



# Study of the effect of short-term and long-term institutional shareholders on the capital structure of companies listed in the Tehran Stock Exchange

**Keyvan Valipoor Hafshejani<sup>1</sup>, Mojtaba Motalebian Chaleshtori<sup>2\*</sup>, Bahareh Banitalebi Dehkordi<sup>3</sup>**

<sup>1</sup>Post-Graduate Student of Accounting, Islamic Azad University, Shahrekord Branch-Iran.

<sup>2</sup>Department of Accounting, Farsan Branch, Payame Noor University, Chaharmahal va Bakhtiari, Iran.

<sup>3</sup>Faculty member of Department Accounting, Islamic Azad University, Shahrekord Branch, Iran

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## ABSTRACT

**Objective:** Managers when making decisions regarding capital structure, look for a way of financing so that it can add to the company's value. Many researches have been done and different theories have been emerged to explain the best model to justify the formed capital structure. It is expected that institutional shareholders, because of their supervisory mechanism, affect decisions regarding the financing and somewhat decrease problems of representativeness; therefore, the aim of this study was to investigate the effect of short-term and long-term institutional shareholders on the capital structure. **Methodology:** In this regard, the level of financial leverage was used to examine changes in the capital structure. In order to analyze data, multiple linear regressions in the panel data were used. For this purpose, financial information of 98 listed companies in the Tehran Stock Exchange during the years 2010 to 2014 was collected. **Results:** The results suggested a positive and significant effect of the percentage of short-term institutional shareholders on financial leverage. **Conclusion:** Moreover, the percentage of long-term institutional shareholders had a significantly negative impact on the company's financial leverage.

## 1. Introduction

Corporate governance is a set of rules and practices governing the relations of managers, shareholders, and company auditors which protect the rights of shareholders by applying a monitoring system. Given that today's organizations stress the separation of ownership from management in order to reduce conflicts of interest between shareholders and management, by increasing the number of stakeholders, especially major ones, conflicts of interest between shareholders and managers increase to the extent that it can endanger the supervision and control over the management performance. Given that there are major shareholders in the ownership board of most listed companies in the Stock Exchange who are more capable of exerting control and supervision compared to minor shareholders according to the corporate governance theory, it seems necessary to study the effect of institutional ownership structure on the capital structure (Huating and Lian, 2016).

The ownership structure of companies means the combination of shareholders. This means that different types of shareholders (institutional and private shareholders) can make different ownership structures each of which may have different impact on fiscal policies and capital structure (Brailsford et al., 2000). Combining companies' ownership structures and division of companies' ownership between minor and major shareholders along with division companies' owners between different real and institutional groups such as the government, banks, financial and investment institutions and other companies control all have different regulatory and supervisory effects on the companies' performances.

The main objective of capital structure decisions is to create the right combination of long-term sources of funds in order to minimize the cost of the company's capital and thereby, maximize the market value of the company. This combination is called optimal capital structure. The capital structure is determined by several factors and measuring all such factors affecting capital structure is not possible. Modigliani and Miller (1958) first began the issue

\* Corresponding author: [accmojtaba1367@yahoo.com](mailto:accmojtaba1367@yahoo.com)

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of capital structure in their studies. They believed that there was no difference between financing through shareholders equity and debt with regard to the company's value. As a result, various methods of financing do not bring extra value to the company, and therefore, there is no limit in any way for the manager; however, subsequent empirical evidence revealed that this claim did not exist in practice. Accordingly, there is a lot of research in the field of financing companies which attempts to explain that the capital structure affects the value of the company. On the other hand, institutional investors have considerable experience in the collection and interpretation of data on the company performance. Agency theory suggests that the optimal capital structure and ownership structure could reduce agency costs. Hence, it is predicted that there is a relationship between the structure of ownership and capital structure. Tsai and Gu (2007) showed that potential institutional investors always seek to invest in companies that have less financial leverage. Previous studies showed a relationship between financial leverage and the company's performance. Moreover, some research suggested that a relationship exists between the institutional structure and performance; accordingly, the purpose of this study is to investigate the influence of institutional shareholders on the capital structure. Long-term institutional investors are divided into two categories of long-term (active) and short-term (passive). Since short-term institutional shareholders have trading strategies and focus current performances, they do not have a great incentive to monitor management and to have a representative on the boards of managers of such companies; the reason is that the interests of such supervision are not earned in the short term. In contrast, long-term institutional shareholders focus on long-term performance, and thus, have great incentive to have representative on the boards of managers of investee companies (Ahmad Pur et al., 2010). In this regard, the capital structure decisions are among the most important decisions and therefore, it is expected that long-term institutional shareholders have a greater impact on the capital structure than short-term institutional shareholders.

