
**EFFECT OF OWNERSHIP STRUCTURE ON EARNINGS QUALITY OF LISTED
INSURANCE COMPANIES IN NIGERIA.**

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ABSTRACT

The Earnings figure is one of the most important economic variables in the financial statement that measures the financial position and performance of an entity. However the earnings reported may not really reflect the true performance of a company due to management manipulation as a result measures are raised to curb this situation among which is ownership structure (distribution of company ownership among its shareholders). The main objective of this study is to determine the effect of ownership structure on earnings quality of listed insurance companies in Nigeria. The study formulates three hypotheses and applied Generalised Least Squared (GLS) Techniques to analyse the relationship between dependent variable earnings quality and the independent variable, institutional ownership, managerial ownership and ownership concentration of the sampled Insurance Companies. Data were extracted from the annual reports and accounts of the Insurance Companies over the period 2012 to 2021. The data analysis technique was regression using STATA version 14. The study found that: Institutional ownership negatively influences earnings quality, Managerial ownership negatively influences earnings quality and ownership concentration negatively impacts on earnings quality but not significant. The study recommends that Nigerian Insurance companies should reduce the shareholding of their managers, motivates their institutional investors to become long term institutional investors and reduces the shareholding of their major investors.

Keywords: earnings quality, managerial ownership, ownership structure, institutional ownership.

1.1 Introduction

Insurance business involves pooling of funds from many individuals and entities known as policy holders to indemnify losses and damages incurred by any of the contributors. The compensation of the risk and losses is dependent upon the terms and conditions of the insurance policy. Insurance policy is therefore, a form of risk management primarily designed to hedge against the risk of a contingent and uncertain loss. Hence, insurance business is a major part of the financial service industry, and as such a vital factor in the protection of the national economy as no modern economy can survive without the support of a viable and disciplined insurance industry (Tran & Hung, 2021).

The quality of accounting information is influenced by an array of factors, most of which stem from the demand for such information for use in contractual arrangements and from the incentives and opportunities of management to manage the reported numbers (Oyebamiji, 2021). Both the demand for quality accounting information for contractual purposes and management incentives to adjust the reported earnings are likely to be influenced by whether the equity of the company is privately held or publicly traded (Fryman, Gray, Hessel&Rapaczynski, 2019).

Many scholars have identified relevance and reliability as the key qualitative characteristics determining the usefulness of accounting information for making economic decisions (Fogel-Yaari, Ronen, 2020). Accounting earnings information is relevant when it influences user's decisions by helping them to form predictions and/or confirm or correct past judgments. Accounting earnings information is reliable if it can be depended upon to faithfully represent, without bias or undue error, the transactions or events that it professes to represent.

To minimize the occurrence of earnings management measures, then the company needs to implement good corporate governance mechanism in the system of control and management of the company. Poor corporate governance practices are often blamed to be one cause of the crisis. Mechanism of good governance is to ensure the owners or shareholders who earn returns of the undertaken activities by the agent or manager (Schleifer & Visny, 2017).

Ownership structure of a firm can be categorized into two groups: proportion of shares owned by insiders and outsiders; proportion of shares owned by institutional versus individual shareholders. For the insider and outsider shareholders category, Jacoby, Li, and Liu (2019) found that managerial ownership is negatively associated with earnings manipulation. Managerial ownership is a variable that might reduce the agency costs as the motivations of managers are aligned closely to the objectives of

other shareholders.

Institutional investors are large investors, other than natural person, who exercise discretion over investment of others. Organizations which are considered as institutional investors are insurance companies (life and non-life), pension funds, investment trusts (including unit trusts), financial institutions (including banks, finance companies, building societies and credit cooperatives), investment companies, and other nominee companies associated with the above categories of institutions (Lang and McNichols, 2017). Institutional investors have the opportunity, resources and ability to monitor, discipline and influence a manager's decision in the firm (Monks & Minow, 2015).

As literature posits, managers of firms that are highly concentrated stand the chance to be highly monitored (Ramsey & Blair, 2013). A firm is said to be highly concentrated if a significant portion of its equity is in the hands of few individuals (Lakhal, 2015). Few individuals with more stakes have more reason to be worried about their investments and hence monitor the management of the firm's affairs. Evidence documented in favour of this hypothesis exist (e.g Hung, Do, Tran, Tran & Ha, 2018). However, other studies documented evidence suggesting that ownership concentration actually induces earnings management (e.g. Latif, Latif, & Abdullah, 2017). The argument here is that, large shareholder have the capacity to pressure the managers to improve earnings so that their market value may improve, and due to this excessive pressure, the managers will then have to resort to earnings management.

