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Earnings Quality and Government Influence: A Review of Political Economy Theory

Mohsen Imeni^{1*} , Sogand Tayebinaz² 

¹ Department of Accounting, Ayandegan Institute of Higher Education, Tonekabon, Iran; imeni@aihe.ac.ir.

² PhD Candidate, Belk College of Business, University of North Carolina at Charlotte, USA; stayebin@charlotte.edu.

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Abstract


This study examines the impact of justice shares, a state-sponsored ownership transfer intended to redistribute income, on the earnings quality of firms listed on the Tehran Stock Exchange (TSE) from 2013 to 2022. Drawing on a political economy perspective, it investigates how populist state ownership and political influence affect financial reporting in weak governance environments. Using a panel dataset of 1,150 firm-year observations, the analysis employs multivariate fixed-effects regression models to assess the relationship between the share ownership and earnings quality. To ensure robustness, two alternative proxies, income smoothness and Earnings Predictability (EP), are used along with the primary earnings quality metric. The theoretical framework draws on recent studies of real versus accrual-based earnings management and the trade-offs firms face under political insulation. The results reveal a significant negative association between the share of ownership held by justice and earnings quality, suggesting that politically motivated ownership structures incentivize earnings management. These findings align with recent evidence from China and other emerging markets showing that government-controlled firms often prioritize social or political objectives over transparency. In contrast to studies from Vietnam and Indonesia that highlight governance-enhancing effects of certain ownership forms, our results underscore the destabilizing role of populist state interventions in financial reporting. This study contributes to the growing literature on political economy and accounting by empirically testing the consequences of state-led populism on corporate earnings quality. It introduces the concept of publicness as a lens to interpret how hybrid state-market control, exemplified by Iran's Justice Shares program, can compromise financial accountability. In contrast to emerging-market studies suggesting that board diversity or Institutional Ownership (INSOWN) can mitigate earnings manipulation, our study shows that politically embedded ownership models are resistant to such corrective mechanisms. It is one of the first studies to empirically investigate the intersection of earnings quality, state ownership, and political influence in the context of an emerging Middle Eastern economy.

Keywords: Earnings quality, Political economy, State ownership, Populism, Justice shares, Government intervention.

1 | Introduction

Political economy explores the interplay between political institutions and economic outcomes [1]. In this context, government intervention in corporate activity, whether through regulation, ownership, or informal

 Corresponding Author: imeni@aihe.ac.ir

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influence, can significantly shape firm behavior, especially in emerging markets. Prior research has shown that politically connected firms often benefit from preferential treatment, including tax breaks, easier access to capital, and favorable IPO conditions [2], [3]. While such connections may compensate for market imperfections, they also risk distorting market mechanisms and compromising firm-level transparency and accountability [4], [5].

Recent studies from emerging economies have further complicated this narrative. In Vietnam, for instance, Tran and Dang [6] find that state ownership can reduce earnings management, suggesting that the effect of government control depends heavily on institutional design and incentive alignment. In contrast, Ruggiero et al. [7], studying Italian State-Owned Enterprises (SOEs), argue that "publicness", a condition marked by state ownership, goal ambiguity, and political interference, consistently weakens financial accountability. These divergent findings highlight the need for contextual analysis when evaluating the state's role in financial reporting.

In developing economies such as Iran, where state presence remains dominant in key industries despite ongoing privatization efforts, political influence over firm operations remains pronounced [8], [9]. A noteworthy example of such influence is the "Justice Shares" program, a populist initiative launched in 2006 to redistribute shares of large SOEs to low-income citizens. Although intended to promote economic inclusion, this policy introduced a new layer of state involvement by requiring firms to align with governmental social objectives. The consequences for firm transparency and governance remain underexplored, particularly within the broader MENA context [10].

Under the Justice Shares scheme, firms were expected to generate sufficient profits to subsidize the state's installment repayment plan for share recipients, often leading to pressure on executives to overstate earnings or prioritize government mandates over market signals [11]. This type of political interference can compromise earnings quality by incentivizing short-term income smoothing or accrual manipulation. Kustono et al. [12], examining Indonesian firms, show that income smoothing may not always signal opportunism; it can reflect efficient communication in well-governed environments. However, in politically influenced firms lacking independent oversight, such practices are more likely to erode financial transparency.

