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The Political Roots of Income Smoothing: The Moderating Influence of Institutional Investors

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Abstract

This study examines the effect of Political Connections (PCF) on income smoothing and investigates the moderating role of institutional investors in this relationship. The study aims to provide empirical evidence on how political ties and institutional investment jointly influence firms' income-smoothing practices. This study employs a descriptive research design based on panel data from the period 2017–2023. Excel software was used for data collection, organization, and preparation, while EViews was employed to conduct the statistical analyses. The hypotheses were tested using panel data regression techniques. The results indicate that PCF have a significant effect on income smoothing. Furthermore, institutional investment significantly moderates the relationship between PCF and income smoothing, suggesting that the presence and influence of institutional investors can alter the extent to which PCF affect firms' income-smoothing practices. This study contributes to the literature by examining the interaction between PCF, income smoothing, and institutional investment within an integrated framework. By highlighting the moderating role of institutional investors, the findings provide additional insight into how political ties and ownership structure may jointly shape corporate financial reporting behavior.

Keywords: Political connections, Income smoothing, Institutional investment.

1 | Introduction

There is a form of interaction between governments and firms. In return for firms implementing government policies, governments provide these firms with a range of benefits, including preferential access to markets, tax incentives, easier access to credit, government subsidies, profitable contracts, reductions in customs tariffs, and other advantages.

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Firms seeking opportunities to grow and improve their current conditions welcome this two-way interaction between the government and firms. The government considers establishing relationships with these firms as a means of controlling them.

Shleifer and Vishny [1] argue that governments attempt to bring firms under their influence through subsidies and financial assistance, while firms seek to influence governments through political costs. Since politically connected firms generally seek to pursue their interests through political relationships, they may conceal or hide any deliberate misleading actions in their financial reports from investors, thereby sacrificing the interests of minority shareholders [2]. Public opinion polling is one of the technological developments that has influenced the nature of political communication and is used in various forms of such communication. Public opinion polling has generally been regarded as a means of advancing social research and shaping public attitudes or promoting political ideas and candidates. Experts believe that when public opinion polling serves political propaganda, it enhances the capacity of governments, political parties, and wealthy pressure groups to influence public opinion.

One of the objectives of accounting reporting is to provide useful information about the financial performance of a business entity to a broad range of users. The income statement is one of the basic financial statements that fulfills this objective. Some argue that investors place greater value on firms with stable and sustainable earnings; consequently, managers may engage in earnings management to increase their firms' stock prices [3]. From the perspective of political economy, major shareholders and managers who are connected to political power centers can influence the financial performance of their firms [4].

Furthermore, within the political process, politicians, like any other individuals, have incentives to transfer wealth. They are not merely intermediaries between competing interest groups; rather, they are themselves an interest group. Politicians and all political parties have incentives to increase the resources under government control because such an increase enhances their ability to exercise power [5].

Income smoothing enables managers to reduce investors' perceptions and estimates regarding fluctuations in the underlying earnings trend, which, in turn, reduces their assessment of the probability of bankruptcy. Income smoothing decreases in proportion to the level of information asymmetry. This managerial action can improve the information content of earnings figures and ultimately enhance the efficiency of accounting information in improving investors' decision-making. This process occurs through a reduction in information asymmetry and lower errors by investors in using such information. Since users' ability to utilize information is limited and heterogeneous, income smoothing also affects investors' perceptions of risk, because firms with highly volatile earnings are perceived as riskier than firms with smoother earnings, thereby reducing investors' confidence in the future [6]. In light of the foregoing discussion regarding Political Connections (PCF) and income smoothing, the present study examines the effect of PCF on income smoothing, with institutional investment serving as a moderating variable.

2|Literature and Background

Corporate governance has paid particular attention to the separation of ownership and control in modern corporations and has consequently attracted considerable interest from fields such as accounting and finance. This is because many theorists have considered corporate strategy to be a fundamental factor in corporate performance.