In addition, the dearth of empirical researches on the relationships between ownership structure and earnings quality in Nigeria particularly in the insurance companies prompted this study. It is against this background that this study examined the relationship between ownership structure and earnings quality of listed insurance companies in Nigeria. In line with the objectives of the study, the following null hypotheses were formulated:

H01: Institutional ownership has no significant impact on earnings quality of insurance companies in Nigeria.

H02: Managerial ownership has no significant impact on earnings quality of insurance companies in Nigeria.

H03: Ownership concentration has no significant impact on earnings quality of insurance companies in Nigeria.

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Conceptual Framework

In this part, the concept of earnings quality, ownership structure, managerial ownership, institutional ownership as well as ownership concentration are discussed.

2.1.1 Earnings Quality

Earning quality has various definitions in the literature, and there is no generally accepted definition (Ali, Salleh & Hassan, 2008). This diversity could be as a result of different views of researchers on the different dimensions of the concept. Therefore, earnings quality is of a complex nature, and no researcher has ever been able to define it comprehensively or has found a complete index for it (Alves, 2012). Different researchers have suggested different concepts for earning quality, among which are that earnings quality is the degree of conservatism applied in calculating earnings (White et al., 2013) and accruals volume (Dechow, Sweeney, & Sloan 2012). While Hicks (2011) defined earnings quality as the extent to which reported earnings correspond to economic income: The amount that the firm can pay out as dividends (that is, the amount that can be consumed) during a period, while leaving the firm equally well off at the beginning and the end of the period.

Houqe, van Zijl, Dunstan and Karim (2011) and Myers, Myers and Omer (2013) used accruals quality to draw conclusions about earnings quality and view earnings to be of higher quality if accruals quality is high. But, Beneish and Vargus (2012), Penman and Zhang (2012), and Richardson (2013), viewed earnings to be of higher quality when an earnings is more persistent. On their part, Mikhail, Walther, & Willis (2013), defined earnings quality as the extent to which a firm's past earnings is associated with its future cash flows, where high earnings quality occurs when a firm's earnings has high predictability.

2.1.2 Ownership Structure

Incentives to engage in earnings management could be mitigated through effective corporate governance mechanisms such as board structure, ownership structure and capital structure. Among all the corporate governance mechanism, ownership structure as proposed by agency theory is one of the most important corporate governance mechanisms. Ownership structure is the distribution of a company stock among its major shareholders. The separation of ownership and control gives rise to the conflict of interest between owners and their managers who run the day to day business of the company. Lakhali (2015) stated that managers (agents) act on behalf of the shareholders (the principal), who are the actual owners of the firm. This

relationship empowers the manager's position and leave the firm shareholders with no control over the decision making process. Literature shows that, ownership structure is in two forms, firstly, insiders or managers of a firm who also act as shareholders if they possess some portion of the company shares (Latif, Latif & Abdullah, 2017). Secondly, outsiders who own significant number of the company shares have more power and incentive to monitor management actively especially the financial reporting process, thereby reducing the earnings management probability, also increasing earnings quality. As such, ownership structure is expected to have a positive relationship with earnings quality.

2.2 Institutional Ownership and Earnings Quality

Institutional investors are large investors, other than natural person. Organizations which are considered as institutional investors are insurance companies (life and non-life), pension funds, investment trusts (including unit trusts), financial institutions (including banks, finance companies, building societies and credit cooperatives), investment companies, and other nominee companies associated with the above categories of institutions (Latif, Latif & Abdullah, 2017). Institutional investors have the opportunity, resources and ability to monitor, discipline and influence a manager's decision in the firm (Monks & Minow, 2018). Institutional investors are classified into two main groups. The long term institutional investors who invest in a firm with the intention of holding their ownership stake for a long period. Therefore, they have strong incentive to monitor managers because of the huge investment they have in the firm. In this case the relationship between institutional ownership and earnings quality is expected to be positive. The second class is the short term institutional investors, they focus mainly on current earnings rather than in long term earnings, they engage less in monitoring management activity, if they are unhappy with the performance of a firm they sell their ownership stake rather than monitor or remove inefficient managers (Coffee, 2015). In this situation, institutional ownership is negatively associated with earnings quality.