Moreover, the ability of governance mechanisms to moderate the effects of earnings management appears limited under state-populist regimes. Islam et al. [13] show that poor earnings quality undermines financial flexibility in Chinese firms, particularly where governance systems are weak. Similarly, Han et al. [14] find that foreign ownership enhances earnings quality through transparency, though its impact is diminished in SOEs due to entrenched political influence. These insights suggest that populist ownership models, like Iran's Justice Shares, operate in a governance vacuum that amplifies the negative effects of political control on earnings quality. It is consistent with Rezaee and Safarzadeh [15], who demonstrate that governance effectiveness in emerging markets must be interpreted through behavioral lenses that account for bounded rationality and institutional norms.

This study investigates whether the Justice Shares program undermines the earnings quality of publicly listed firms in Iran. By analyzing firms listed on the Tehran Stock Exchange (TSE) between 2013 and 2022, this paper contributes to ongoing debates about the impact of political influence on financial transparency in emerging markets. In contrast to earlier studies that focused on performance outcomes, this research centers on how populist economic policies affect accounting choices and earnings management behavior. In doing so, we build on recent studies demonstrating that government control impairs financial statement comparability [16] and that political disentanglement improves earnings quality [17]. The remainder of the paper is structured as follows: Section 2 provides historical background and develops the study's hypothesis. Section 3 outlines the research methodology and variables. Section 4 presents the empirical models. Section 5 discusses the results and robustness checks. Section 6 concludes with implications and recommendations.

2 | Background and Hypotheses Development

2.1 | Background

Following the 1979 Islamic Revolution, the new regime emphasized economic justice and promised to reduce inequality through wealth redistribution. In practice, this translated into widespread nationalization of banks, insurance firms, and large industrial enterprises. But the outbreak of the Iran-Iraq War soon after shifted priorities and delayed these redistributive efforts. Over the next few decades, reconstruction programs and intermittent privatization initiatives failed to reduce inequality or improve efficiency meaningfully. Instead, many sectors remained under state control, reinforcing a political economy defined by centralized ownership and weak market discipline [18].

In this context, the Justice Shares program, launched in 2006 by President Mahmoud Ahmadinejad, represented a populist effort to simultaneously privatize and redistribute wealth. Under this initiative, partial ownership of large SOEs in sectors such as energy, telecommunications, banking, and steel was transferred to nearly half of the Iranian population. Shares, nominally valued at 10 million Rials (around \$1,000), were distributed through a deferred-payment model supported by expected dividend flows [11]. Promoted as a strategy to broaden economic inclusion and empower disadvantaged households, Justice Shares became one of the region's most ambitious state-led ownership transfer schemes.

But rather than expanding private ownership in any meaningful sense, the program introduced a complex layer of state-influenced ownership that exacerbated governance and accountability concerns. Beneficiary shareholders were largely excluded from exercising their rights, including voting and dividend collection, due to structural opacity and centralized control. At the same time, managers of Justice Share firms faced dual obligations: to pursue commercial goals while aligning with state-mandated objectives such as politically determined employment, subsidized pricing, or populist fiscal targets. This duality created pressures for income inflation and undermined the credibility of financial reporting, a dynamic that was consistent with Gong and Choi's [19] findings on SOEs in China. Similarly, Gerged et al. [20] show that in Jordanian firms, governance structures moderate the link between disclosure and earnings management, but such mechanisms are often weak or absent in MENA contexts.

This finding aligns with other studies on the impact of political involvement on earnings quality. For example, Ruggiero et al. [7] discuss the concept of publicness, which refers to situations in which state ownership, political interference, and unclear organizational goals converge. In their study on Italian state-owned firms, they find that these conditions often lead to more earnings manipulation, mainly because accountability is weakened and market performance becomes a secondary concern. A similar logic applies to Iran's Justice Shares structure, which embeds political objectives into firm operations and opens the door for managers to adjust earnings in ways that serve those goals [16].