### ***1 Theoretical foundations and the study background***

The impact of ownership structure on the performance and companies returns is a complex and multidimensional issue. Therefore, variety of conflicts of interest between individuals and groups can be expected, among which are conflicts of interest between owners, managers, shareholders and creditors, real and legal shareholders, internal and external stakeholders, etc. However, one of the most important aspects of agency theory is related to the inconsistency of interests between managers and shareholders, which is the main theme in most studies in the field. According to experts, investors should always apply effective and careful monitoring on management and always try to prevent conflicts in goals and deviation in managers' efforts to occur (Pushner, 1993).

Ownership structure is an important issue of corporate governance as it affects the motivation of managers and thus, is influential in the performance of each company. In recent years, many cases of conflict of interest between groups and ways companies encounter such conflicts have been discussed under the title of "agency theory". The basic question that arises in this context is whether the difference in companies' ownership structures influences their performance and value? And if so, which of different combinations of ownership is more effective in improving performance and increasing the company's value and shareholders' wealth? An increasingly important external control mechanism affecting corporate governance is the emergence of institutional investors as owners of capital. Institutional shareholders have the potential to influence managers' practices directly through ownership and indirectly through the exchange of their shares. Indirect effect of institutional shareholders can be very strong.

Researchers such as Elyasiani and Jia (2010), and Cornet et al. (2007) divided institutional investors into two groups of pressure-sensitive (long-term) and non-pressure sensitive (short-term). In this regard, the pressure-sensitive institutional investors are those who are less willing to challenge management; therefore, the idea seems to be that this type of institutional shareholders are more in line with the convergence of interests hypothesis. Other group of institutional investors is the one insensitive to pressure who has a greater incentive to monitor management. This group of institutional shareholders is more in line with efficient monitoring hypothesis (Elyasiani and Jia, 2010).

Since the various forms of financing have impact on the capital structure and cost of capital rate, and also these decisions are under the effect of the type of ownership structure and governance system, it is necessary to show the impact of ownership structure on the capital structure.

Financial leverage and the use of debt in the capital structure are both influential on risk; thus, it can be concluded that the financial leverage affects investors' decisions. In support of this, the research results of Guney et al. (2011), showed that any increase in earnings before deduction of interest in companies with more debts and bonds in their capital structure, i.e., greater financial leverage, compared with firms with less debts is, i.e., smaller financial leverage, has less impact on the stock price and the decisions of investors. Dhingra and Dev (2016), in a study entitled "determinants of capital structure: a case study of the India oil industry" investigated the effect of accounting variables including financial strength, profitability in the long run, tangibility of assets and properties, and business risk on capital structure of listed oil companies in the India National Stock Exchange. For this purpose, financial leverage as the dependent variable and other accounting variables as independent variables are considered. The collectively analyzed data of 10 companies from the beginning of April, 2006 up to the end of March, 2015 were used. The obtained results showed that accounting variables such as financial potential has a direct connection with financial leverage and other variables have a reverse correlation with the dependent variable. It was also found that, regardless of whether companies belong to a joint industry, they use different strategies for the formation of capital structure.

Tharmalingam and Weerakoom (2016) in a study entitled "determinants of capital structure of the top companies in Sri Lanka" investigated the determinants of capital structure of the 55 top companies in the Colombo Exchange, Sri Lanka's capital. According to group data analysis during 2003 to 2012, the profitability has a significant inverse relationship with the practice of financing for investment while the size and growth of the company reflect significant direct relationship with financing for investment. Non-debt tax shields and the tangibility of assets have a non-significant relationship with this action. The results of this study show that there exist strong documents and evidence in support of the hierarchical theory for these companies in terms of the profitability variable, and also the company's growth variable is also strongly supportive of the hierarchical theory.