2.3 Managerial Ownership and Earnings Quality

Insider or managers of a firm act also as shareholders if they possess some portion of the company shares; this reduces the agency conflicts and aligning the interest of management and that of shareholders. Agency theory predicts that low insider ownership implies poor alignment of interest between managers and shareholders (Jensen & Meckling, 2014). This insider with low ownership manages earnings for better compensation, relax contractual constraint or avoid debt covenants (Saona, Muro & Alvarado, 2020). It is suggested that they will be more involve in the firm when they own larger ownership, thus, the need for outside monitoring will be reduced, as

long as the interest of insider and outsider converge. There are two views concerning managerial ownership. The convergence hypothesis states that insiders will be seen as monitoring mechanism when they acquire some portion of the company equity, they will prevent managers' opportunistic behavior, and the magnitude of discretionary accruals is predicted to be negatively associated with insider ownership (Lazzem & Jilani, 2018). On the other hand, when there is little separation between managers and owners (that is, when the managers are also part of the owners), management face less pressure from capital markets to signal the firm value to the market and they pay less attention to the short term financial report (Klassen, 2017). Then highly invested managers are more likely to manipulate earnings, since the lack of market discipline, may lead managers to make accounting choice that is out of self-serving interest.

2.4 Ownership Concentration and Earnings Quality

Ownership concentration is a measure of the existence of large block holders in a firm (Tran, 2020). Normally, a shareholder who holds 5% or more of a corporation common stock is considered a major shareholder or block holder. The shareholding of an owner should be significant enough to provide for monitoring the action of the management. The major shareholder can be an individual, a domestic foreign corporation, an institutional investor and or the state. Large block holders have greater incentive to monitor management as the costs involved in monitoring is less than the benefits to large equity holdings in the firm. Wu, Coleman and Bawuah (2020) pointed out that increased ownership concentration provides large block holders with sufficient incentives to monitor managers. Demsetz and Lehn (2013) and Stiglitz (2015) found that large block holders have the incentive to bear fixed cost of collecting information and to engage in monitoring mechanisms. In contrast dispersed ownership leads to weaker management monitoring. That is in a situation where the shareholders hold lower stock in a firm the incentive to monitor management is low because the costs involved in monitoring outweigh the benefits to be derived. Hence, dispersed ownership is expected to impact negatively on earning quality. Theoretically, the presence of a majority of shareholder in the company can result in agency problems between controlling and minority shareholders (Shleifer & Vishny, 2017.). Following this argument, some studies find nonlinear relationship between ownership concentration and profitability. To this end, Oyebamiji (2021) claimed that, management entrenchment occurs causing a moral hazard and information asymmetry problem between the owner and outside investors.

In summary, the findings on the relationship between earnings quality and ownership structure are mixed. Almost all the studies reviewed, measured discretionary accruals

with modified Jones model. Even though it is given more preference than other model, Kothari et al (2005) model, is also ranked the best in dictating earnings management (Moslemany, Nathan, 2019). The studies that used Kothari et al model are few and are foreign studies, also research has not documented any domestic study that determine ownership concentration through Herfindal Hitch man Index (HHI). Also not available is a study of this nature on the insurance sector. Therefore, this study has filled these gaps.

3.0 Methodology

This study adopted a correlation research design to examine the strength and direction of relationship between the dependent and independent variables. The research population consists of all the 35 Insurance companies listed on the Nigerian Stock Exchange as found in the 2011/2020 fact book. The study used secondary sources of data; this is due to the fact that, the models of the study require the use of quantitative data. The technique of data analysis in this study was Generalized Least Square (GLS) regression model. Specifically, a panel data multiple regression technique was used to determine the relationship between ownership structure and earnings quality. Earnings Quality measured by discretionary accrual as residual of accrual model of Kothari et al (2005). Institutional ownership is measured by percentage of shares owned by institution. Managerial Ownership is measured by percentage shares held directly (shares own by the director only) or indirectly (When the director represent the interest of others) by directors. Herlfindal index is used to determine the ownership concentration. Natural log of total assets was used to measure firm size and Ratio of total liabilities to total assets was used to measure leverage. The model of this study is depicted as follows:

$$TA_{it} = \beta_0 + \beta_1 \Delta REV_{it} / A_{it-1} + \beta_2 PPE_{it} / A_{it-1} + \beta_3 ROA_{it-1} + \mu_{it} \dots \dots \dots i$$

All variables are scaled by lagged total asset

Where;

TA_{it} = is defined as the difference between net income before tax (NI) and cash flow from operating activities which is as follows:

$$T A \quad \quad \quad = \quad \quad \quad N I \quad \quad \quad - \quad \quad \quad O C F \dots \dots \dots ii$$

TA_{it} = Total Accruals for firm i in year t

A_{t-1} = Total assets for firm I in previous year

ΔREV_{it} = Change in Revenue of firm i between year t and t-1

PPEit= Gross Property, Plant and Equipment for firm i in year t

ROAit-1 = Net income /lagged total asset

B0, β1, β2 and β3 are the parameters estimate for each firm and each year.