At the same time, comparative studies suggest that the consequences of state ownership are not uniformly negative. For instance, Tran and Dang [6] find that in Vietnam, state ownership can actually reduce earnings management when paired with institutional oversight mechanisms. Similarly, Kustono et al. [12] argue that income smoothing, often viewed as a sign of manipulation, may enhance earnings quality when used to communicate long-term profitability in well-governed environments. These studies highlight the critical role of governance structures in determining whether state influence is stabilizing or distorting [19].

In systems with robust external oversight, ownership forms such as foreign institutional investment can mitigate managerial opportunism. Han et al. [14] studying Chinese firms, find that foreign ownership significantly curbs earnings management through enhanced transparency and monitoring, but this effect weakens in SOEs due to entrenched government control. Iran's Justice Shares structure shares this weakness: while framed as citizen ownership, it lacks true market discipline or external governance enforcement [15], [17].

The impact of low earnings quality goes far beyond a lack of transparency. Islam et al. [13] show that when financial reports can't be trusted, firms lose flexibility in how they fund operations, both internally and externally. For companies in emerging markets, this often means tighter liquidity, limited long-term planning, and slower responses during crises. These challenges are even more serious for firms operating under hybrid or populist ownership structures, where the boundaries between commercial decision-making and political pressure are often blurred.

The Justice Shares program is a clear example of how politically motivated state ownership can deepen this problem. Unlike models of state capitalism that tie control to performance or technocratic oversight, the Justice Shares structure offers few checks and balances. This paper examines whether, and to what extent, this type of ownership affects earnings quality in Iran, offering new insights into how political agendas shape corporate governance and financial reporting in emerging markets.

2.2 | Hypotheses Development

Earnings quality reflects the extent to which reported earnings truthfully represent a firm's economic performance. High-quality earnings are typically persistent, predictive of future outcomes, and minimally distorted by managerial discretion or opportunistic accruals [21], [22]. However, political intervention, whether through direct ownership, coercive regulation, or populist mandates, can reshape managerial incentives in ways that undermine the integrity of financial reporting [16], [23], [24].

A substantial body of research has documented that state-owned or politically connected firms are more susceptible to earnings manipulation. These firms are often tasked with advancing socio-political goals such as maintaining employment, achieving politically driven profitability benchmarks, or fulfilling redistributive obligations [25], [26]. To meet these aims, managers may overstate profits or defer losses, reducing the informativeness and reliability of reported earnings [27–29]. Hope et al. [17] provide compelling evidence that removing politically connected directors can improve earnings quality, further supporting the notion that political entrenchment undermines financial transparency.

A good example of this dynamic is Iran's Justice Shares program. While the program was supposed to promote social equity by giving shares to low-income citizens, in practice, it kept control in the hands of the state. It gave new shareholders almost no real decision-making power. As Mehrani et al. [30] show, only active institutional investors enhance earnings quality, while passive or politically motivated ownership arrangements tend to weaken it. In the case of Justice Shares, the state's indirect presence continues to shape firm behavior, despite the appearance of privatization.

Recent international evidence reinforces this concern. Han et al. [14] find that foreign ownership in Chinese firms reduces earnings management through better external monitoring, but this disciplinary effect vanishes in SOEs, where political ties insulate managers. Similarly, Islam et al. [13] demonstrate that poor earnings quality impairs financial flexibility. This problem hits hardest in firms with weak governance, especially those shaped by populist policies or where investors lack real protections. The nature of earnings management can also be context-dependent. For example, Kustono et al. [12] show that income smoothing in Indonesia can signal efficient communication under well-governed settings. However, in politically motivated ownership structures such as Justice Shares, where transparency is not an institutional priority, income smoothing is more likely to reflect opportunistic behavior aimed at meeting political expectations.