Revathy and Santhi (2016), in a study entitled "effect of capital structure on the profitability of manufacturing companies in India" studied the effects of capital structure on profitability of manufacturing companies in India and tried to investigate the extent variables related to capital structure influence business revenues and earnings of companies and the interrelation between the variable related to capital structure and profitability. In this study, a sample of 70 companies was selected by multistage sampling techniques. The results show a strong one to one relationship between the capital structure variable and profitability. The results also revealed that an increase in the debt-to-equity ratio adversely affected the profitability of the listed manufacturing companies in the Bombay Stock Exchange in India.

Ben Said (2016), in a study entitled "factors explaining the investment decision: an international comparison" assessed the determinants of the decision related to the company's investment. The study analyzed four countries which included Maldives, Romania, Russia, and Serbia. The target sample consisted of 170 companies for each country over a period of 8 years from 2003 to 2010. Using data and information panels, the empirical results obtained in this study showed that profitability positively and significantly influenced the company's investments for the markets of Maldives and Romania under two alternative solutions as well as for the markets of other countries under a characteristic and feature. However, the positive effect of financial assets was only seen for companies in Maldives and Serbia. In fact, profitability in a positive significant manner is indicative of the company's investment for real and service capital sectors. This result was also found for other countries in these two sectors. In contrast, for Russia, increase in profitability for the mining sector and agricultural companies did not encourage managers for greater investment.

Al-Najjar and Taylor (2008), in a study examined the relationship between ownership structure and capital structure for the sample of companies listed in the Jordan Stock Exchange. Their research results showed no negative and significant correlation between the capital structure and institutional investors. They stated that an external control mechanism affecting corporate governance is the emergence of institutional investors as owners of capital. Institutional investors monitor the company implicitly by collecting information and pricing the management's decisions and explicitly by directing the company's performance. In addition, according to their findings, liquidity, size, and structure of assets have a significant positive correlation and profitability a significant negative relationship with the indebtedness of the Jordan companies.

Mohseni Maleki et al. (2015), in a study entitled "financial flexibility and speed of capital structure adjustment" examined the role of financial flexibility in quick adjustment of financial leverage in companies. For this purpose, from among the companies listed in the Tehran Stock Exchange, 108 companies were selected and their financial information relating to the years 2003 to 2013 was examined. The results indicated that for companies above the optimal leverage, financial flexibility is not a determining factor for speed of leverage adjustment in these types of companies; however, a significant positive correlation with the speed for leverage adjustment was obtained for companies below the optimal leverage.

Khajavi et al. (2014), in a study entitled "examining the relationship between capital structure, ownership structure, and performance using data envelopment analysis approach" investigated effects of the relationship between capital structure, ownership structure, and companies' performances. This study tries to answer the following question: do the capital structure and the extent of focus of companies' ownership have any impact on their performance? The study population consisted of 128 companies listed in the Tehran Stock Exchange within the period 2007 to 2009. The multivariate linear regression analysis was used to test the hypotheses. The results of the study indicate that capital structure (debt ratio) and ownership structure (ownership concentration) in companies have significant positive effects on their performance. The result also showed that the level of companies' performance has a significant positive impact on determining their capital structure.

Fathi et al. (2014), in a study entitled "meta-analysis of the determinants of the capital structure at the corporate level" investigated to determine the best combination of capital structure using a meta-analysis approach. For this purpose, the results of statistical analysis of 127 studies in this area during the years 1990 to 2013 were used. The findings of this study indicate that, size, asset structure, growth opportunities, profitability, liquidity and volatility play crucial roles in deciding capital structure. In addition, the factors examined in this study in countries with different degrees of development and at different times have various impacts on capital structure.

Asadi et al. (2014), in a study entitled "financial and non-financial factors affecting capital structure decisions" examined financial and non-financial factors affecting capital structure decisions in companies listed in the Tehran Stock Exchange. To this end, a total of 74 companies eligible to be included in the research during the years 2005 to 2010 were investigated as the study population. The results suggest that, despite different leverage forms and definitions in the sample companies, in all cases, significant negative correlation between capital returns and the company's leverage, and a significant positive correlation between the size of company and the company's leverage had been observed.