μit = Residual and discretionary accruals portion

The residuals from this industry-year specific regression model are used to determined earnings quality.

Following the estimation of the earnings quality from model 1, the model of the study from which the hypotheses of the study is tested is as follows;

$$EQ = \beta_0 + \beta_1 INTOWN_{it} + \beta_2 MANOWN_{it} + \beta_3 OWNCON_{it} + \beta_4 FIRMSZ_{it} + \beta_5 LEV_{it} + \mu_{it} \dots \dots \dots iii$$

Where;

EQ = Earnings Quality

INTOWN= Institutional Ownership MANOWN= Managerial Ownership OWNCON = Ownership Concentration Control variables

FIRMSZ = Firm Size

LEV = Leverage

B0 is the intercept and β1 ...β5 are Parameters of the model to be estimated

εi = Error term

4.1 Result and Discussion

In this section, the results of data analysis are presented. The hypotheses testing were also carried out and on which basis the null hypotheses were rejected or supported.

4.2. Descriptive Statistics

The summary of descriptive statistics of the variables used in this study is presented in Table 4.1

Table 4.1: Summary of Descriptive Statistics

Variables	Mean	Std. Dev.	Min	Max
EMGT	.110	.149	.000	.823
INSTOWN	.397	.200	.070	.790
MANOWN	.237	.233	.010	.850
OWNCON	.416	.213	.040	.960
TA	22.607	1.609	15.689	25.291
LEV	44.432	429.368	.038	4953.190

Table 4.1 shows the summary of empirical distribution of all the variables used in the study. The full result is attached as appendix A. The mean and standard deviation of earnings management is .110 and .149 respectively. The

percentage of institutional ownership ranged from 7 to 79 percent with an average of 40 percent. The share holdings of managers ranged from 1 to 85 percent with 0.24 as average. Ownership concentration ranged from 4 to 96 percent. The control variables of firm size and leverage ranged from 15.69 to 25.29 and 0.04 to 4953.19 with averages of 1.609 and 429.37 respectively.

4.3 Correlation between variables.

Pearson correlation was computed to determine the degree of relationship between the dependent variable (earnings quality) and independent variables of the study (institutional ownership, managerial ownership, ownership concentration firm size and leverage). Summary of the results are in Table 4.2 below.

This indicates that institutional ownership and managerial ownership is positively correlated with earnings management; this indicates that the higher its shareholdings in those firms the more the earnings management and consequently the lower the quality of the earnings they report. Also the relationship between managerial ownership and earnings management is positive, indicating a negative correlation with earnings quality. Meanwhile, the correlation between earnings management and ownership concentration is negative, suggesting that ownership concentration reduces earnings management, thereby increases earnings quality. Furthermore, the correlation between earnings management and the control variables revealed that; earnings management is negatively correlated with leverage, thus positively correlated with earnings quality, and positively correlated with firm size, hence negatively correlated with earnings quality.

4.5 Results and Discussion of Regression Analysis

In order to determine the best fitted estimate of the model of the study, pooled Ordinary Least Squared (OLS) was run first to determine the coefficient. This was followed with heterokedasticity test. The null in this test is homoscedasticity. The result showed a P-value that is significant at 1%, thereby indicating the presence of heterokedasticity. The full result is attached as appendix E. Since the pooled OLS revealed heterokedasticity, Generalised Least Squared (GLS) technique was further employed in order to capture the special features or heterogeneity of each entity or cross-sectional unit, which was used to run both the fixed and random effects. In addition, the FE Hausman specification test was carried out in deciding between FE and RE estimate of the coefficients, based on the estimate of the two models (FE and RE). The Hausman specification test suggested FE as evidence with $p > 0.02$. The result of Fixed Effect (FE) proved fitted with $\text{Prob} > F 0.0032$. The details can be found on appendix G.

Table 4.3 Summary of Fixed Effect Regression Result

Variables	beta value	t value	p value
C	-.01	-.36	.72
INSTOWN	.53	2.59	.01
MANOWN	.22	2.25	.03
OWNCON	.07	.83	.41
FIRMSIZE	.00	-.59	.56
LEV	.00	-.51	.61
R ²	.15		
F-Stat	3.81		
Sig.	.00		