Conceptually, Ruggiero et al. [7] introduce the notion of publicness, a condition where state ownership, political control, and goal ambiguity converge to dilute accountability and increase managerial discretion. Justice Share firms in Iran embody this condition: their financial reporting tends to follow political goals more than business logic, for example, paying out dividends mainly to show the program is working, rather than based on actual firm performance. It is particularly concerning in a MENA context, where governance gaps and state entanglement in business are widespread [10]. Taken together, these theoretical and empirical insights suggest that politically motivated ownership structures, particularly those shaped by populist redistribution, can compromise earnings quality by embedding political objectives into corporate reporting.

These dynamics are especially salient in environments lacking institutional checks, independent oversight, or market discipline [15], [20]. We therefore hypothesize:

H₁: Ceteris paribus, the existence of shares of justice in a firm's ownership structure decreases earnings quality.

3 | Research Method

3.1 | Data Selection

The data were obtained from the Tehran Stock Exchange (TSE) and accounting research databases, and the process of determining the final observations is presented in *Table 1*.

Table 1. Determine the number of observations.

Row	Observations	Description
1	4260	Samples selected before 2013 were listed on the TSE.
2	(905)	In terms of increasing the comparability of its financial period, it will be due in March.
3	(870)	During the years studied, there has been no change in activity or in the fiscal year.
4	(700)	There has been no interruption of more than 3 months in their transactions, and the equity of these companies is not negative.
5	(635)	The number of companies working on holding, investing, and managing funds, etc.
	(3110)	
	1150	Number of final firm-year observations

After deletion, our final sample comprises 1,150 firm-year observations from 2013 to 2022.

3.2 | Dependent Variable

The dependent variable in this research is the earnings quality. This variable is calculated from the residuals of the Kothari et al. [31] model. To calculate the residual values, data on the firms were collected during the research period; calculations were based on industry-year analysis. We use the standard deviation of the regression residuals, as in [32–36]. Therefore, the standard deviation (σ) of five firm-year residuals is used to measure a firm's earnings quality. The Kothari model is as follows:

$$\frac{TA_{it}}{A_{i,t-1}} = a_0 + a_1 \left[\frac{1}{A_{i,t-1}} \right] + a_2 \left[\frac{\Delta REV_{i,t}}{A_{i,t-1}} - \frac{\Delta REC_{i,t}}{A_{i,t-1}} \right] + a_3 \left[\frac{PPE_{i,t}}{A_{i,t-1}} \right] + a_4 \left(\frac{EAR_{i,t}}{A_{i,t-1}} \right) + \varepsilon_{i,t}$$

$A_{i,t-1}$ = total assets at the beginning of year t ; ΔREV_{it} = changes from total revenue of the company's i in year t ; ΔREC_{it} = changes in receivables accounts from a company i in year t ; PPE_{it} = represents the gross amount of plant, property, and equipment of the company i in year t ; EAR_{it} = operating earnings of the company i in year t . TA_{it} denotes total accruals, which is the difference between net income and cash flow from operating (CFO). In this model, the residual values are ε_{it} .

3.3 | Independent variable

The independent variable in this research is the justice shares (DJustice). This variable equals a dummy variable represented by 0 and 1. If there is justice, the share of stockholders in the firm's ownership structure is 1; otherwise, it is 0.

3.4 | Control Variables

3.4.1 | Firm size

Studies have shown that large firms most probably use accounting procedures to reduce earnings relative to small firms [37], [38]. The size and largeness of the firm are indicators of political attention and consideration. Accordingly, the larger the firm, the more managers tend to reduce the firm's earnings to focus on politics and reduce political attention and related costs [39]. In a political process statement, politically sensitive companies are choosing to reduce earnings; therefore, larger firms are less likely to manipulate earnings [40]. Consequently, it can be said that the size of the firm has an inverse relationship with earnings management [41], [42], thereby increasing earnings quality. Overall, it is expected that there will be a positive relationship between firms' size and earnings quality [43], [27].

