

Does Ownership Concentration Influence Discretionary Earnings Quality in Emerging Market: Evidence from Nigeria

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Abstract

The purpose of this study was to ascertain the influence of ownership concentration on discretionary earnings quality among quoted non-financial companies on Nigeria stock exchange. The study used panel data, Diagnostic tests were performed such as linearity test, Autocorrelation test, and heteroscedasticity. Thereafter correlation and simple regression was performed on 105 quoted non-financial companies for 15 years from 2002 to 2016. The findings revealed a positive and significant relationship between ownership concentration and discretionary earnings quality. The study recommends that non-financial companies should also ensure that the ownership structure is diverse and widely owned to safeguard the minority shareholders and reduce the overbearing power of the majority shareholders as it was discovered that concentrated ownership has positive significant relationship with discretionary earnings quality of the quoted non-financial companies in Nigeria.

Keywords: Ownership concentration, discretionary earnings quality corporate governance, shareholders

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Introduction

The question whether ownership concentration affect companies performance in terms of profitability, efficiency and earnings manipulation are abound in literature and with mixed results. Management have certain degree of latitude in discretionary earnings practice and managing earnings through the element of judgment which can lead to abuse. Where ownership is concentrated in the hands of few individuals the interest of many may be at risk (Cornett et al.; 2009 & Leventis and Dimitropoulos, 2012)

Several companies were liquidated and many jobs including life savings were lost as a result poor and selfish decision by block holders of shares. However, there are companies where the shares are concentrated in the hands of few individuals and such companies did very well in all performance indices (Zattoni and Cuomo, 2015).

This study therefore, aims to discover the influence of ownership concentration on discretionary earnings quality among quoted non-financial companies on Nigeria stock exchange. The study hypothesized that ownership concentration does not have effect on discretionary earnings quality of quoted companies on Nigeria stock exchange.

This study investigates the effect of ownership concentration on discretionary earnings quality of quoted companies on Nigeria Stock exchange over a fifteen years period spanning January 2002 through December 2016. This study focuses on all the quoted companies that meet the earnings quality data criteria from all the 130 quoted non-financial companies as at the end of December 31 2016.

Theoretical Framework

This study adopts two theories that explain the influence of ownership concentration on discretionary earnings quality. The theories are stakeholders and stewardship: for stakeholders theory quoted companies are owned by shareholders who are either majority or minority shareholders; however quoted companies are responsible to stakeholders. Boards of directors are appointed by the shareholders due to the agency cost to monitor and supervise the management who are the agent. The executive are compensated for the task of managing the companies and are required to comply with corporate governance code and any regulatory directives. Also report in a transparent manner and ensures that earnings disclose to stakeholders reflect the true economic situation of the companies (Brennan, 1995; Bartram, Brown, How & Verhoeven, 2012; Saltaji, 2013). However, stakeholder theory has been criticised by Blattberg (2004) on the ground that in reality it is not possible to meet the needs and interest of all stakeholders without prejudice. Also Mansell (2013) posit that under capitalism stakeholder theory undermines principles of free market and that stakeholder theory is akin to applying political concept of social contract to companies.

For stewardship theory, places greater importance on goal convergence among the parties involved in corporate governance than on the agent's self-interest and focused on intrinsic rewards that are not easily quantified, such as growth, achievement, and duty (Van Slyke, 2007)

For the purpose of this study, stewardship theory is found relevant so as to offer compliment for stakeholder's theory since the latter captures all other vital stakeholders apart from management such as shareholders, regulators, creditors, employees, financial analysts, and potential investors etc. who rely on earnings reports to make economic decisions.

Ownership Concentration and discretionary Earnings Quality

Alves (2012) posit that the concentration of ownership and the dispersion of shares between shareholders would influence corporate activities and performance. This position has been collaborated by other authors, Bhattacharya, Desai and Venkataraman (2013) states that ownership concentration is high in emerging markets and developing economies. While Zattoni and Cuomo, (2015) point out that the differences in the legal, political and corporate culture factors; play a key role in elucidating the ownership concentration in emerging markets and developing countries. There have been a number of empirical studies on the relationship between ownership concentration and earnings quality.

