

The Effect of Block Holders on the Quality of Financial Reporting in the Listed Companies in Tehran Stock Exchange

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Abstract. The present study aimed to examine the effects of block holders on the financial reporting quality in listed companies in Tehran Stock Exchange. Accordingly the systematic elimination was used for sampling. The study, includes companies ranging from financial year 1388 to 1392 (2009-2013)(five financial year). Among 592 main companies of the stock, and after deducting a number of banks and insurance and investment companies and a number of companies with incomplete financial information, finally 119 companies with full financial information were selected. To examine the relationship between dependent and independent variables, panel or pooled regression was used. After examining the research model variables, which are the competition of block and institutional shareholders, the quality of financial reporting and other control variables, it was found that block holders influence the quality of financial reporting of listed companies in Tehran Stock Exchange.

Keywords: Block holders, institutional investors, the quality of financial reporting

1. INTRODUCTION

The main objective of financial reporting is to provide useful information about the financial status and operation results of the business unit for decision-making of customers and shareholders, etc.

Shareholders who are the major users of financial statements need reliable and useful information for decision-making. Mentioned information should have some quality features and these features include conservation which is a limited approach in identifying revenues and costs. In most of the times the manager in order to protect its interests shows that the business unit is in a good status so that he can get more rewards. On the other hand, shareholders are business owners and need reliable information without any bias, so the role of block holders (owners of more than 5% of shares) is very effective as a deterrent or incentive factor of managers' opportunistic behavior, it would be useful in better understanding of information as well.

As a result, in companies which have block holders, earnings management occurs and results show that the deterrent role of block holders is a deterrent factor against increasing corporate value due to emphasizing the importance of self-interests and earning management. (Vakilifard 2012).

The aim of this study is to examine the effect of block holders on financial reporting quality. Through conducted studies and its research models (Edmans & Manso, 2011) the block holders

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increases the quality of financial reporting. In this study, it's attempted to study block holders as one of the most influencing factors on financial reporting quality as well as guidance and directing of the company on the quality of financial reporting. However, some research is done on this case and there are some limitations, one of the major limitations is the management effect and manager's encounter with stock prices. In companies whose manager is one of the block holders, such number of shares cannot be acquired and that this limitation is commonly accepted.

2. LITERATURE OF RESEARCH

According to the experimental theory of studies on investment and trade, we can say that the block holders control the performance of the managers through involvement, and giving them opinions or recommendations of strategic opportunities to avoid actions that undermine the values of the company as well as removing incompetent managers, and those managers who have a very poor performance.

When ownership has a wide and extended distribution, it's economically undesirable for a shareholder to incur significant costs control and supervision. Because they only receive a small part of the benefits. Also when the ownership is distributed, shareholders cannot easily control the functions of managers. Applying interference by block holders include activities such as obtaining the positioning of the board of directors through applications, personal relationships with managers, the rules of operation and other forms of activities, which according to empirical evidence the positive impact of applying of interference on the value of the company is proven (Dou & All, 2014).

The block holders limit the opportunistic activities of managers, synchronize the benefits of shareholders and managers, and demotivate managers in manipulating the benefits. So there is a positive relationship between the quality of financial reporting and existence of block holders. In the meanwhile block holders benefit from earnings management and limit small shareholders through termination of more efficient contracts, reducing the cost of foreign investment, non-repayment of debt, receiving interest, receiving personal benefits of small shareholders, and selling shares at a high rate. Therefore block holders limit managerial freedom in financial reporting to a less degree which leads to the lower quality of financial reporting. (Dou & All, 2013).

Three Important Features of Described Research Plan

- The focus of block holders is studied and the shareholder's focus is studied with Herfindahl Index.
- Liquidity, encourages block holders to seek personal information that are important in business
- The relationship between liquidity and the quality of financial reporting is determined in accordance with invisible features at the company level and reduce liquidity crisis as well as the role of other factors that change over time (Dou & All, 2014).

Block Holders

Evidence for this issue is provided in capital studies on the role of shareholders in the markets' capital. Although shareholders represent the block holders and their personal property is greater than 5%, thus control and supervision is provided to them. Therefore, the existence and role of these block holders in the company's governance and leadership will be discussed. They base their trade and activities on the activities and performance of managers that raise the value of the company so that they are reported based on accounting statistics, as a result, the rates reflect

the fundamental value of the company and the motivation of managers to manage earnings is reduced and optimized incentives are almost excluded. (Dou & All, 2014).

