



OWNERSHIP STRUCTURE AND AUDIT FEES AMONG LISTED FINANCIAL SERVICE FIRMS IN NIGERIA

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Abstract

This study aims at examining the effect of ownership structure on audit fees among listed financial service firms in Nigeria. In realizing the objectives of the study, the study adopts correlational research design using ordinary least square regression as a tool of analysis. The study used secondary data extracted from the published financial statements of the sampled firms for the period (2007 to 2020). The population of the study consists of 53 listed financial service firms in Nigeria. The dependent variable of the study is audit fees while managerial and institutional ownership were used as independent variables of the study. The findings suggest a significant positive association between institutional ownership and audit fee. Conversely, the findings do not propose any association of managerial ownership with the audit fee. The empirical finding of the study reveals that the explanatory powers of institutional ownership shows a positive significant effect on the predictive factor (audit fees) among listed financial service firms in Nigeria. This study provides useful insights into the importance of ownership role in enhancing the effectiveness of external auditing among listed financial service firms in Nigeria. The study provides evidence that, the monitoring role of institutional ownership has significant effect on audit fees. Also, firm size as a control variable of the study has positive and significant effect on audit fees. The findings of this study may prove helpful to regulators and investors to have insight into the nature of ownership structure in the Nigerian listed financial service firms as an important factor to determine the quality of financial reporting and cost of audit. Based on the findings of this study, it is therefore recommended among others that, Nigerian Security and Exchange Commission should support and encourage institutional investment among Nigerian listed financial firms. In essence this will improve their monitoring roles, ensure the selection of a reputable external audit firm, and have better financial reporting process.

Keyword: *Audit Fees, Managerial Ownership, Institutional Ownership, Financial service firms*

1. INTRODUCTION

The external audit function plays a crucial role in bridging the existing gap between the management of the firm who are responsible in the preparation of company financial statements and the stakeholders that use the information for their decision making. Therefore, external audit services serve as a control and appropriate monitoring device that guide investors in taking a sound decision that may resulted to their wealth maximization. The most important responsibility of an external auditor in both developed and developing economy is to ensure trust on corporate information produced through eradicating where necessary or minimizing the practicability of window dressing of accounting information.

Practically, the majority owners of listed firms are not actively involved in the day-today running of their companies' affairs. Consequently, they hire the services of managers to run and manage the businesses on their behalf. However, this division between managers and owners of the



business creates the agency problem among themselves as a result of asymmetric information between the two. The asymmetry of information raises the significance of financial reports issued by the business firms (William, Glover & Prawitt, 2016).

There are numerous researches on the relationship between ownership structures as a corporate governance mechanism and audit fees in both developed and developing countries such as Nelson and Mohamed-Rusdi (2015), Shan, Troshani and Tarca (2019), Liang, Qin and Xin (2020), Lobanova, Mishra and Raghunandan (2020), Widmann, Follert and Wolz (2020), Waweru, (2020). However, countries in the developing economy like Nigeria have received less attention, and corporate governance and audit fees research in this country remains underdeveloped. The investigation from the developed markets leaves uncertainties concerning the direction and magnitude of the empirical relationship in a developing market, such as Nigeria. These uncertainties relate to the institutional differences, culture and regulatory differences, less restrictive auditor's liability, lower disclosure requirements, and lower government enforcement. The managerial and institutional owners of the firms are bound to create a different perspective of agency problem which is known as principal - principal agency problem perspective. This is a situation where the agency problem is majorly between two sides – managerial ownership on one side and institutional ownership from the other part. Consequently, this structure will lead to expropriation of minority shareholders' value (Bao & Lewellyn, 2017) due to the fact that the major policies and decisions are solely in the hand of a small fraction of the company shareholders. In addition, this structure is characterized by inadequacy or lack of effective oversight and separation of responsibilities that are crucial in restraining abuse of office by the majority shareholders of the firm. Consequently, the concerns of the minority shareholders is obviously alarming, thereby increasing the demand for the services of a reputable audit firm with high audit quality as a contingent measure to mitigate there problems (Habib & Jiang, 2015).