Jensen and Meckling [7] proposed the foundations of agency theory and defined the manager as the agent and the shareholder as the principal. In their analysis, the shareholder stands in opposition to the manager. One of the main assumptions of agency theory is that the principal and the agent have conflicting interests; therefore, the separation of ownership from management has resulted in an organizational problem known as the agency problem. The primary agency problem concerns the existence of conflicting interests between shareholders and managers; that is, shareholders seek to maximize the value of their investment, whereas

managers primarily seek to increase their own wealth. Therefore, managers may not necessarily act in the interests of shareholders.

Managerial embezzlement and financial corruption, as well as the diversion of shareholders' interests from the company, are extreme examples of such conflicts of interest. This agency problem highlights the necessity of controlling corporate management by shareholders. Today, the term corporate governance is an important and evolving concept in the business world. Corporate governance forms the foundation of a company's relationships with its stakeholders. In general terms, corporate governance refers to the system by which a company is controlled and directed; a system that determines, controls, and guides the relationship between a company and its stakeholders. At the micro level, corporate governance seeks to achieve corporate objectives, while at the macro level, it aims at the optimal allocation of society's resources. Corporate governance consists of a set of internal and external corporate control mechanisms that establish an appropriate balance between shareholders' rights, on the one hand, and the needs and authorities of the board of directors, on the other. Ultimately, these mechanisms provide shareholders, providers of financial resources, and other stakeholders with reasonable assurance regarding the preservation of their interests [8].

Early contributors to agency theory, Spence and Zeckhauser [9], attempted to introduce the basic framework of agency theory. Agency theory begins with the assumption that individuals act in pursuit of their own self-interest and encompasses the notion that, under normal circumstances, the objectives, interests, and risks of the two parties (the principal and the agent) are not identical. This theory states that when a manager does not own 100 percent of the company's shares, an inherent conflict between shareholders and the manager is inevitable.

This situation gives rise to several agency problems, including conflicts of interest between shareholders and managers, moral hazard, uncertainty and risk-sharing, information asymmetry between shareholders and managers, and the adoption of undesirable decisions (ibid.). One solution to the agency problem is the establishment of appropriate corporate governance practices.

Shleifer and Vishny [1] defined corporate governance as a means through which providers of corporate finance ensure that they receive a return on their investment. Another definition of corporate governance describes it as a set of mechanisms that have evolved to mitigate the effects of the separation between management and the financing of business organizations.

Corporate governance mechanisms affect the information disclosed by companies to their shareholders and reduce the likelihood of incomplete and inadequate disclosure, as well as the disclosure of less reliable information [10]. From an international perspective, corporate governance can be defined as a set of mechanisms that encourage corporate managers to pursue their self-interest in decision-making while maximizing firm value for owners [11].

Appropriate corporate governance facilitates timely disclosure and reporting by companies. The objective of corporate governance is to ensure that opportunistic behavior does not occur, which is achieved by reducing agency problems and potential information asymmetry between agents and various stakeholders, including shareholders, creditors, and others. Reducing such problems increases shareholders' willingness to trade in these markets and enhances the liquidity of shares in the market [12].

Tee [13] examined the relationship between PCF and income smoothing, with institutional investment as a moderating variable. The results showed that PCF affect income smoothing. Institutional investment moderates the relationship between PCF and income smoothing.

Kim et al. [14] examined short-term institutional investment and the cost of debt. The results obtained from data analysis using panel data regression showed that short-term institutional ownership affects the cost of debt.

Tee [13] examined the effect of institutional ownership on the relationship between corporate PCF and audit fees. This study used financial statement information from companies listed on the Malaysian Stock Exchange

during the period 2003–2011. The results indicate that firms with institutional ownership incur higher audit fees, and this positive relationship is more likely to occur in firms with PCF.

Chen et al. [15] investigated the relationship among income smoothing, institutional ownership, discretionary accruals, and stock price crash risk. The sample consisted of all non-financial firms from 1993 to 2011. Income smoothing does not reflect firms' actual performance. The findings indicate that income smoothing reflects managerial reporting opportunities and increases private information, which, in turn, encourages managers to conceal bad news.

Liu et al. [16] examined the relationship between PCF and auditor choice and the transparency of financial statements. The study used financial statement information from 3,640 firm-year observations of companies listed on the Chinese Stock Exchange. The results showed that PCF, measured by payments made to the government, have a positive effect on the relationship between auditor choice and accounting information transparency.