The block holders can easily separate ownership and control from each other by using the pyramid group. They can select the board of directors that they wish. Their benefits are supplied at the expense of small shareholders. And based on the effect of block holders' stimulus, the value of the company increases when cash flow is increased in the hands of block holders. For inclusion in the line of other competitors, block holders tend to participate in projects with positive NPV, so managers find opportunities to increase the wealth of shareholders towards their claim on future cash flows (Demestzh and All, 1993).

In the traditional view, the view of the shareholders is that the block holders should have exact monitor and control on the company or otherwise problems would happen regarding the control of the company. However, the block holders' supervision is very costly that they may prefer to leave the company rather than having a remote control. (Sias and All, 2005)

Reasons for Studying Block Holders

1. They are an example of shareholders that are expected to have a significant impact on financial decisions of companies.
2. We will be able to track (follow up) the individual block holders and their relationship with the quality of financial reporting.

Institutional Investors

In recent decades the shares owned by institutional investors have remarkably increased. By institutional investors, we mean insurance companies, investment funds, financial institutions, banks and Joint Stock companies that invest in other Joint Stock companies. Hence, institutional investors make up the biggest investors in joint stock companies. In a study done by (Seyyed Hossein Sajjadi et al., 2011) entitled as "the relationship between institutional investors and the quality of the earnings" the relationship between institutional investors and the quality of earnings based on conceptual framework of qualitative characteristics of accounting standards of the Editor's Board including having a predictive value, feedback value, fairness, timeliness and honest expression was studied. A study done by (Hashim and Devisd, 2008) investigated the relationship between corporate governance, ownership structure and the earnings quality, their results showed a positive and significant relationship between institutional ownership of shares, increase of earnings quality in institutional shareholders significantly increases the quality of earnings. They also showed that there is no relationship between the existence of irresponsible managers at the board of directors and earning quality.

The Quality of Financial Reporting

In many studies, the accuracy of financial data is used as a benchmark to measure the quality of financial reporting. The accuracy of financial information reflects the ability of the components of accounting accrual benefit under flexibility conditions and action freedom in choosing among procedures and accounting estimates to predict expected future cash flows. Therefore high accuracy and predicting ability of accrual benefit components is one of the determination indexes of the data content and high quality of financial reporting. According to this view accruals improve profit value by reducing the effect of unstable fluctuations in cash flow, accruals are also estimates of future cash flows and income, also the quality of financial reporting may be affected by features of company such as size, growth opportunities and financial leverage, these effects could be seen clearly (Moein Al-Din et al., 2012).

Samadi Lorgany (2012) in his doctoral thesis, with an emphasis on the transparency of financial reporting, studied its relationship with tax reporting. The results of the study indicate

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the existence of a positive relationship between tax reporting and financial reporting transparency so that in case of providing tax reporting to financial reporting enclosure, transparency in financial reporting would be provided to a large extent. Research of (Edmans, 2014) is about the competitive advantage of block holders in stock selection and investment companies. They specialize in gathering previous information to assess the present value of the related company which depends on past decisions. Despite such specialty, successful involvement of block holders can be complex and difficult, and the company can use its resources to support the Board of Directors which can be done with competition between block holders.

There are much empirical evidence that shows that the reason for the weak profit - efficiency relationship is because of low information content of reported profits and this consequence is due to the low reliability of earnings because of management manipulation. The issue of reliable profits becomes more important when managers are motivated to manipulate it. Such manipulation changes the view of shareholders, whether major or institutional ones over the reliability of reported earnings. Reliability and awareness of the accounting earnings increases when the opportunistic behavior of managers are controlled with supervisory systems. (Bugshan, 2005).

The only research hypothesis is as follows:

The existence of block holders, increases the quality of financial reporting.

The question that arises in the study include:

Does the existence of block holders increase the quality of financial reporting?