Most of prior researches which focused on the impact of ownership structure on audit pricing were carried out majorly among common law countries, particularly in the United Kingdom (UK), United States of America (USA) and China where their companies' ownership structures are dispersed in nature (for example, Lobanova *et al.*, 2020; Liang *et al.*, 2020; Hall, Hoffman & Liu, 2020). These studies have documented mixed findings on the relationship between ownership structure variables and audit fees and the results provided an evidence that external audit plays a significance governance role in mitigating firm's agency problems (Nikkinen & Sahlstöm 2004; Chiraz and Lesage 2010; Liang *et al.*, 2020 & Hall *et al.*, 2020).

Some of the empirical studies used the amount of fees paid to external auditors to represent the level of audit quality (Zaman, Hudaib, & Haniffa, 2011; He, Pittman, Rui, & Wu, 2017; Ghafran & O' Sullivan, 2017). The higher the cost of audit the better the audit quality, *ceteris paribus*, this is attributable to audit effort exerted (i.e., more audit hours) or external audit specialty and expertise (higher billing rates). Sundgren and Svanström (2013) suggested audit fees to be a proxy for audit quality due to the fact that, higher costs of audit service are normally associated with higher quality, it is expected that a greater volume of audit investigation requires more audit hours and/or the use of more-specialized audit staff – resulting the cost of audit to be higher.

Conceptually, based on agency theory perspective, firm's ownership structure and auditing can be conceptualized as two different corporate governance mechanisms which may work either as a



substitute or complement of each other. External audit as a part of monitoring mechanisms represents the interest of shareholders in which external auditors examine and audit affairs of firms which shareholders delegate to management and express their opinion (Nelson & Mohamed-Rusdi, 2015). Accordingly, they suggest that the shareholders relied on the external auditors as specialist that monitor and control the agency problems that exist within a particular firm. The relationship between ownership structure and audit fees symbolized the interaction between the internal and external governance mechanisms that works as either complement or substitute to each other (Barroso, Ben Ali, & Lesage, 2018) in order to ensure that firms are properly and effectively managed, directed and controlled. Also, good understanding of the interaction between them and how they influence the monitoring and controlling of agency problems is of paramount important both in academic and practical perspectives. This study therefore, examine the influence of ownership structure on audit fees among listed financial service firms in Nigeria.

The main objective of this study is to examine the effect of ownership structure on audit fees among listed financial service firms in Nigeria. Other specific objectives are:

- i. To examine the effect of managerial ownership on audit fees among listed financial service firms in Nigeria.
- ii. To assess the influence of institutional ownership on audit fees among listed financial service firms in Nigeria.
- iii. To evaluate the impact of firm size on audit fees among listed financial service firms in Nigeria.

In line with the objectives of the study, the following hypotheses are formulated:

H₀₁: Managerial ownership has no significant effect on audit fees among listed financial firms in Nigeria

H₀₂: Institutional ownership has no significant effect on audit fees among listed financial firms in Nigeria.

H₀₃: Firm size has no significant effect on auditor selection among listed financial firms in Nigeria.

2. LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Managerial Ownership

Idris (2008) defines managerial ownership as the percentage of equity shares in possession of directors and principal owners who influence significantly the company's' affairs. Managerial ownership is a continuous variable that is measured as the proportion of ordinary shares owned by executive directors on the board of directors (Shan *et al.*, 2019).

It is an established fact that if an agency problems was not well monitored and controlled it can have an adverse effect on the Performance of the company. Therefore, principals have no other option than to control the agency problems through providing some incentive as well as monitoring measures (Munisi, 2023). These measures serve either as complement or substitute to control agency problems. One of the incentive measure explored by principals in order to minimize agency problems is to provide agents with ownership of shares in the company, this kind of ownership is referred as managerial ownership. Managerial ownership significantly minimizes agency problems thereby aligning interests of agents with those of principals (Jensen & Meckling, 1976). The stake holding of managers helps in providing monitoring mechanism to curtail the manipulation of accounts by the managers. However, the effectiveness of managerial ownership in providing



monitoring role depends on the percentage of their holdings in the firm. If the holding is not substantial enough, the workability of corporate governance regarding monitoring mechanism might be far from being achievable. Similarly, from theoretical opinion, the segregation of ownership from control increases agency cost and predict that if more shares are given to the insiders the issue of conflict would be drastically reduced.

