size of company).

The following model was used to estimate the second hypothesis of the research.

**Model 2:** Short-term ownership of the relationship between transactions with affiliated entities and management of listed companies affects the stock market.

$$DAC_{i,t} = \beta_0 + \beta_1 RPT_{i,t} + \beta_2 SHORT_{i,t} + \beta_3 (RPT_{i,t} + SHORT_{i,t}) + \beta_4 CFO_{i,t} + \beta_5 Leverage_{i,t} + \beta_6 ROA_{i,t} + \beta_7 Frim\ Size_{i,t} + \epsilon_{i,t}$$

In the model for the second hypothesis, short-term ownership has been added as a moderator variable.

$SHORT_{i,t}$  = Percentage ownership of the investors, depending on the short-term investment horizon in Company  $i$  at the end of year  $t$ .

## RESULT

The researcher provided detailed descriptive statistics because information about the characteristics of the audit committee, the quality of the audit and the quality of profit and their effect on the renewal of financial statements are rarely listed. The descriptive statistics about the research variables are shown in the table 1.

**Table 1.** Descriptive statistics of the study variables

Variable	Symbol	observations	Mean	SD	Skewness	Kurtosis
Discretionary accruals credits	DAC	435	1.028	1.452	1.623	3.834
Related Party Transactions	RPT	435	11.681	3.483	-0.43	3.554
Operating cash flows	CFO	435	0.198	0.121	0.511	2.351
Leverage	Leverage	435	0.619	0.239	-0.43	2.754
Return on assets	ROA	435	0.178	0.141	0.398	4.140
Company size	Frim Size	435	13.42	1.53	0.891	3.342
Long-term institutional ownership	LONGDP	435	7.846	13.649	0.712	2.488
short-term institutional ownership	SHORT	435	0.252	0.675	1.318	4.162

The descriptive findings of the research variables, as presented in Table 1, show that the total number of investigated companies and research observations, the average of accruals accounted for is 1.028; the Related Party Transactions is 11.681; the average operating cash flow is equal to 0.121; the average leverage is 0.619; the average return on assets in the companies is equal to 0.178 and the average size of the companies is equal to With 13.42. Also, the average long-term institutional ownership was 7.846 and the average short-term institutional ownership was also

0.252. Investigating the degree of Skewness and Kurtosis of each of the variables and comparing it with normal distribution shows that all research variables are distributed normally.

**Table 2.** The results of the test of the effect of long-term institutional ownership on the relationship of Related Party Transactions and management of profits in listed companies

$DAC_{i,t} = \beta_0 + \beta_1 RPT_{i,t} + \beta_2 LONGDP_{i,t} + \beta_3 (RPT_{i,t} + LONGDP_{i,t}) + \beta_4 CFO_{i,t} + \beta_5 Leverage_{i,t} + \beta_6 ROA_{i,t} + \beta_7 Frim Size_{i,t} + \epsilon_i$				
The general results of the regression model				
R	0.535			
R <sup>2</sup>	0.286			
Adjusted R <sup>2</sup>	0.290			
F	12.549			
P	0.001			
Durbin-Watson	1.926			
<b>Detailed Results of the regression model</b>				
Variable	Symbol	Coefficient	T value	P.
Related Party Transactions	RPT	0.116	2.654	0.009
operating cash flows	CFO	0.285	7.334	0.001
Leverage	Leverage	1.111	8.153	0.001
Return on assets	ROA	0.458	3.06	0.006
Size	Frim Size	0.46	25.36	0.001
long-term institutional ownership	LONGDP	0.211	11.805	0.001

The results of the first hypothesis test showed that according to the fact that the coefficient of determination of the model is 0.286 and the value of P, is less than 0.01, it is concluded that 28.6 percentages refers to the impact of long-term institutional ownership on the relationship of Related Party Transactions and profit management. Given the Durbin-Watson coefficient of the model, the assumption of the independence of the residues is acceptable and the results of the model are reliable.

**Table 3.** The Results of the Effect of Short-Term Institutional Ownership on the Relationship of Related Party Transactions and the Management of Profits in Listed Companies in the Stock Exchange

$DAC_{i,t} = \beta_0 + \beta_1 RPT_{i,t} + \beta_2 SHORT_{i,t} + \beta_3 (RPT_{i,t} + SHORT_{i,t}) + \beta_4 CFO_{i,t} + \beta_5 Leverage_{i,t} + \beta_6 ROA_{i,t} + \beta_7 Frim Size_{i,t} + \epsilon_i$				
The general results of the regression model 2				
R	0.563			
R <sup>2</sup>	0.317			
Adjusted R <sup>2</sup>	0.319			
F	16.813			
P	0.001			
Durbin-Watson	1.91			
<b>Detailed Results of the regression model 2</b>				
Variable	Symbol	Coefficient	T value	P.
Related Party Transactions	RPT	0.464	9.253	0.001
operating cash flows	CFO	0.533	2.41	0.03
Leverage	Leverage	1.073	5.021	0.001
Return on assets	ROA	0.218	3.469	0.02
Size	Frim Size	0.284	6.306	0.001
Short-term institutional ownership	LONGDP	0.328	4.612	0.001

The results of the model 2 test showed that considering the fact that the coefficient of determination of the model was equal to 0.317 and the value of P. is less than 0.01, it is concluded

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that 31.7% refers to impact of short-term institutional ownership on the relationship of Related Party Transactions and profit management. Given the Watson coefficient of the model, the assumption of the independence of the residues is acceptable and the results of the model are reliable.

## CONCLUSION

The results indicate that long-term institutional ownership can reduce the forecast of profit management through Related Party Transactions. The results show that the prediction in the first hypothesis is equal to 55.2%, but in the second hypothesis and the mediator role of long-term institutional ownership, the relationship's explanation of the relationship is reduced to 28.6. Accordingly, it should be noted that long-term institutional ownership pursues transparency of profit and prevents profit management. Individuals with a long-term perspective on investing with a better view of capital and financial performance, therefore, seem to naturally appear to be diminishing with the proliferation of institutional ownership. Short-term institutional ownership has also reduced the forecast of profit management through Related Party Transactions.

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