Research Methodology

Type of research in terms of goal is developing practical knowledge in a particular field. This study is conducted with the aim of applying the result of its findings to solve the existing problems and it tries to respond to problems and scientific problems that exists in the real world. The method of this study is correlational and regression analysis is used to examine the relationship between dependent and independent variables of the study, because it can be applicable in the process of using financial information reporting. The population of this research consists of all listed companies in Tehran Stock Exchange. One of the reasons for choosing Tehran Stock Exchange as the main population is the existence of criteria and information needed to examine the hypotheses, this information includes items written in the financial statements of companies that are accessible, and the researcher proceeds to determine the research sample through screening method. In practice sampling is better to be done through systematic method. In this study, to collect data both library and field methods are used. In the library part, theoretical foundations and research literature are extracted mainly from valid papers, specialized Persian and Latin magazines, and books published in this field. In the part of field research in order to collect needed data, information reflected in the financial statements and computer databases (Rahavard Novin software) were used. Finally the collected data was entered into the Eviews software using Excel software after applying necessary reforms and necessary classifications on the basis of studied variables. The final analysis was done with the help of Eviews software.

To test the research hypothesis and data analysis the following model was used:

$$FRQ_{i,t} = \alpha_0 + \beta_1 BHCMP_{i,t} + \beta_2 LIQUIDITY_{i,t} + \alpha_n Contorol_{n,i,t} + \varepsilon_{i,t}$$

Measuring Financial Reporting Quality:

It is calculated according to the model of (Kothari & All, 2011) (discretionary accruals model) in fact it moderates Jones model by considering the performance.

This model is used in this study (Chen & All, 2005) as a benchmark for measuring the quality of financial reporting.

$$TACC_{i,t} = EXBI_{i,t} - CFO_{i,t} \quad (1)$$

In this equation:

i represents companies, and t represents years.

TACC: the total accruals.

EXBI: profit before extraordinary items.

CFO: Operating cash flow from continuing operations.

Then, the discretionary accruals (Kothari & All, 2005) is estimated. Thus, for each year and each industry category, the ordinary least squares regression is estimated:

$$\frac{TACC_{i,t}}{TA_{i,t-1}} = \alpha_0 \frac{1}{TA_{i,t-1}} + \alpha_1 \frac{\Delta S_{i,t}}{TA_{i,t-1}} + \alpha_2 \frac{PPE_{i,t}}{TA_{i,t-1}} + \alpha_3 ROA_{i,t} + \varepsilon_{i,t} \quad (2)$$

In this equation:

$TA_{i,t-1}$: is total assets at the beginning of the year t.

$\Delta S_{i,t}$: is the change in sale during the year t.

$PPE_{i,t}$: Gross property, machinery and equipment of the year t.

$ROA_{i,t}$: return on assets in the year t.

Then, the estimated coefficients of equation (2) is used to calculate the total non-discretionary accruals for each year of the company.

$$NDA_{i,t} = \hat{\alpha}_0 \frac{1}{TA_{i,t-1}} + \hat{\alpha}_1 \frac{\Delta S_{i,t}}{TA_{i,t-1}} + \hat{\alpha}_2 \frac{PPA_{i,t}}{TA_{i,t-1}} + \hat{\alpha}_3 ROA_{i,t} \quad (3)$$

The total discretionary accruals is estimated for each year:

$$DA_{i,t} = \frac{TACC_{i,t}}{TA_{i,t-1}} - NDA_{i,t} \quad (4)$$

$NDA_{i,t}$: non-discretionary accruals

$DA_{i,t}$: discretionary accruals

According to the study done by (Chen & All, 2011) we use the absolute value of discretionary accruals as a benchmark of the financial reporting quality. Then, the absolute value of discretionary accruals is multiplied by -1, so higher values for this amount indicates a higher quality of financial reporting. Measuring competition between block holders (Block holders and institutional shareholders): (BHCOMP)

Herfindahl index was used to calculate the concentration of block holder's ownership. Herfindahl index of Hirschman is an economic index, which is used to measure the degree of monopoly in the market. So the percentage shares of each of the block holders (total shares held by each shareholder K in the company i in year t, is divided on the total shares issued by company i in year t) is squared and then added together. The result is between zero and one, the more it is close to 1 the more focused are the shareholders and vice versa.

$$BHCOMP_{i,t} = -1 * \sum_{K=1}^N \left(\frac{Block_{K,i,t}}{Block_{i,t}} \right)^2$$

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$k = Block_{k,i,t}$ is the number of block holders in the I and time t.