Holderness (2003) argues that concentrated shareholders have better incentive and motivation to monitor and better control the manager's behaviour because of their substantial economic stakes. Shareholders with greater stakes in a company have greater incentive to ensure that the companies do not fail and the need to control and monitor managers or insiders. Alves (2012) appraise the relationship between corporate ownership structure and earnings quality of non-financial listed Portuguese companies for a period of six years from 2002 to 2007. The study used a sample size of 34 non-financial companies and findings shows that earnings quality was significantly enhanced with both managerial ownership and ownership concentration. Divergent result by Arouri, Hossain, Badrul and Muttakin (2014) examines the effect of ownership structure and board composition on bank performance in Gulf Co-Operation Council (GCC) countries. A sample of 58 quoted banks cut across Gulf Co-Operation Council (GCC) countries and multivariate regression analysis was used for the period 2010. The finding shows significant positive association between ownership concentration and bank earnings.

Kouaib and Jarboui (2014) investigate the effect of jointly external audit quality and ownership structure on earnings management specifically focusing on the industrial and commercial sectors of Tunis Stock Exchange during the period 2007-2011. The sample of 61 Tunisian firms listed and unlisted were used. The result shows audit quality and ownership concentration has a negative and significant effect on earnings management in industrial firms but it has a positive and non-significant effect in commercial firms. Also, ownership concentration has a positive and significant effect on earnings management.

Liu, Saidi, and Bazaz (2014) study the effect of government (concentration) ownership and its associated institutional incentives on firms' earnings quality. The study spans 8 years from 1998 and 2005, the organisations were listed on Chinese stock exchanges. The results shows that state-owned firms demonstrate a lower earnings quality tendencies than non-state-owned firms, also state-owned firms have significantly higher

discretionary current accruals than non-state-owned firms with the gross implication of ownership concentration having negative impact on earnings quality.

Bouvatier, Lepetit and Strobel (2014) investigate the influence of ownership concentration and the regulatory environment on way a bank might use loan loss provisions to smooth its income, panel of commercial banks in Europe were used and the results shows that banks with concentrated ownership use discretionary loan loss provisions to smooth their income while Banks with low levels of ownership concentration do not display such discretionary income smoothing behaviour. The summary reveals that high level ownership concentration encourages discretionary income smoothing behaviour. There are various indices to measure ownership concentration, general rule to know large shareholder is any shareholder owning minimum of 5% of the total share capital in issue. This study used the aggregate ownership of all large shareholders of 5% and above. The percentage of large shareholders was extracted directly from the annual audited financial reports of quoted companies on Nigerian stock exchange for the period study.

Methodology

This study adopts panel data to ascertain the effect of ownership concentration on discretionary earnings quality over fifteen years period from January 2002 to December 2016. Also, quantitative portion of this study involved the use of simple regression, t test and correlation. The regression was subject to diagnostic tests.

The sample is made up of one hundred and five (105) companies from table 1 and consist of five quoted agricultural companies, five conglomerate companies, seven quoted construction/ real estate companies, twenty-six quoted consumer goods companies, eleven quoted health care companies, four quoted companies in information, communication & Technology. Eighteen industrial goods quoted companies four quoted companies operating in natural resources, ten quoted companies in Oil & Gas, twenty one quoted companies in services sector. The 105 companies were chosen based on the fact that they meet all the data requirements for hypothesis test in this study.

Table 1: Sectoral Breakdown of sampled Nigerian Listed Companies

Sector	Non-Financial companies	Sampled Companies
Agriculture	5	5
Conglomerate	5	5
Construction & Real Estate	9	7
Consumer Goods	27	26
Healthcare	11	11
ICT	9	4
Industrial Goods	21	18
Natural Resources	5	4
Oil and Gas	14	10
Services	23	15
Total	130	105

The study involved the use of only secondary data from sample quoted company audited financial report covering the period January 2002 to December 2016. The data is restricted to the companies that trade at the Nigeria Stock Exchange. This is because the data is easily available and that since they are quoted companies their corresponding financial statement data that is needed for this study is also available. The information was obtained from the audited financial statement of the quoted companies was also compared with the documentation of the security and exchange commission, Nigeria stock exchange fact books to ensure accuracy in data collection.

Various tests were done to ascertain the non-collinearity of data set and to be certain that OLS assumptions are addressed, Variance Inflation Factors (VIF) was used on variance of an estimator, The VIF formula - $1 / (1-R^2)$. While modify Kolmogorov-Smirnov (K-S) test called Lilliefors test for normality was performed to test for normality on the data set, using SPSS 24. Also linearity test, Autocorrelation test and heteroscedasticity test was performed on the data set. To guard against the problem of heteroscedasticity, Breusch-Pagan test was applied to the data set. T-test and F-Statistic at 5% level of significant was used to examine significance of coefficients of variables in the model. Explanatory power of corporate governance on earnings quality for the total period of observation, adjusted coefficient of determination (R^2) was performed. Also Ordinary Least Square (OLS) simple, regression analysis and Pearson correlation test was performed on data set.