Jin et al. [17] examined the relationship between PCF and stock price crash risk. Their findings indicate that politically connected firms have lower stock price crash risk than their peers. In addition, the effect of PCF varies depending on their type and strength.

Brama et al. [18] examined real earnings management, accrual-based earnings management, and PCF. The objective of the study was to investigate the relationship between real earnings management, accrual-based earnings management, and PCF. The results showed that firms' PCF have a significant relationship with both real earnings management and accrual-based earnings management. Furthermore, the level of public monitoring of firms with PCF is significantly related to both their real earnings management and accrual-based earnings management.

H1: PCF have an effect on income smoothing.

H2: Institutional investment moderates the relationship between PCF and income smoothing.

3 | Research Method

This study is quantitative and applied in nature. The research design is quasi-experimental and uses a one-time ex post facto approach using historical data. The ex post facto method is used when the researcher examines an issue after the occurrence of events and when manipulation of the independent variables is not possible [19].

A library research method was used to examine the theoretical foundations and research background. The required data and information for the selected companies were collected by referring to the financial statements and accompanying notes to the financial statements of companies listed on the Tehran Stock Exchange, available through the Codal system and Rahavard Novin Version 3 software.

Finally, the data were prepared using Excel software, and descriptive statistics, validity and reliability assessments of the research variables, the effects of the research variables, and inferential tests were conducted using SPSS Version 25 and EViews software.

3.1 | Statistical Population

The statistical population of the study consists of companies listed on the Tehran Stock Exchange after applying the following restrictions:

I. They were listed on the stock exchange before March 2017 and remained actively listed through the end of March 2024.

II. All of their trading symbols remained active throughout the fiscal period from March 21, 2017, to March 20, 2023. Therefore, companies whose trading symbols were delisted during the aforementioned period, as well

as companies whose symbols were newly added during this period, were excluded from the statistical population.

III. Their required data were available.

IV. To ensure comparability, the fiscal year-end of the companies had to be 29/12.

V. The selected companies were not investment companies, holding companies, or leasing companies; and

VI. They did not experience a trading halt lasting more than three months.

Using the systematic elimination method and applying the restrictions listed above, 186 companies were selected as the statistical sample (*Table 1*).

Table 1. Statistical population of the research.

Row	Limitations	Number
1	Number of companies listed on the Tehran Stock Exchange from 2017 to 2023	659
2	Number of companies classified as investment companies, banks, and insurance companies	132
3	Number of companies whose fiscal year does not end on March 20	124
4	Number of companies that changed their fiscal year during the study period and companies whose trading symbols were suspended for more than three months	217
5	Screened Sample	186

3.2 | Research Model

To examine the effect of PCF on income smoothing and to investigate the moderating role of institutional investors in this relationship, the study employs panel data regression models. The research models are designed to test the proposed hypotheses while controlling for firm-specific characteristics that may influence income-smoothing practices. Accordingly, two baseline models are specified using alternative measures of PCF:

Model (1):

$$SMOOTH_it = \alpha_0 + \alpha_1 PCF_it + \alpha_2 LEV_it + \alpha_3 ROA_it + \alpha_4 CF_it + \varepsilon_it \quad (1)$$

In these models, the coefficient α_1 captures the effect of PCF on income smoothing. A statistically significant coefficient on the political-connection variable provides evidence in support of H1.

To examine H2 and determine whether institutional investment moderates the relationship between PCF and income smoothing, an interaction term between PCF and institutional investment is introduced into the regression model. The moderating model is specified as follows:

Model (2):

$$SMOOTH_it = \alpha_0 + \alpha_1 PCF_it + \alpha_2 INST_it + \alpha_3 (PCF_it \times INST_it) + \alpha_4 LEV_it + \alpha_5 ROA_it + \alpha_6 CF_it + \varepsilon_it \quad (2)$$

3.2.1 | Income smoothing (SMOOTH)

Income smoothing is the dependent variable of the study and represents the extent to which firms attempt to reduce fluctuations in reported earnings over time. In this study, income smoothing is measured using the Eckel index, which compares the coefficient of variation of changes in net income with the coefficient of variation of changes in sales. The index is calculated as follows:

$$IS = CV(\Delta NI) \,/\, CV(\Delta Sales),$$

where CV(ΔNI) represents the coefficient of variation of changes in net income and CV(ΔSales) represents the coefficient of variation of changes in sales. Consistent with the income-smoothing approach, firms with an index below one are classified as income smoothers, whereas firms with an index equal to or greater than one are classified as non-smoothers. Depending on the empirical specification, SMOOTH can therefore be operationalized as a binary indicator equal to one for income-smoothing firms and zero otherwise.