Moin-ud-Din et al. (2014), conducted a study entitled "study of the impact of corporate governance system on the relationship between capital structure and company's value using the structural equation modeling approach in companies listed in the Tehran Stock Exchange". Ownership percentages of board members and an institutional shareholder, the proportion of non-bound managers in the board of managers, duality of CEO responsibility, board size, and existence of both the internal and independent auditor were among the corporate governance mechanisms taken into account in this study. Capital structure also includes ratio of short-term debts to market value of shareholders' equity, ratio of long-term debts to market value of shareholders' equity, ratio of short-term debts to book value of shareholders' equity, and ratio of long-term debts to book value of shareholders' equity. The company's value is measured by Tobin's Q ratio. The findings suggest that corporate governance does not play the role of mediator in the relationship between capital structure and company's value, but there is a significant relationship between corporate governance with company's value and capital structure.

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## 2. Materials and methods

### 2.1 Research hypotheses

According to the theoretical foundation of the study, hypotheses are formed as follows:

H1: the short-term institutional shareholders do not influence the company's financial leverage.

H2: the long-term institutional shareholders influence the company's financial leverage.

### 2.2 Method

This research is practical-empirical in terms of purpose since the results can directly be used by different individuals. The research is also descriptive-correlational in nature as it examines the status quo on the one hand, and attempts to explore the correlation between the study variables through regression analysis using panel data on the other. Moreover, the study is of inductive type, and also ex post facto in terms of time since the data are obtained from past events without direct involvement of the researcher.

### 2.2.1 Defining and measuring the study variables

The dependent variable in this study is capital structure (LEV), for measuring of which the market leverage ratio is used as in the equation (1), according to the research by Gooney et al. (2011).

Equation (1)

$$LEV_{i,t} = \frac{D_{i,t}}{D_{i,t} + S_{i,t} P_{i,t}} \quad (1)$$

where  $LEV_{i,t}$  is the market leverage of the company  $i$  in the year  $t$ ,  $D_{i,t}$  is the book value of the company  $i$ 's debts in the year  $t$ ,  $S_{i,t}$  is the number of shares of the company  $i$  in the year  $t$ , and  $P_{i,t}$  is the market price per share of the company  $i$  in the year  $t$ .

The independent variables in this study include short-term and long-term institutional shareholders for measuring of which the research by Ahmed Pur et al. (2010), has been used as follows:

The total percentage of institutional shareholders of the company  $i$  used to investigate the effect of short-term institutional shareholders (SHTIS)

The total square percentage of institutional shareholders of the company  $i$  used to study the effects of long-term institutional shareholders (LTIS)

In this study, the institutional nature of shareholders has been determined based on the Iran's Accounting Standard No. 18 and Statement No. 20 of the Accounting Principles Board. Based on the aforementioned statements, "direct or indirect investment in at least 20% of the shares with voting rights of the investee unit leads to significant influence in the investee unit unless the contrary is proved" (Hashemi and Bekrany, 2011).

In order to better clarify regression models according to the literature, a set of control variables were used as follows: the company's size which equals the natural logarithm of total assets of the company  $i$ , ratio of book value to market value of shareholders' equity (BTM), ratio of tangible fixed assets (TANG) which equals tangible fixed assets divided by the company's total assets, sales growth (SG) which equals the natural logarithm of total sales, revenue fluctuations ( $\Delta EPS$ ) which equals the actual EPS at the end of the year minus the predicted EPS in the beginning of the year.