Model Specification

The regression model is specified in the equation (i)

$$\text{DisEQ} = \beta_0 + \beta_1 (\text{OC}_t) + \varepsilon_t \quad (\text{i})$$

Where:

β_0 = regression output the constant

β_1 = the coefficient of the independent variable

DisEQ = earnings quality measure which is discretionary earnings.

OC_t = Ownership Concentration in time t

Findings

The relationship between ownership concentration and discretionary earnings quality was first confirmed. The finding was that a positive and significant relationship exists between ownership concentration and discretionary earnings quality. $R=0.694$ and $R^2=0.481$. This implies that 48% of the variation in return on discretionary earnings quality can be attributed to a unit change in ownership concentration. Thus, a unit change in ownership concentration causes an increase in discretionary earnings quality. The remaining 52% of the variation can be explained by other variables such as board size, interlocking directorship, audit, outside directors.

This implies that, based on the results, the null hypothesis should be rejected. It can therefore be concluded that ownership concentration has significant effect on discretionary earnings quality of quoted non-financial companies in Nigeria. Comparing the results across the ten sectors sampled in this study, it was also discovered that ownership concentration was higher in the natural sector of the economy with 70% than other sectors of the economy in Nigeria.

Conclusion

For the ownership concentration, the conclusion was that, it is a significant positive influence on discretionary earnings practice. Thus for best global practices the share ownership should be dispersed among several holders to guide against any single individual or group of individuals to engaged in high powered discretionary earnings practices. Where the ownership is concentrated there should be presence of outside directors, interlocking directors and any of big four audit firm to assure other stakeholders.

Discussion

Inferential Analysis

The data for the study were subjected to diagnostic tests before being used for inferential analysis. The inferential analyses for this study were Pearson correlation analysis and regression analysis.

Diagnostic Test

The different diagnostic tests were carried out in this study and they include normality test, autocorrelation test (also known as test for independence) and homoscedasticity test.

Normality Test

A One-Sample Kolmogorov-Smirnov Test was done to test the normality of the dependent variable discretionary earnings quality. The null and alternative hypotheses were as follows:

H_0 : The data was normally distributed

H_1 : The data was not normally distributed

The results obtained in table 2 indicate that Kolmogorov-Smirnov Z was 0.345 (P value = 0.000). Since the P value is lower than 0.05, the null hypothesis was rejected and concluded that the data was not normally distributed. It was also revealed in the table that Shapiro-wilk was .351 and P value =.000 respectively indicating that the data are closely related and can therefore be relied on for statistical analysis.

Table 2 One-Sample Kolmogorov-Smirnov Test

	Discretionary Earnings Quality
N	1574
Kolmogorov-Smirnov Z	.345
Shapiro-Wilk	.351
Sig	.000
Asymp. Sig. (2-tailed)	.000

Source: Idode, (2017)

Test for Autocorrelation-Durbin Watson Statistic for independent and dependent variables

The Durbin-Watson d-test was used to interrogate serial correlation in the data. when d value is approximately 2, an indication that there is neither positive nor negative first order autocorrelation. Therefore, the null hypothesis that there was no autocorrelation in the data collected was purposed and tested for this study with Durbin Watson Statistics. The results as presented in table 3 revealed that the Durbin Watson Statistics for was 2.1970 with a p-value of 0.073. Since the p-value was greater than 0.05, the null hypothesis which stated that there was no autocorrelation in the data was not rejected. Furthermore, this implies that the residuals were independent from each other. As revealed that Durbin Watson Statistics for lag 1 was 2.1970 with a p-value of 0.073 while the Durbin Watson Statistics for lag 2 and 3 were 2.1875 and 1.9779 with a p-value of 0.096 and 0.108 respectively. Since the p-value was greater than 0.05, the null hypothesis which stated that there was no autocorrelation in the data was accepted. It can therefore be said that the discretionary earnings for year 2003 was not a function of discretionary earnings for the year 2004. Discretionary earnings for 2009 was also not a function of discretionary earnings for 2010 and soon.