$-Block_{i,t}$ is the total number of shares at the time t.

N is the total number of shareholders, for example Herfindahl index of concentration of ownership of block holders multiplied by -1. If the value obtained is higher than 1 then it indicates that there is competition between block holders.

Other control variables:

SIZE (size of the company): the natural logarithm value of the company is used at the end of the period.

ROA: Earnings before Extraordinary Items divided by total assets.

REVOL (Income fluctuations): standard deviation of income since last 5 years.

OCFVOL (liquidity flow fluctuations): standard deviation of operating cash flow since last 5 years.

LEV (power and financial strength): Long-term debt divided by the sum of long-term debt and equity book value.

BTM (book value to market): This criteria has been achieved through the division of book value to market value of the company at the end of the period.

ε : The Company Error

We also delete the effect of time. (Removal of the effect of year), if we eliminate year in which the results are obtained then we can extend the results to other years.

3. HYPOTHESIS TEST RESULTS

This study examined the effect of block holders on the quality of financial reporting of listed companies in Tehran Stock Exchange, the following results were obtained after studying the research model and population variables (listed companies in Tehran Stock Exchange):

- Block holders affect the quality of financial reporting.
- Liquidity also affects the quality of financial reporting.
- Other control variables of research model, such as the ratio of book value to market, return on assets and the size of the company have an impact on the quality of financial reporting but the financial leverage, income fluctuations and cash flow fluctuations do not influence the quality of financial reporting.

Table 1. Results of model estimation through Panel method with fixed effects (dependent variables: tax performance)

variables	Variable coefficient	standard deviation	T Statistics	significance level	Compared to 0.05	Results in the model
<i>BHCOMP</i>	0.000	0.000	0.959	0.037	smaller	Affective
<i>LIQUIDITY</i>	2.26E-07	1.24E-07	1.827	0.006	smaller	Affective
<i>SIZE</i>	-0.035	0.009	-3.680	0.0003	smaller	Affective
<i>ROA</i>	0.027	0.034	0.814	0.041	smaller	Affective
<i>REVOL</i>	-5.38E-09	7.32E-08	-0.073	0.941	Bigger	Not Affective
<i>OCFVOL</i>	-4.97E-09	4.09E-08	-0.121	0.903	Bigger	Not Affective
<i>LEV</i>	0.001	0.001	1.012	0.311	Bigger	Not Affective
Durbin Watson Statistics	2.13	Errors are not correlated in the model it means that Durbin Watson Statistics is in the range of 1.5 to 2.5				
model determination Coefficient	0.86	86% of the changes in the financial reporting quality is expressed by the significant independent variables				
Fisher Statistics	6.19					
significance level	0.000	Part of the research model is confirmed				
By removing control variables REVOL, and OCFVOL and LEV, which do not affect the quality of financial reporting, the coefficient of determination model is obtained 0.08, as a result, 8% of changes in the financial reporting quality is expressed through significant independent variables.						

Given the results obtained and stated in this study, and the results of the base article (Dou & All, 2014), by studying more than 1,500 companies it was found that threatening to remove and resignation of block holders and also the existence of block holders, are effective on the quality of financial reporting. Only the existence of block holders affect financial reporting quality in the listed companies in Tehran Stock Exchange, but according to the study of (Moein Al-Din et al. 2012), which examined the effect of block holders ownership on financial reporting quality of listed companies in Tehran Stock Exchange, the result of research shows that there's no significant relationship between ownership of block holders and financial reporting quality variable.

Recommendations Arose From Research Results

- Auditing Institutions as another regulatory body in this market should increase audit quality of financial reports, so as to guarantee the quality of these reports for user groups, and do their best to validate these reports to practically attract the attentions to these active groups in the market away from sole reliance on the quantity of items in financial reports. Particularly the attention of these groups should be oriented towards the sum of the fixed assets of the company on the origin of financial reporting which itself leads to quality.

4. SUGGESTIONS FOR FUTURE RESEARCH

- The sample for this study consisted of all industries, for further research some certain industries can be emphasized so that the difference impact in industry is controlled on the results.

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