In addition to managerial ownership incentives, principals may use various monitoring mechanisms to control agency problems. One of these monitoring mechanisms is ensuring hiring services of a reputable audit firm. Chiraz and Lesage (2010) and Munisa (2022) observed a significant inverse association between audit fee and managerial ownership. This signifies that there is no conflict of interests between directors and managers, they have access to private information needed to enhance monitoring and control, thereby reducing audit risk. The presence of a sound and objective decision-making mechanism arising from segregation of responsibilities results in lowering the audit fees which is consistent with the agency theory.

Nelson and Rusdi (2015) found no significant relationship between greater managerial ownership and audit fees. Lin and Liu (2013) categorized the managerial ownership into 3 categories namely; low or no managerial ownership at all; intermediate or a situation whereby the interest of managers are aligned with the interest of external shareholders and high region which is a situation where managers have 100 percent ownership. Lin and Liu (2013) found a significant negative connection between audit fee and managerial ownership in low and high regions. They further observe that managers would act in the best interest of shareholders and they tend to report the true financial position of the firm when the ownership structure moves from low level to the next level of managerial shareholding. In line with agency theory, this study expects managerial ownership to enhance monitoring and mitigate audit risk and lower the cost of external audit.

2.2 Institutional Ownership

Institutional ownership is simply the investment in company's equity by large institutions such as banks, pension funds, investment and discount firms and other firms that are associated with these categories. Institutional investors are the equity ownership by large investors having greater control compared with those owned by insurance firms, mutual funds and other institutions of finance. Institutional investors play a critical role in strengthening the firm corporate governance systems. This is due to the fact that they have indestructible motives and power for effective monitoring and compelling managers to act in the best interest of shareholders that would results to their wealth maximization. These motives and power exist due to their fiduciary duties, large voting blocs (Alhababsah, 2019) and business expertize (Shehu & Ahmed, 2012). Thus, institutional investors are most likely to demand (or encourage management to demand) high-quality audits as an effective monitoring (bonding) mechanism.

Khan, Hossain and Siddiqui (2011) posits that effective monitoring mechanism of institutional investors is a function of the quantum of their interest in the firm, the higher the ownership of institutional shareholders the better and effective monitoring of their investment portfolios thus, reducing the audit risk leading to a lesser audit fee. Conversely, Han, Kang & Rees (2009) suggests that the quality of auditing is dependent on nature of institutional ownership in the company. Long-term institutional ownership requires high quality audits from a reputable audit firm for effective corporate governance and reducing the direct monitoring costs for the institutional investors, which increases the audit fee. Also, audit firms charge higher fees in a situation where short term



institutional investors are higher. Similarly, Alzeaideen and Al-Rawash (2018) reported a statistically positive significant relationship between audit fees and institutional ownership while Jamei and Koolivand (2022) investigation of the relationship between institutional ownership and audit fees in Iran for the period of seven years (2011-2017) indicates that there is a significant negative relationship between institutional ownership and audit fees. This implies that the institutional investors manage their investments more actively which translate to less audit work that results to decrease in cost of audit.

For the purpose of this study, agency theory was adopted as underpinning theoretical framework. This theory is rooted in the work of Berle and Means (1932) on the separation of firm ownership from management. Later, Jensen and Meckling (1976) identified the agency relationship between principal (the owner, shareholder) and agent (the management), whereby the principal engages the agent to perform services on their behalf. According to Jensen and Meckling (1976), the management is obliged to maximize the shareholder's wealth for long-term survival of the business. Therefore, some decision-making authority is given to the top management to ensure smooth business operation. There are costs associated with the agency problem which arise from the conflict between the principal (shareholders) and the agent (the management), such as costs associated with monitoring management.

Jensen and Meckling (1976) categorized agency cost into monitoring costs, bonding costs and residual costs. Monitoring costs are defined as the costs paid by shareholders to measure, monitor and control the activities and behavior of the management. Included in these costs are the cost of appointing the board of directors to monitor management's activities and the cost paid to external auditors to verify the accuracy of the financial statements prepared by the management. Bonding costs, on the other hand, relate to the debt contract between the principal (the lenders) and agents (the borrowers). It is the cost of establishing and complying with the mechanisms of guaranteeing that the agent's remuneration is based on the principal's expectations on how much the agent's behavior is likely to oppose the principal's interests. The main focus of the theory in the agency relationship is the selection of an appropriate governance mechanism between principal and agents to efficiently align the principal's and agents' interests, and hence minimize agency costs.