3.2.2 | Political connections

PCF represent the extent to which a firm is connected to political institutions or influential political actors. PCF is measured based on the existence of political ties between the firm's directors, senior managers, or major shareholders and government or political institutions. A higher value of PCF indicates a stronger or more substantial political connection.

3.2.3 | Institutional investment

Institutional investment is the moderating variable of the study and represents the ownership or investment participation of institutional investors in the firm. It is measured as the percentage of the firm's outstanding shares held by institutional investors. A higher value of INST indicates a greater presence of institutional ownership and, consequently, a potentially stronger monitoring influence on managerial decisions and financial reporting practices.

3.2.4 | Financial leverage

Financial leverage is included as a control variable and reflects the extent to which a firm relies on debt financing. LEV is measured as the ratio of total liabilities to total assets:

$$LEV = \text{Total Liabilities} / \text{Total Assets}.$$

A higher leverage ratio indicates greater reliance on debt financing and potentially greater pressure on managers to achieve or maintain particular levels of reported earnings.

3.2.5 | Return on assets

Return on Assets (ROA) measures the firm's profitability and is included as a control variable. ROA is calculated as the ratio of net income to total assets:

$$ROA = \text{Net Income} / \text{Total Assets}.$$

This variable controls for differences in firms' operating performance that may affect their incentives to engage in income smoothing.

3.2.6 | Cash flow

Cash Flow (CF) represents the firm's operating cash-generating capacity and is included as an additional control variable. CF is measured using operating CF, scaled by total assets:

$$CF = \text{Operating Cash Flow} / \text{Total Assets}.$$

Including CF in the models helps control for differences in firms' underlying liquidity and cash-generating performance that may be associated with income-smoothing behavior.

4 | Findings

To evaluate the proposed research hypotheses, the estimated regression models were analyzed using panel data regression techniques. *Table 6* summarizes the statistical results of the hypothesis test, including the estimated coefficients, standard errors, t-statistics, and significance levels for the explanatory and control variables. The table also reports the overall significance of the regression model, its explanatory power, and the Durbin–Watson statistic. These results provide the basis for assessing the statistical significance and direction of the relationships between PCF, the control variables, and income smoothing.

Table 6. Summary of statistical results of the hypothesis test.

Variable	Coeffi.	S.D	t-Stat	Sig.	Result
C	-3.879	1.097	-3.535	0.000	-
PCF	-0.311	0.082	-3.799	0.024	Significant
LEV	0.001	0.000	2.492	0.012	Significant
CF	-0.071	0.422	-1.692	0.090	Not significant
ROA	0.511	0.105	4.869	0.018	Significant
Fisher F-statistic (significance level)	13.8468 (0.0000)	Durbin–Watson statistic		1.8044	
Coefficient of determination	0.6415	Adjusted coefficient of determination		0.5713	

Political connections: PCF, Institutional Investment: SHR, Income Smoothing: SMOOTH, Financial Leverage: LEV, Return on Assets: ROA, Cash Flow: CFO

Table 6 presents the results of the regression analysis conducted to examine the effect of PCF on income smoothing. The results indicate that the coefficient of PCF is -0.311, with a standard error of 0.082 and a t-statistic of -3.799. The significance level associated with this coefficient is 0.024, which is below the conventional 5% significance threshold. Therefore, PCF have a statistically significant effect on income smoothing. The negative coefficient indicates that an increase in the level of PCF is associated with a decrease in income-smoothing behavior.