3.4.2 | Leverage

The relationship between debt financing and the quality of earnings can be positive and negative [44]. In large firms, managers are motivated to accumulate wealth for their shareholders and debt holders [45]. Major shareholders, because of the high level of supervisory costs and fewer benefits, reduce monitoring of managers' activities, while holders of debt securities are required to monitor management's actions. So, companies try to provide high-quality information to lenders [46]. Thus, managers' opponents do not have accurate, high-quality information about their performance, and by reducing information asymmetry [47], lenders will provide a higher level of loans to companies at lower costs. Therefore, there is a positive relationship between debt financing and the quality of earnings.

On the other hand, debt financing can have a negative relationship with the quality of earnings due to the agency conflict between lenders and managers. Based on the hypothesis of debt in positive theory, a high debt-to-capital ratio in firms is likely to lead executives to use accounting procedures to increase earnings [37]. Hence, holders of debt securities will use debt contracts to reduce management ownership [48]. A debt contract with lenders will protect by limiting borrowers' activities (e.g., by providing guarantees, contract termination, or raising interest rates). [48], [49] showed that high leverage to lead increases the management of earnings, thereby reducing the quality of earnings. There is a negative relationship between debt financing and earnings quality. Overall, there is a positive relationship between financial leverage and earnings quality [51] or a negative relationship [52].

3.4.3 | Growth opportunities and firm performance

The value of a firm is a profitability function of its investment [53]. Fairfield et al. [54] argue that firms with high growth opportunities often exhibit sustained growth. They say that ROA has a strong positive correlation with the CFO's accruals proportion. Chan et al. [55] declare that there is a positive relationship between the quality of their earnings and their future performance; Huang et al. [56] also claim that the performance of firms decreases with a decrease in the quality of their earnings. Generally, it's expected that there is a positive relationship between growth opportunities and the profitability of firms with the quality of earnings [27], [57].

3.4.4 | Costs of the agency

There is a general belief that managers may manage earnings for their own benefit, which may not be useful to shareholders and other stakeholders. In this regard, agency theory has been used to distinguish between opportunistic and efficient earnings management. If earnings management is done by managers for opportunistic purposes, then firms with higher agency costs will exhibit greater earnings management. In contrast, the level of earnings management is positively associated with the severity of the agency conflict. In other words, firms with higher earnings quality have lower agency costs, and this relationship is inverse; that is, there is a negative relationship between agency costs and earnings quality [58–60]. Ang et al. [61] reported that the ratio of operating expenses to net sales is a criterion for measuring agency costs, and the lower this ratio, the lower the agency's costs.

3.4.5 | Economic conditions

Economic conditions, as an important factor, will affect companies' financial results. Also, it is assumed that under good economic conditions, managers are less motivated to "manage earnings." In other words, decreased economic growth will reduce the quality of earnings [62]. Results from previous studies show that during years with high GDP growth, earnings quality was high. In other words, earnings reflect a company's economic performance and are also strongly related to its financial situation. Generally, it's expected that there is a positive relationship between the GDP index and the quality of earnings.

4 | Empirical Methodology

4.1 | Regression Models

The Eq. (1) has been used to test the research hypothesis:

$$EQ_{it} = \beta_0 + \beta_1 DJUSTICE_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + \beta_4 STDROA_{it} + \beta_5 GROWTH_{it} + \beta_6 EX/S_{it} + \beta_7 LNGDP_{it} + \varepsilon_{it} \quad (1)$$

where,

EQ = Indicator of the earning quality of the firms resulting from the data error of the Kothari et al. [31] model. The standard deviation (σ) of five firm-specific residuals is used to measure a firm's earnings quality. Djustice equals 1 if the firms are subject to justice shares in their ownership structure; otherwise, it equals 0. The firm size (SIZE) is the natural logarithm of the firm's total book value of assets [63]. Leverage (LEV) is derived from the ratio of total debt to total assets [29]. Asset returns (STDROA) are calculated as the standard deviation of net profit divided by total assets over the previous five years [27]. Assets Growth (Growth) is the total assets growth [27] to examine growth opportunities; firms with above-median number 1, otherwise 0. EX/S is by dividing operating costs by net sales [61]. LnGDP is the natural logarithm of the gross domestic product [27]. The definitions of the variables are given in *Table 2*.