3. METHODOLOGY

This study adopted a correlational design. The design has supported the analysis, interpretation and description of the collected quantitative data of the study population. The population of the study consists of all the 53 listed financial service firms in Nigerian Exchange Group (NEG) as at 31st December 2020. The period of the study is considered adequate because it will afford an analysis of the association and the extent of the relationship between the independent variables and the dependent variable over a period that coincides with the aftermath of financial crises and share prices fluctuations in the capital market which eroded the performance of many Nigerian firms in 2009. The period also coincides with fallout of the economic recession of 2016 through to 2017 that affected the operations of financial institutions in the country.

Also, for a firm to be included in the study it must have its data available throughout the period under study, on the basis of this, twelve (12) firms were removed. Thus 41 out of 53 listed financial service firms in Nigeria that have their data available throughout the study period have satisfied this criterion. Therefore, the study adopted census approach in which all the 41 firms were used in



the investigation. The data of this study was extracted from the annual reports of the sampled firms for the period of fourteen years (2007 to 2020). In view of the nature of the Dependent variable, the study used ordinary least square regression as a tool of the analysis.

3.1 A prior Expectation

The following represent an apriori expectation on the relationship between the independent variables (Managerial ownership, institutional ownership, firm size (control) and audit fees as the explained variable of study).

Variable	Sign
Managerial Ownership	+/-
Institutional Ownership	+/-
Firm Size	+/-

Table 3.1 Variable Measurement

Variable	Variable Type	Operational definition	Source
Audit Fees (LAUF)	Dependent	A dummy variable 1 if the auditor is an industry specialist in a given year otherwise 0.	Khan <i>et al.</i> , (2015)
Managerial Ownership (MNOW)	Independent	Percentage of shares held by the executive directors of the firm	Salehi <i>et al.</i> , (2018)
Institutional Ownership (INOW)	Independent	Proportion of shares held by institutional investors	Azrul <i>et al.</i> , (2016)
Firm Size	Control	Natural logarithm of firm's total asset in a given year	Alzoubi (2016)

Sources: Literature reviewed by the Author (2023)

3.2 Model Specification

The model will evaluate and test for significance to establish the relationship between the explained and the explanatory variables.

$$LAUF = \beta_0 + \beta_1 MGOW_{it} + \beta_2 INOW_{it} + \beta_3 FSIZ_{it} + \mu_{it}$$

Where:

LAUF	=	Natural Logarithm of Audit Fees
MGOW	=	Managerial Ownership
INOW	=	Institutional Ownership
FSIZ	=	Firm Size (Control variable)

3.3 Control Variable

Apart from ownership structure variables, other variables which may affect audit fees was also included in the model. A model will be misspecified without controlling for the effects of these variables (Hair *et al.*, 2010). Controlling the variables will improve the internal validity of the study and reduce the noise.

The study used firm size as control variable. This is because firm size relates to the internal control system. Large firms are expected to engage team of competent and qualify auditors to audit their



affairs. The larger the firms the more information available to the stakeholders especially investors for investment decision and also, the severity of agency conflict increases as firm size increases. The control variable used were based on prior studies (Gul, 2006; Guedhami, Pittman & Saffar 2014). As widely documented in the previous literature, firm-level characteristics such as firm size is controlled for, and the expectation is that the variable will affect the audit fees. Firm size was proxied by the natural logarithms of total assets, as noted by Palmrose (1984).

4. RESULTS AND DISCUSSIONS

4.1 Descriptive Statistics

The summary statistics of the variables are presented Table 4.1 below.

Table 4.1

Descriptive Statistics

	LAUF	MGOW	INOW	FSIZ
Mean	7.266	0.047	0.295	8.339
Maximum	9.000	0.552	0.890	9.890
Minimum	6.000	0.000	0.000	7.010
Std. Dev.	0.639	0.079	0.204	0.542

Source: Stata output (2023).