Accordingly, H1 is supported, indicating that PCF significantly affect firms' income-smoothing practices. With respect to the control variables, Financial Leverage (LEV) has a positive and statistically significant coefficient of 0.001 ($t = 2.492$, $p = 0.012$), suggesting that firms with higher financial leverage tend to exhibit greater income-smoothing behavior. ROA also has a positive and statistically significant coefficient of 0.511 ($t = 4.869$, $p = 0.018$), indicating that more profitable firms are associated with a higher level of income smoothing. In contrast, CF has a negative coefficient of -0.071; however, its significance level is 0.090, which exceeds the 5% threshold. Thus, CF does not have a statistically significant effect on income smoothing at the 5% significance level.

The overall significance of the regression model is indicated by the Fisher F-statistic of 13.8468, with a significance level of 0.0000. This result indicates that the explanatory variables, taken together, have a statistically significant relationship with income smoothing and that the estimated regression model is statistically significant as a whole. The coefficient of determination (R^2) is 0.6415, indicating that approximately 64.15% of the variation in income smoothing is explained by the variables included in the model. The adjusted coefficient of determination is 0.5713, suggesting that after adjusting for the number of explanatory variables, approximately 57.13% of the variation in income smoothing is explained by the model. These values indicate a relatively satisfactory explanatory power for the estimated model. Finally, the Durbin–Watson statistic of 1.8044 is close to the benchmark value of 2, suggesting that there is no serious evidence of first-order autocorrelation in

4.1 | Results of the Second Model Test

To examine the moderating role of institutional investment in the relationship between PCF and income smoothing, an interaction term between PCF and institutional investment (PCF × INST) was incorporated into the regression model. *Table 7* presents the results of the moderating regression analysis, including the estimated coefficients, standard errors, t-statistics, and significance levels for the main variables, interaction term, and control variables. The table also reports the overall significance of the regression model, its explanatory power, and the Durbin–Watson statistic. The coefficient and statistical significance of the interaction term provide the primary basis for evaluating the second research hypothesis.

Table 7. Summary of statistical results of the hypothesis test.

Variable	Coef.	S.D	t-stat	Sig.
C	0.979	0.020	4.897	0.000
PCF	-0.030	0.014	2.130-	0.033
PCF*INST	0.006	0.003	2.02	0.045
INST	0.390	0.176	2.21	0.029
LEV	0.014	0.007	2.019	0.045
ROA	0.038	0.010	3.792	0.000
CF	-0.387	0.059	-6.487	0.000
Fisher F-statistic (significance level)	29.2464 (0.0000)	Durbin–Watson statistic		1.9126
Coefficient of determination	0.7952	Adjusted coefficient of determination		0.7625

The results presented in *Table 7* provide evidence regarding the moderating role of institutional investment in the relationship between PCF and income smoothing. The coefficient of PCF is -0.030, with a standard error of 0.014 and a t-statistic of 2.130. The reported significance level is 0.033, which is below the 5% significance threshold. Therefore, PCF have a statistically significant effect on income smoothing. The negative coefficient indicates that PCF are negatively associated with income-smoothing behavior, consistent with the findings reported in the baseline model.

The coefficient of the interaction term between PCF and institutional investment (PCF × INST) is 0.006, with a standard error of 0.003 and a t-statistic of 2.02. The significance level is 0.045, indicating that the interaction effect is statistically significant at the 5% level. This finding demonstrates that institutional investment significantly moderates the relationship between PCF and income smoothing. Thus, H2 is supported. The positive coefficient of the interaction term suggests that institutional investment changes the negative relationship between PCF and income smoothing by weakening its negative effect. In other words, as institutional investment increases, the negative association between PCF and income smoothing becomes less pronounced.

The coefficient of institutional investment (INST) itself is 0.390, with a t-statistic of 2.21 and a significance level of 0.029, indicating a statistically significant positive relationship between institutional investment and income smoothing. This result suggests that, independent of the interaction effect, firms with higher institutional investment tend to exhibit higher levels of income-smoothing behavior. However, the significance of the interaction term indicates that the effect of institutional investment cannot be interpreted independently of PCF when assessing the conditional relationship between the two variables. Among the control variables, financial leverage (LEV) has a positive and statistically significant coefficient of 0.014 ($t = 2.019$, $p = 0.045$), suggesting that firms with higher financial leverage are associated with greater income-smoothing behavior. ROA also has a positive and statistically significant coefficient of 0.038 ($t = 3.792$, $p < 0.001$), indicating that more profitable firms tend to exhibit greater income smoothing.