Table 2. Definition of variables.

Variable Symbol	Description
EQ	The residuals from the industry-year regression model of Kothari et al. [31] are used to proxy for discretionary accruals. We use the standard deviation (σ) of five firm-specific residuals to measure a firm's earnings quality.
SMOOTH	To calculate income smoothing, the ratio σ (Earnings from operations) / σ (Cash flows from operations) is used.
EP	$E_{i,t} = \beta_0 + \beta_1 E_{i,t-1} + \varepsilon_{i,t}$ The standard deviation of the error values indicates the quality of earnings.
DJustice	DJustice is a dummy variable that equals 1 if a firm year has Justice Share's ownership and 0 otherwise.
SIZE	The natural logarithm of total assets.
LEV	The ratio of long-term debts to total assets.
STDROA	The standard deviation of the ratio of net income to total assets over five years.

Table 2. Continued.

Variable Symbol	Description
GROWTH	Asset Growth is total asset growth. Firms that are with above-median number 1, otherwise 0.
EX/S	The Costs of the Agency to calculate the operating cost by dividing net sales.
LnGDP	is the natural logarithm of the Gross Domestic Product (GDP)
INSOWN	INSOWN is the percentage of shares outstanding owned by institutions that hold at least 5% of equity shares.
OWNCON	OWNCON refers to shareholders who hold at least 5% of the firm's shares.

5 | Empirical Results and Analysis

5.1 | Descriptive Statistics and Correlation Analysis

First, the results of the descriptive statistics and the correlation between the data related to the hypothesis are summarized in *Table 3*:

Table 3. Descriptive statistics.

	Mean	Median	Max	Min	Std. Dev.
EQ	0.092716	0.087400	0.248695	0.012775	0.042405
StdROA	0.091556	0.067885	0.637344	0.005337	0.083346
Size	13.68718	13.63368	18.87824	8.899731	1.521226
EX/S	0.072305	0.057525	0.406055	0.000114	0.058148
LEV	0.611542	0.608021	3.721954	0.090164	0.241467
LnGDP	15.75993	15.65114	16.10246	15.58269	0.206142
INSOWN	59.1504	64.8350	89.5500	5.0000	26.9496
OWNCON	42.6710	45.1800	99.2500	5.0000	22.7336
Smooth	0.098212	0.094650	0.229614	0.010001	0.044480
EP	0.091915	0.087054	0.234438	0.010747	0.041810
DJustice	Observations	Growth	Observations		

It should be noted that 115 firms were tested over 10 years. As a result, the number of observations was 1150 years. Meanwhile, 36 firms are between the justice shares on firm ownership structure, and 79 firms are between other firms. Also, about 456 observations have had asset growth during the research period. The results show that the firm's profitability is 9 percent. Debt has accounted for 61% of firms' assets. 7.2% of the corporate sales are spent on their operating costs. 59% of the firms have Institutional Ownership (INSOWN), and 42% have Ownership Concentration (OWNCON).

Table 4. Pearson correlation matrix.

	Correlations							
	EQ	DJustice	Ex/s	Growth	Lev	LnGDP	Size	StdROA
EQ	1							
DJustice	0.049	1						
Ex/s	0.095**	-0.010	1					
Growth	0.001	0.724		1				

Table 4. Continued.

	Correlations							
	EQ	DJustice	Ex/s	Growth	Lev	LnGDP	Size	StdROA
Growth	-0.082**	0.108**	-0.007	1				
	0.005	0.000	0.811					
Lev	0.066*	0.008	-0.226**	0.025	1			
	0.026	0.792	0.000	0.391				
LnGDP	0.035	0.011	0.030	0.028	0.007	1		
	0.230	0.708	0.311	0.337	0.814			
Size	-0.042	-0.048	0.096**	0.041	0.069*	-0.225**	1	
	0.155	0.104	0.001	0.166	0.019	0.000		
StdROA	0.190**	-0.100**	0.118**	0.021	-0.134**	-0.011	-0.041	1
	0.000	0.001	0.000	0.467	0.000	0.700	0.166	

**Significant at the 1 percent level

*Significant at the 5 percent level

The results of the Pearson correlation test in Table 4, at the 0.01 significance level, indicate that there is a correlation between the dependent variable, earnings quality, and the variables profitability (StdROA), firm growth, and Costs of the Agency (EX/S). Also, there is a significant correlation between the dependent variable, earning quality, and financial leverage at the 0.05 significance level.