### 2.3 Statistical models and methods to test the hypotheses

In this study, both descriptive and inferential analyses of the data have been conducted. At the descriptive level, using statistical characteristics such as frequency, median, mean, standard deviation, and maximum and minimum general characteristics of the society have been described. At the inferential level, for data analysis and hypothesis testing, multivariate regression models were used as follows:

$$Lev_{i,t} = \beta_0 + \beta_1 SHTIS + \beta_2 LTIS + \beta_3 Size + \beta_4 MTB + \beta_5 Tang + \beta_6 SG + \beta_7 EPS + \varepsilon_i \quad (2)$$

The measurement method of the variables of the above model has been described in the previous section. In the method of the combined data, F Limer test (Chow) is used to choose between panel and pooling (collation) data. Moreover, in case of selecting panel data, Hausman test is used to choose between random-effects and fixed-effects methods. In addition, prior to deciding on the results of testing the hypotheses, regression assumptions and other assumptions about the data must be established. Accordingly in this study, to investigate the serial autocorrelation of the error terms, the Wooldridge test was used and to assess the variance inconsistency of the error terms, the adjusted Wald test in the STATA software was used. Finally, to test the first and second research hypotheses, the significance of coefficients  $\beta_1$  and  $\beta_2$  was evaluated through t test via the EvIEWS software, respectively. Further, in order to evaluate the validity of the whole model, the significant level of F test and the adjusted coefficient of determination (Adj R2) were examined.

### 2.4 The population and sample selection

The population of this research was companies listed in the Tehran Stock Exchange. The sampling method was systematic elimination method. Therefore, companies with the following conditions were chosen as the samples and those companies without these conditions were removed from the sample. These conditions are as follows:

For the comparability of the data, companies' fiscal year should end in March.

In the period of the study, their shares are traded at least every three months.

Except for investment companies, financial intermediaries and leasing must be excluded.

During the period under review, companies' fiscal year should not be changed.

All the variables required for the research should be accessible.

According to the conditions and limitations above, from among the listed companies in the Tehran Stock Exchange, a total of 98 companies were selected. The study was conducted between the years 2010 to 2014. Moreover, theoretical foundations for the study were obtained using the library method. To this end, bibliography information for the research was collected by using books and articles in libraries of universities. Moreover, document mining was used to gather the information needed to calculate the variables of the research. In this regard, for the collection of required data, the financial statements of companies listed in the Tehran Stock Exchange have been used. Information published by the Tehran Stock Exchange (Codal website), Rahavard Novin information software, and other related internet resources are among the data collection tools in this study.

## 3. Discussion and results

### 3.1 Research findings

To provide an overview of important characteristics of the calculated variables, some of the concepts of descriptive statistics of these variables, including mean, median, maximum, minimum, and standard deviation are reflected in Table 1.

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

	size	TANG	SHTIS	MTB	LTIS	LEV	GROWTH	ΔEPS
Mean	13.740	0.238111	.25	916348	.0949	4.315039	5.672993	960.1
Maximum	18.775	0.893277	.99	1964482	.980	158.1719	193.0315	9276.4
Minimum	10.22687	0.003789	0.00	13985.	.00	0.002776	0.110548	-1520.89
Std. Dev.	1.2471	0.173722	.18	1233646	.41	13.66032	18.6391	1429.0

For example, the mean of the variable SHTIS show that the average institutional ownership in the selected companies is about 25 percent. Among the variables of the study, ΔEPS and TANG have the highest and lowest standard deviation, respectively.

The results of the F Limer (Chow) and Hausman tests for the research hypothesis are provided in the table (2):

**Table 2. Results of the F Limer (Chow) and Hausman tests**

Hausman test		F Limer (Chow) test		Research model
p-value	Chi-Sq. Statistic	p-value	F	
0.6632	4.973	0.000	2.84	Main model

Significance level (p-value) of the F Limer test is less than 5 percent for the model and confirms panel data. Moreover, the significant level of the Hausman test is more than 5% for the model which expresses random effects of the intercept.

As mentioned earlier, prior to estimating the research models, underlying regression assumptions should be examined. The results of the adjusted Wald for the model showed that the significant probability of this test is more than 5% and thus, the assumption of the homogeneity of variance of the error terms is accepted. In addition, the Wooldridge test results showed that the significance level of the test was more than 5% and thus, there is no serial correlation in the error terms of the model.

### 3.2 The results of testing the research hypotheses

The results of testing the research hypotheses are presented as in Table 3:

As is clear from the results of the table, the significance level of t-statistic of the SHTIS variable is less than 5% and therefore, the first hypothesis is confirmed. In addition, the coefficient for this variable is positive, i.e., by increasing the ownership percentage of short term institutional shareholders, the financial leverage level increases. Moreover, the significance level of the LTIS variable is less than 5% and therefore, the second hypothesis is confirmed. Since the estimated coefficient for this variable is negative, an increase in ownership percentage of long-term institutional shareholders causes the company's financial leverage to decrease.