Table 4.1 shows the descriptive statistics for the variables and as can be observed, LAUF which is natural logarithm of audit fees has a mean of 7.27 which is equivalent to N53,546,426 (Fifty three million five hundred and forty six thousand four hundred and twenty six Naira only) in monetary term which suggested that the listed financial service firms in Nigeria on average paid the sum of Fifty three million five hundred and forty six thousand four hundred and twenty six Naira annually for the period under study.

From the descriptive statistics in Table 4.1, it can be observed that the average managerial shareholding among the listed financial service firms in Nigeria for the period of study is 0.047 with 0.079 as standard deviation which indicates wide range of dispersion from the mean. This implies that the sampled firms differ in terms of managerial shareholding. It can be seen from the result that it has a minimum of 0 and maximum of 0.552, this implies that while some sampled firms do not have managerial ownership during the study period others have ownership of up to 55.2% managerial shareholding among the listed financial service firms.

Also, the result from Table 4.1 reveals that the descriptive statistics of INOW shows an average of 0.295 with 0.208 standard deviation. This implies that from the value of standard deviation, the responses of the study data are fairly not uniform in view of the fact that the variation is significant. This means that the institutional ownership or indirect holding in the holding structure of listed Nigerian financial service firms during the period of the study is not widely spread. The institutional ownership among the sampled firms are as low as 0% and as high as 89%. The higher value of 89% implies that some sampled firms are exposed to the influence and dictate of institutional shareholders and the risks of taking over the business were high in those firms.



4.2 Correlation Analysis

The Pearson analysis of correlation shows the relationship between the independent and the dependent variables and also the relationship among all pairs of explanatory variables themselves. Table 4.2 presents the correlation matrix for all the variables.

Table 4.2 Correlations

Variables	LAUF	MGOW	INOW	FSIZ
LAUF	1.0000			
MGOW	0.1897	1.0000		
INOW	0.0985	-0.0266	1.0000	
FSIZ	0.7145	0.2088	0.0396	1.000

Source: Stata Output (2023).

From Table 4.2, it is observed that the correlation of independent variables was between -0.0266 and 0.1897. There was no relationship among the independent variables that is strong enough (higher than 0.7) to constitute multicollinearity problem (Hassan, 2011). The extent of the relationship among all the independent variables is therefore slightest and insignificant.

The Table 4.2 shows that MGOW is positively (0.1897) associated with audit fees of the sampled firms. The positive relationship is expected because board ownership of the Nigerian listed financial service firms, due to their nature of business have more stimulus to assign external auditing services to an industry specialist auditor as they wish to protect their investment and also, there major concerned about financial statement is centered on the authenticity and quality of the information provided. The Table also reveals a positive but weak correlation coefficient between INOW and audit fees of the sampled firms (0.0985). The positive association between INOW and audit fees is because institutional shareholders have advantages in terms of knowledge, experience and technical know-how which serve as a very good monitoring tools. This implies that the greater the institutional ownership among the sample firms the higher the demand for hiring the services of a reputable external audit firm which invariably translate into payment of higher charges of audit fees.

4.3 Diagnostic Tests

This study tested for the existence of multicollinearity using variance inflation factor (VIF) and the tolerance value. The results proved of lack of significant multicollinearity among the explanatory variables which resolves suspicion of multicollinearity as presented previously by correlation matrix. The rule of thumb is that if the variables have VIF above ten and tolerance value of less than 0.1 there is a strong indication of the existence of excessive multicollinearity. VIF and tolerance value of less than 10 and 1 respectively confirm the lack of harmful multicollinearity. Similarly, the result of heteroscedasticity shows that the p-value is significant at 1% level, hence indicating that there is evidence of heteroscedasticity. Hence, the need for Generalized Least Square (GLS) because the OLS assumptions concerning homoscedasticity failed. Based on the heteroscedasticity result the use of GLS for the study was recommended, the GLS required Hausman test. The rule of thumb is that if chi-square is significant, then fixed effect GLS is appropriate and vice-versa. The result shows a chi-square of 5.29, $Pr > 0.0214$ which fails the asymptotic assumption of Hausman test, therefore, the study failed to reject the null hypothesis.