In contrast, CF has a negative and statistically significant coefficient of -0.387 ($t = -6.487$, $p < 0.001$), suggesting that firms with higher CF tend to exhibit lower levels of income-smoothing behavior. The overall significance of the estimated regression model is confirmed by the Fisher F-statistic of 29.2464, with a significance level of 0.0000. This result indicates that the explanatory variables jointly have a statistically significant relationship with income smoothing and that the regression model is statistically significant as a whole. The coefficient of determination (R^2) is 0.7952, indicating that approximately 79.52% of the variation in income smoothing is explained by the variables included in the model. The adjusted coefficient of determination is 0.7625, indicating that after adjusting for the number of explanatory variables, approximately 76.25% of the variation in income smoothing is explained by the model. These results indicate that the estimated model has relatively strong explanatory power. Finally, the Durbin–Watson statistic of 1.9126 is close to the benchmark value of 2, suggesting that there is no serious evidence of first-order autocorrelation in the regression residuals.

Overall, the findings provide empirical support for both the direct effect of PCF on income smoothing and the moderating role of institutional investment. In particular, the significant positive interaction coefficient

indicates that institutional investment moderates the negative relationship between PCF and income smoothing, reducing the magnitude of this negative association as institutional investment increases.

To address the research question, hypotheses were formulated, and models incorporating the independent, control, and dependent variables were developed to test them. The results obtained from testing the research hypotheses are presented in *Table 8*.

Table 8. Summary of the hypothesis test results.

Row	Hypothesis	Result
1	PCF have an effect on income smoothing.	Accept
2	Institutional investment moderates the relationship between PCF and income smoothing.	Accept

5 | Discussion and Conclusion

This study examined the effect of PCF on income smoothing and investigated whether institutional investment moderates this relationship. Using panel data covering the period from 2017 to 2023, the study employed regression models to examine the proposed hypotheses while controlling for financial leverage, ROA, and CF. The findings provide evidence that PCF and institutional investment are relevant factors in explaining firms' income-smoothing behavior. The results of the first hypothesis indicate that PCF have a statistically significant negative effect on income smoothing. The coefficient of PCF is negative and statistically significant, suggesting that firms with stronger PCF tend to exhibit lower levels of income-smoothing behavior. This finding indicates that political ties may influence firms' financial reporting practices and managerial incentives in ways that affect the extent to which reported earnings are smoothed over time. The finding regarding the first hypothesis is not consistent with Habib et al. [20], who argued that policymakers require or encourage firms to disclose information concerning their relationships with governments, political parties, and politicians so that policymakers and other stakeholders can better assess the quality of firms' reported earnings.

However, the present finding is consistent with Braam et al. [18], who reported that the existence of political relationships among sampled firms is associated with higher accrual quality. It is also consistent with Lin et al. [21], who found that firms with stronger PCF exhibit greater use of accounting accruals and that managers may use their accounting discretion to influence reported earnings, including reducing reported earnings to lower tax payments and potentially increase managerial benefits. Taken together, these findings suggest that the consequences of PCF for corporate financial reporting may depend on the institutional environment, the nature of political ties, and the incentives faced by managers. The results of the second hypothesis provide evidence of a significant moderating effect of institutional investment on the relationship between PCF and income smoothing. The interaction term between PCF and institutional investment (PCF × INST) is positive and statistically significant. Given the negative coefficient of PCF in the regression model, the positive interaction coefficient indicates that institutional investment weakens the negative relationship between PCF and income smoothing. In other words, as institutional investment increases, the negative association between PCF and income smoothing becomes less pronounced.