5.2 | Multivariate Analysis

The test result of the research hypothesis is as follows:

Table 5. Fixed effects regression panel estimation results.

Variable	Pred. Sign	Coef.	t-Stat.
C		0.090	0.823
DJustice	-	-0.016	-3.261
EX/S	-	0.094	4.528
Growth	+	-0.008	-1.971
LEV	?	-0.004	-0.678
LnGDP	+	0.002	0.439
Size	+	-0.003	-1.515
StdROA	+	0.104	5.769
Model summary			
F-stat.	10.067	R ²	0.542
Prob (F-stat.)	0.000	Adj R ²	0.488

After examining regression assumptions and ensuring their establishment, the results of fitting the above regression equation are presented in Table 5. The F-statistics and p-value (10.067 and 0.000) also indicate the significance of the regression model. Also, the t-statistic of -3.261 is equivalent to the normal distribution; therefore, at the 95% confidence level, the H1 hypothesis that the shares of justice in firm ownership structure have a significant effect on earning quality is rejected. The results of the study comply with Chaney et al. [64], Narayanaswamy [65], Ben-Nasr et al. [27], and Liu [66], and opposed the result of He [67] since he believes that most of the firms owned by the government and its affiliated organizations are controlled and supported, and are intervened and controlled by the government in the stock market. With this sense of security, the firms earn less.

5.3 | Robustness Tests

5.3.1 | Sensitivity analysis

To re-evaluate the hypothesis results, two variables of the alternative are used as other criteria for quality of earnings, such as 1) income smoothness, and 2) Earnings Predictability (EP). According to the income smoothing criterion, the quality of earnings is closer to cash and has continuous capability. Therefore, it is believed that accruals reduce the quality of earnings. We used the income-smoothing term in Eq. (2) to retest the research hypothesis.

$$\text{Smooth}_{it} = \beta_0 + \beta_1 \text{DJUSTICE}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LEV}_{it} + \beta_4 \text{STDROA}_{it} + \beta_5 \text{GROWTH}_{it} + \beta_6 \text{EX/S}_{it} + \beta_7 \text{LN GDP}_{it} + \varepsilon_{it} \quad (2)$$

To calculate income Smoothing (Smooth), the ratio of the standard deviation of operational earnings scaled by assets to the standard deviation of cash flows of operations scaled by assets is used [16]. A higher ratio indicates lower earning quality, and vice versa.

Furthermore, for a retest of the research hypothesis, we used EP as an additional criterion for measuring earning quality in *Eq. (3)*.

$$\text{EP}_{it} = \beta_0 + \beta_1 \text{DJUSTICE}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LEV}_{it} + \beta_4 \text{STDROA}_{it} + \beta_5 \text{GROWTH}_{it} + \beta_6 \text{EX/S}_{it} + \beta_7 \text{LN GDP}_{it} + \varepsilon_{it} \quad (3)$$

To calculate EP, we use *Eq. (4)*:

$$E_{i,t} = \beta_0 + \beta_1 E_{i,t-1} + \varepsilon_{i,t} \quad (4)$$

EP is the standard deviation of the error values over five years. Therefore, the high error values indicate lower earnings quality. The results of the sensitivity analysis of these two variables are presented in *Table 6*.

Table 6. The results of the robustness analysis of the research hypothesis.