Table 3 Durbin Watson Statistics for Autocorrelation

Lag	D.W Statistics	P-Value
1	2.1970	0.073
2	2.1875	0.096
3	1.9779	0.108

Source: Idode, (2017)

Cohen, Cohen, West and Aiken (2013) and Barley (2009) posit that heteroscedasticity violation make it difficult to gauge the true standard deviation of the forecast errors, usually resulting in confidence intervals that are too wide or too narrow. The existence of heteroscedasticity is a major concern in the application of regression analysis, including the analysis of variance, as it can invalidate statistical tests of significance that assume that the modelling errors are uncorrelated and uniform—hence that their variances

do not vary with the effects being investigated. Therefore, to prevent the problem associated with homoscedasticity in research, it is useful to test for homoscedasticity in this study. Thus this study tested the null hypothesis that the data deployed for this study was homoscedastic in variance using Bruisch pagan test.

The result of the test presented in table 4.revealed that the test statistics was 4.015108 while the P value was 0.55 indicating that the data collected was not heteroscedastic in variance and thus necessitating the acceptance of null hypothesis that the data collected was homoscedastic in variance and can be relied on for regression analysis.

Table 4 Bruisch Pagan Test for Homoscedasticity

Test Statistics	Degree of Freedom	Prob.
4.015108	5	0.5472

Source: Idode, (2017)

Test for collinearity for Discretionary Earnings

As far as collinearity is concerned, two tests the Tolerance and the Variance Inflation Factor (VIF) tests are used in this study. The Tolerance and VIF values are compared to 1. When the values are close to 1, the data is assumed not to contain statistically significant levels of multicollinearity particularly if it falls between the values of 1 and 5. As it was observed from table 5 the tolerance statistics shows .949 for ownership concentration while the VIF results revealed 1.054 for ownership concentration. It therefore implies that since the tolerance results is close to 1 and variance inflation factors values are all between 1 and 5. The data is does not contain statistically significant level of multicollinearity.

Table 5 Tolerance and the Variance Inflation Factor (VIF) tests for collinearity

	Collinearity Statistics	
	Tolerance	VIF
OC	0.949	1.054

Source: Idode, (2017)

Correlation Analysis

Correlation has been defined by Yang (2008) as a statistical measure that indicates the extent to which two or more variables fluctuate together. A positive correlation indicates the extent to which those variables increase or decrease in parallel while a negative correlation indicates the extent to which one variable increases as the other decreases. Kothari and Garg (2014) stated that Pearson Correlation Coefficient is the most widely used method of measuring the degree of relationship between two variables. It ranges from -1 to +1. A correlation coefficient of -1 indicates a perfect negative correlation, 0 indicates no correlation while +1 indicates a perfect positive correlation. It is a statistical

test that informs a researcher the magnitude and direction of the relationship between two variables.

Pearson Correlation Analysis for Ownership Concentration and Discretionary Earnings

The Pearson Correlation Coefficient of ownership concentration and discretionary earnings quality was computed and established as 0.620 (p-value =0.000) indicating a positive relationship between ownership concentration and discretionary earnings quality. From table 6, it could then be concluded that there is a significant positive linear relationship between the two variables since the correlation coefficient is between 0.4 and 0.69 in line with Rumesy (2016) categorization of correlation coefficient. A related study by Wang and Shailer (2015).Shahab-U-Din and Attiya (2012) which evaluates the impact ownership concentration on the profitability in emerging market for five years reported a positive relation between the ownership variable and earnings. The dependent variable was earnings which were measured by earnings per share and the independent variable was ownership concentration.

Table 6 Pearson Correlation Matrix for Independent and Dependent Variables

	DisEar	OC
DisEar	1	
OC	.620**	1

* DisEar- Discretionary Earnings, OC- Ownership Concentration
 Source: Idode, (2017)

The objective was to test the hypothesis that the ownership concentration has no significant effect on discretionary earnings quality of the companies listed at the NSE. A positive association is expected between ownership concentration and discretionary earnings quality. Regression analysis was carried out to establish the statistical significance of the independent variable (Ownership Concentration) on the dependent variable (discretionary earnings quality). The result of the regression analysis as presented in table 7 revealed that $R=0.694$ and $R^2=0.481$. This implies that 48% of the variation in return on discretionary earnings quality can be attributed to a unit change in ownership concentration. The remaining 52% of the variation can be explained by other variables such as board size, interlocking directorship, audit, outside directors.

Table 7 Model Summary for Ownership Concentration and Discretionary Earnings Quality

R	R Square
0.694 ^a	0.481

a. Predictors: (Constant), Ownership Concentration
 Source: Idode, (2017)

To further confirm the relationship, F-test was carried out to test the null hypothesis that there is no relationship between ownership concentration and discretionary earnings quality. Analysis of variance (ANOVA) was used to determine whether there is a regression relationship, between ownership concentration and discretionary earnings quality. The analysis of variance (ANOVA) test in Table 8 revealed that the significance of the F-statistic 0.019 is less than 0.05 meaning that null hypothesis is rejected and can be concluded that there is a significant relationship between ownership concentration and company's discretionary earnings quality.