This finding highlights the importance of ownership structure in understanding the consequences of PCF for corporate financial reporting behavior. Institutional investors generally possess greater resources and incentives to monitor managerial decisions and corporate reporting practices. However, the positive interaction observed in this study suggests that the presence of institutional investors does not simply eliminate the influence of PCF. Rather, institutional investment changes the strength of this relationship. Therefore, PCF and ownership structure should be considered jointly when analyzing firms' income-smoothing behavior. Overall, the findings contribute to the literature by integrating PCF and institutional investment within a single analytical framework. While previous research has largely examined PCF or ownership characteristics separately, the present study demonstrates that the relationship between PCF and

income smoothing is conditional on the firm's institutional ownership structure. The results therefore provide a more nuanced understanding of how political and ownership characteristics jointly shape corporate financial reporting behavior.

5.4 | Practical Implications of the Hypothesis Test Results

The findings of this study have several practical implications for shareholders, institutional investors, corporate managers, regulators, and other users of financial information. First, the significant relationship between PCF and income smoothing suggests that investors should consider the political characteristics of firms when evaluating their financial reporting behavior. PCF may affect managerial incentives and the manner in which financial information is presented. Therefore, investors should not rely exclusively on reported accounting earnings when assessing the financial performance and reporting quality of politically connected firms. Second, the significant moderating effect of institutional investment highlights the importance of ownership structure in the monitoring of corporate reporting practices. Institutional investors may play an important role in influencing the relationship between PCF and income smoothing. Accordingly, institutional investors should strengthen their monitoring mechanisms and pay particular attention to the financial reporting practices of politically connected firms. Third, the findings may be relevant to regulators and policymakers. The existence of politically connected firms and the significant interaction between PCF and institutional investment indicate that effective monitoring of corporate financial reporting should take ownership structure and political affiliations into account. Strengthening disclosure requirements concerning significant PCF may improve transparency and enable investors and other stakeholders to make more informed decisions. Finally, the results suggest that shareholders should consider both PCF and institutional ownership when evaluating potential investments. Rather than viewing PCF as an isolated characteristic, investors may benefit from assessing how such connections interact with the firm's ownership structure and governance mechanisms [22], [23].

5.5 | Research Recommendations

Based on the findings of this study, the following recommendations are proposed for investors, institutional investors, corporate managers, and policymakers:

I. Shareholders are advised to consider the PCF of firms when making investment decisions and evaluating the reliability of reported earnings.

II. Institutional investors are encouraged to strengthen their monitoring of firms with significant PCF and to pay particular attention to their financial reporting practices.

III. Corporate managers should enhance transparency regarding political relationships and ensure that financial reporting practices comply with applicable accounting and disclosure requirements.

IV. Regulators and policymakers should consider strengthening disclosure requirements related to firms' PCF to improve transparency and reduce information asymmetry between firms and investors.

V. Investors should consider ownership structure, particularly the presence and extent of institutional investment, when evaluating the potential effects of PCF on corporate financial reporting behavior.

5.6 | Suggestions for Future Research

Although this study provides evidence regarding the relationship between PCF, income smoothing, and institutional investment, several avenues remain open for future research.

I. Future studies may examine the effect of PCF on stock price crash risk to determine whether politically connected firms face different levels of downside market risk.

II. The relationship between PCF and corporate risk-taking may be investigated to provide further evidence on the broader consequences of political ties for corporate decision-making.

III. Future research may replicate the present study across different industries to determine whether the relationship between PCF, institutional investment, and income smoothing varies across industry characteristics.

IV. Future studies may employ alternative measures of income smoothing and PCF to examine the robustness of the reported findings.

V. Researchers may investigate other corporate governance characteristics, such as board independence, managerial ownership, audit committee characteristics, and audit quality, as potential moderating or mediating variables in the relationship between PCF and financial reporting behavior.

VI. Future research may also examine whether the moderating effect of institutional investment differs according to the type and concentration of institutional ownership.

Abbreviation

PCF	Political Connections
ROA	Return on Assets
CF	Cash Flow

Conflict of Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

Data Availability

The data that support the findings of this study are available within the article. No additional data are associated with this publication.

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Use of Artificial Intelligence

ChatGPT (GPT-4, OpenAI) was used solely for language editing and structural refinement of the manuscript. The AI tool was not used to generate research ideas, conduct the literature search, interpret findings, or produce any data or mathematical content. The author has reviewed and verified all AI-assisted text and takes full responsibility for the integrity and originality of the work.

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