Variable	Pred. Sign	Income Smoothness (Smooth)		Earnings Predictability (EP)	
		Coef.	t-Stat.	Coef.	t-Stat.
C		0.058	0.522	-0.013	1.322
DJustice	-	-0.015	-2.973	0.091	-2.566
EX/S	-	0.087	4.102	-0.009	4.155
Growth	+	-0.006	-1.414	-0.006	-2.018
LEV	?	-0.003	-0.557	-0.0008	-0.948
LnGDP	+	0.003	0.594	-0.003	-0.143
Size	+	-0.002	-0.918	0.169	-1.745
StdROA	+	0.084	4.581	0.153	8.899
		R ²	0.509	R ²	0.538
		Adj R ²	0.451	Adj R ²	0.484
		F-stat.	8.819	F-stat.	9.912
		Prob (F-stat.)	0.000	Prob (F-stat.)	0.000

5.3.2 | Endogeneity

If there is an endogeneity problem, estimating the coefficients using Ordinary Least Squares (OLS) can be problematic, and the estimates may be inappropriate. There may be an endogenous issue in our findings, as INSOWN and OWNCON affect the ownership structure of firms with Justice Shares. In this research, we attempted to address endogeneity using the instrumental variables approach, employing Two-Stage Least Squares (2SLS) as a test alternative. We select two instrumental variables. The first Variable is INSOWN. INSOWN is the percentage of shares outstanding owned by institutions that hold at least 5% of equity securities [68]. The second instrumental Variable is OWNCON, defined as shareholders who hold at least 5% of the firm's shares [69]. To address endogeneity concerns, we used the Durbin-Wu-Hausman test. Based on the results of the Durbin-Wu-Hausman test ($p \leq 0.0555$), the share of ownership in justice is not an endogenous variable, and the results of Least Squares Regression (OLS) are more consistent than those of 2SLS; therefore, the use of 2SLS is not justified.

6 | Conclusion

This study investigates the impact of politically embedded ownership, specifically Iran's Justice Shares program, on earnings quality. The results demonstrate a significant negative association between Justice Share ownership and earnings quality, suggesting that this populist ownership model, despite its redistributive framing, undermines financial reporting integrity. These findings echo the recent international evidence showing that politically influenced firms, particularly in weak institutional contexts, are more prone to

earnings manipulation and lower transparency [13], [16], [17]. Conceptually, this research advances the political economy literature by illustrating how hybrid state-market ownership structures, under the mask of citizen empowerment, sustain state control and distort managerial incentives. The Justice Shares initiative typifies what Ruggiero et al. [7] term “publicness,” where goal ambiguity, political oversight, and weak accountability converge to compromise earnings quality. In that way, the program isn’t just a failed attempt at privatization; it’s a clear example of how populist policies can lead to weak oversight and poor governance outcomes.

In line with Han et al. [14], our findings emphasize that governance mechanisms, such as foreign or INSOWN ownership, may fail to constrain managerial discretion when political interests dominate firm objectives. Similarly, Kustono et al. [12] note that income smoothing can serve constructive purposes in well-governed firms. Still, in politically directed entities such as Justice Share firms, it is more likely to signal opportunism driven by state mandates rather than market logic. From a policy standpoint, these findings underscore the dangers of conflating ownership redistribution with privatization. While Justice Shares aimed to promote equity and broaden capital participation, they ultimately entrenched political interference without improving accountability. Future reform efforts in Iran and similar emerging economies should focus on restoring market discipline, strengthening external governance mechanisms, and reducing political entanglement in corporate affairs. This study adds to the debate on state ownership and earnings management by bringing in a Middle Eastern perspective that’s often missing from the literature. While much of the existing work examines SOEs in East Asia and Europe, this paper focuses on how politically motivated ownership programs, such as Iran’s Justice Shares, interact with weak institutions and contribute to lower earnings quality. By examining this unique case, we offer evidence that helps expand the discussion on how state control can distort reporting practices in emerging markets.

Author Contributions

Both authors contributed to all stages of the research, including design, analysis, and writing, and have approved the final version of the manuscript.

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Data Availability

The data used in this study are available to the authors and can be provided upon request.

Conflict of Interest

The authors reported no potential conflict of interest.

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