Table 8 ANOVA for Ownership Concentration and Discretionary Earnings Quality

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	1248.264	1	1248.264	706.261	.0019 ^b
Residual	2778.395	1572	1.767427		
Total	4026.659	1573			
a. Dependent Variable: discretionary earnings quality					
b. Predictors: (Constant), Ownership Concentration					

Source: Idode, (2017)

To establish the significance of regression relationship between the ownership concentration and discretionary earnings quality, the regression coefficients (β) and the intercept (α) in the model were subjected to the t-test in order to test the null hypothesis that the beta is zero. The null hypothesis state that, β (beta) = 0, meaning there is no significant relationship between the ownership concentration and discretionary earnings quality as the slope β (beta) = 0 (no relationship between the two variables). The results on the beta coefficient of the resulting model in table 9 revealed that the constant α = -0.248 which is statistically significantly different from 0, while the p- value = 0.000 which is less than 0.05. The coefficient β = 1.102 is also significantly different from 0 with a p-value=0.046 which is also less than 0.05.

This implies that the null hypothesis $\beta_1=0$ cannot be accepted and the alternative hypothesis $\beta_1 \neq 0$ cannot be rejected which implies that the model $Y = -0.030 + 2.692$ (ownership concentration) is significantly fit. Thus, the model return on discretionary earnings quality = $\alpha + \beta$ (ownership concentration) stands as supported by the result of the regression analysis. This confirms that there is a significant positive linear relationship between the ownership concentration and company's discretionary earnings quality. The result suggests the possibility of higher discretionary earnings quality in a company where ownership is concentrated than those with dispersed ownership. The possible explanation for this result was that if majority owners indeed put greater pressure on managers to meet earnings targets, it may lead to increases in discretionary earnings quality.

Table 9 Coefficient for Ownership Concentration and Discretionary Earnings Quality

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	.248	.069		3.594	.000
Ownership Concentration	3.102	.569	.406	5.451	.046
a. Dependent Variable: Discretionary Earnings Quality					

Source: Idode, (2017)

The result was supported by Nguyen, Locke and Reddy (2015) the study was on the relationship between ownership concentration and earnings performance of companies in Singapore and Vietnam, using a dynamic framework by focusing on two different types of national governance systems i.e. well-developed vs. under-developed. The findings show a positive effect of concentrated ownership on earnings was persists in these markets even after the dynamic nature of the ownership concentration–performance relationship is taken into consideration. Also Claessens and Djankov (2014) the study looked at 706 companies over a period of five years in Czech Republic, the findings shows that ownership concentration has positive effect on earnings. While Wang and Shailer (2015), the study reveal a divergent position from was on ownership concentration and corporate performance in emerging markets, the study used meta-analytical techniques to integrate the diverse empirical findings and investigate factors contribute to the inconsistencies in the empirical evidence, using 419 correlations collected from 42 primary studies of listed corporations in 18 emerging markets, the findings reveals that ownership concentration has negative relation with firm earnings across countries. Our results emphasize the importance of model specification and methods of addressing endogeneity, and support further comparative study of the ownership concentration–corporate performance relation between countries with seemingly similar corporate governance environments.

Recommendation

Following the findings of this study, the following recommendations were made to both management and regulatory authorizes connected with the listed non-financial companies in Nigeria:

Managerial recommendation

The quoted non-financial companies should also ensure that the ownership structure is diverse and widely owned to safeguard the minority shareholders and reduce the overbearing power of the majority shareholders as it was discovered that concentrated ownership has positive significant relationship with discretionary earnings quality of the quoted non-financial companies in Nigeria. Regulatory agencies also need to put stricter regulation on share acquisition of the quoted non-financial companies as was done in the banking sector as it was discovered that family ownership was higher in most of the companies sampled for the study.

Policy recommendation

As is the practice in other clime, companies should be guided by the regulatory authorities on the determination of majority shareholding in quoted non-financial companies in Nigeria in accordance with the international best practices. Strict regulations should also be put in place by the Nigeria stock exchange on reduction of ownership concentration as individual and family form of ownership concentration majorly practiced by the listed companies in Nigeria was found to have adverse effect on earnings quality.

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