The study therefore, conclude that OLS regression with robust standard error is the most appropriate technique of analysis.

4.4 Analysis and Discussion of Robust Regression Result

The regression analysis result is presented in Table 4.3 below:

Table 4.3 Regression Results (Robust OLS)

Variable	Coefficient	Std. Err.	T-Value	Prob.
Constant	0.3379	0.2951	1.15	0.253
MGOW	0.3566	0.3452	1.03	0.302
INOW	0.2237	0.0847	2.64	0.009
FSIZ	0.8209	0.0353	23.24	0.000
R^2	0.5174			
F-stat	190.17	(3, 568)	0.000	

Source: Stata output 2023

Table 4.3 shows that the F- statistic value of 190.17 which is significant at 1% level endorses the general significance and fitness of the regression model which indicates that the model is fit to explain the relationship expressed in the study model and further suggests that the explanatory variables are properly selected, combined and used. Also, the R^2 of 0.5174 which represents the coefficient of multiple determination implies that 51.74% of the total variation in the outcome variable (audit fees) of listed financial firms in Nigeria is jointly explained by the explanatory variables (managerial ownership, institutional ownership and firm size).

From the regression result it is found that managerial ownership has an insignificant positive relation with audit fee. This is consistent with the findings of Nelson and Rusdi (2015), Khan *et al.* (2011) who found that managerial ownership has no meaningful relation with audit fee. However, this result is in contradiction with the findings of Lin & Liu (2013) who found significant positive relationship between managerial ownership and audit fee while Lin and Liu (2013) found a significant negative connection between audit fee and managerial ownership in low and high regions. Munisa (2022) also documented a significant negative connection between audit fee and managerial ownership.

Also, from the Table 4.3, the findings of the effect of institutional ownership on audit fees show a positive and significant relationship which supported the findings of Alzeaiden and Al-Rawash (2018) who reported a statistically positive significant relationship between audit fees and institutional ownership. Nevertheless, this finding contradicts the findings of Khan *et al.* (2011), Mohammadi and Zahra (2014) and Jamei and Koolivand (2022) who documented a significant negative relationship between institutional ownership and audit fees.

On the control variable, the study finding shows that firm size was positively associated with audit fees of listed financial service firms in Nigeria. The relationship was also statistically significant at a 1% level of significance. The result is consistent with findings of Musah *et al.*, 2018; Coffie & Bedi, 2019). This implies that Larger firms requires more attention and strict monitoring than smaller firms; therefore, more time will be spent on audit work, and as a result, high audit fees will be incurred as opposed to smaller ones (Xu, 2011). Bigger firms are more complex and involved



in more activities than smaller ones. Also, they are more publicly visible, as such they tend to disclose more information than their smaller firms.

The overall results of the study provide evidence that ownership structure influences audit fees. In this regard, this study is in support of the previous findings that ownership structure is one of key determining factors of audit fees in Nigeria. The findings have some practical implications on determinants of pricing of audit fees, both to audit engagement clients and external auditors. The findings suggest that ownership structure characteristics are among the determining factors of audit fees.

5. CONCLUSION AND RECOMMENDATIONS

The study examined the effect of the ownership structure of listed financial service firms on audit fees in Nigeria. The study found a positive and significant association between institutional ownership and audit fees among listed financial service firms in Nigeria. The study further uncovered a positive and significant relationship between firm size as a control variable and audit fees. The results, however, found an insignificant association between managerial ownership and audit fees. The results indicated that ownership structure had a significant influence on audit fees among listed financial service firms in Nigeria. The study was underpinned by the agency theory to explain the relationship between ownership structures and audit fees paid to external auditors. It could be deduced from the study result that the higher the agency conflict, the higher the audit fees to be paid to external auditors as it will increase audit risk. This finding can be explained through the influence of institutional investors of the company in ensuring that only a reputable audit firm will be allowed to audit in order to keep them having high quality financial statements which guide them in taking a sound decision.

Based on the findings, the research concluded that institutional ownership plays a positive significant effect on audit fees among listed financial service firms in Nigeria. Therefore, the study recommends that the Nigerian listed financial firms should consider higher percentage of institutional ownership in order to improve their monitoring role.

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