**Table 3. Analysis of the hypothesis**

$$Lev_{i,t} = \beta_0 + \beta_1 SHTIS + \beta_2 LTIS + \beta_3 Size + \beta_4 MTB + \beta_5 Tang + \beta_6 SG + \beta_7 \Delta EPS + \varepsilon_t$$

Dependent Variable: LEV

Total panel (balanced) observations: 490

Cross-sections included: 98

Periods included: 5

Prob.	t-Statistic	Std. Error	Coefficient	Variable
0.0000	4.105569	0.008030	0.032970	SHTIS
0.0028	-3.009671	7.72E-05	-0.000232	LTIS
0.0000	8.544369	0.203728	1.740727	SIZE
0.8256	0.220522	0.697442	0.153801	TANG
0.0008	-3.380980	0.001416	-0.004788	GROWTH
0.0136	-2.475554	3.94E-05	-9.76E-05	ΔEPS
0.1419	1.471016	1.94E-08	2.85E-08	MB_IT
0.0000	-8.321412	2.756323	-22.93650	C
4.315039	Mean dependent var		0.228583	R-squared
7.983992	S.D. dependent var		0.217380	Adjusted R-squared
28255.45	Sum squared resid		7.656453	S.E. of regression

1.810825	Durbin-Watson stat	20.40344	F-statistic
		0.000000	Prob(F-statistic)

The significant level of all the control variables other than the variables TANG and MB is less than 5%, thus controlling these variables except for the two mentioned variables is essential in the research. The adjusted coefficient of determination of the model is 0/21, showing that 21 percent of changes of the dependent variable is explained by the independent variables. According to the probability obtained for the F statistic which is equal to zero ( $p\text{-value} \leq 0.05$ ), the  $H_0$  hypothesis is rejected, and this shows that all the regression coefficients are not zero simultaneously; thus, there is a simultaneous significant relationship between all the independent variables and the dependent variable, and the value of the regression F also indicates explanation power of the model; thus, the reliability of the model is confirmed. Moreover, Durbin-Watson statistic also indicates the lack of autocorrelation between the model conflicting components since its value is between 5/1 is 5/2.

## 4. Conclusion

### 4.1 Conclusion and recommendations

In the competitive environment of capital market, competitors look for ways to increase efficiency. One of the problems decreasing the company's value is agency costs; therefore, identifying the factors reducing such costs is important. In this regard, the present study investigated the effect of short-term and long-term institutional ownership on capital structure as a mechanism to resolve agency issues. To solve this issue, Jensen (1986) stated that the use of debt can cause free cash flows to be created and agency problems to be resolved. The first hypothesis results suggest a positive and significant effect of short-term institutional shareholders on the company's financial leverage. With regard to the theoretical foundations of the research, it could be stated that monitoring of institutional shareholders in the short term causes them to be only interested in making profits in the short term and thus, they are even less tolerant than the company's creditors. As a result, shortage of liquidity in companies makes them create liquidity by financing through different ways to pay dividends, which therefore heightens the company's financial leverage. The results of this hypothesis were consistent with the results of the studies by Godfrey et al. (2009), and Hashemi and Bekrany (2011). Moreover, regarding the second hypothesis denoting significant negative impact of long-term institutional shareholders on financial leverage, the results suggest that in companies with long-term institutional shareholders, they usually keep their shares in investee companies in the long run and have representatives in board of managers. They usually attempt not to have leveraged companies as far as possible (runs hierarchical theory of financing) and reduce the risk of bankruptcy. In other words, they concern survival and profitability of the company in the long run. Thus, in these companies, the level of financial leverage is lower. The results of the research hypothesis are in line with the studies by Ahmed Pur et al. (2010) and Sun et al. (2015). Finally, the study data remained unadjusted in terms of inflation and thus, one must be cautious in generalizing the results. It is also recommended that future studies investigate the effect of managerial, family, and state ownership on the capital structure.

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