Since this study is on earnings quality and the model employed was developed for earnings management, the sign of the coefficient derived from the result would be interpreted as opposite. This is due to the fact that earnings quality and earnings management have inverse relationship, that is, higher earnings management indicates lower earnings quality and vice versa. The analysis therefore revealed that institutional ownership has a significant positive relationship with earnings management ($t = 2.59; p < .01$). This translates to institutional ownership having significant negative relationship with earnings quality. This also indicates that the presence of institutional investors in the ownership structure of Nigerian insurance companies increases the level of earnings management in these companies and thereby reduces the earnings quality they report. This result contradicted the involvement theory that underpins this study which stated that institutional investors reduce earnings management, thereby, improve earnings quality. The reason for the deviation from the theory could be that Nigerian Insurance Companies institutional investors are myopic or short term institutional investors who are more interested in immediate earnings in short term than long run, as a result they do not engage in monitoring the activities of the management, instead they sell their ownership stake and invest somewhere else if anything unfavorable happens. This result is consistent with the findings of Fogel-Yaari and Ronen (2020) who found significant positive relationship between institutional ownership and earnings management. It also does not follow with the study of Chung *et al.*, (2002) who showed that institutional shareholding restrain managers from managing accruals. In terms of earnings quality however, the study contradicts Anagnostopoulou and Tsekrekos (2017) who revealed that institutional investors play a positive role in determining earnings quality. This study also fails to agree with **Oyebamiji(2021)** study, who found a significant relationship between institutional ownership and earnings quality. Therefore, the result of this study did not support the null hypothesis, which stated that there is no significant relationship between institutional ownership and earnings quality. With this empirical evidence the study rejected the null hypothesis, as it is showing that institutional ownership has a significant negative

impact on earnings quality of insurance companies in Nigeria.

Managerial ownership is significantly positive related with earnings management ($t = 2.25$; $p < .03$). This also shows that managerial ownership has a significant negative relationship with earnings quality. It therefore suggests that, having the managers among the shareholders increases earnings management; this is based on the fact that they have access to the financial statement, as a result earnings management may occur, resulting in poor earnings quality. Considering the findings of the research this study has sufficient evidence to reject the null hypothesis which stated that managerial ownership has no significant impact on earnings quality. The result confirmed the studies of Tran M. D. & Hung D. N. (2021). In the same vain this finding disagrees with involvement theory that underpins this study. The contradiction could be due to the percentage of shares owned by this management, as seen in the result the managerial shareholding is 22 percent which is a very substantial holding that makes them among the highest block holders who have more right in the company, apart from the prudential access they have to the financial statement, as such for any unsatisfactory outcome they will use their personal interest to alter the financial figure in order to achieve their goals , consequently reducing earnings quality. Ownership concentration and earnings management are positively related but the relationship is not significant ($t = .83$; $p = .41$). This also means that there is a negative but not significant relationship between ownership concentration and earnings quality. Revealing that, the more concentrated the shareholdings are the higher will be the earnings management. Thus, the more concentrated the ownership structure the poorer will be the earnings quality. Even though this result is not significant, but it also contradicts the study theory which postulates that ownership concentration improves earning quality, the violation could be that the concentration falls in the low concentration ratio as pointed out in the model used in determining concentration ratio Herfindal Hitchman Index that 10 percent concentration indicate low concentration and from the result depicted above the concentration ration is less than 10 percent, as a result the shareholders may not have sufficient resource to monitors the financial activities of managers as the cost of monitoring is more than the benefit therefore they engage in monopolistic power of dictating to managers what to do rather than monitoring financial activities in other to prevent them altering the accounting figures. This result however confirmed, in terms of direction, the study of Saona, Muro and Alvarado (2020) among others. In addition, the positive direction in the relationship between ownership concentration and earnings management, contradicted the study of Hassan and Yero (2012) while in relation to earnings quality, contradicts the study of Tran (2020). Based on this result, there is no sufficient evidence to reject the null hypothesis that ownership structure has no significant effect on earnings quality.

For leverage as a control variable, the result revealed a positive but not significant relationship with earnings management. The result contradicted the saying of

Trueman and Titman (1988) who added that managing earnings enables managers to reduce estimates of various claimants of the firm about the volatility of its earnings process and so lowers their assessment of the probability of bankruptcy. Also firm size showed a positive but not significant relationship with earnings management. This result does not support the statement of Wu, Coleman and Bawuah (2020) who pointed out that larger firms are typically more politically visible than smaller firms, suggesting a lower proportion of earnings management. In the same vain, this outcome disagrees with Tran (2020) statement that larger firms are more closely scrutinized than smaller firms which encourage them to produce higher quality of reported earnings compared to the smaller firms. The control variables; firm size and leverage are included in earnings management model with the believe that they have influence on earnings management order than that of the independent variable, but from the result of the study the control variables are not significant; this could be due to the fact that, the influential power they have on the dependent variable is so insignificant. These findings are in line with that of **Oyebamiji(2021)**. Testing the overall significance of a multiple regression in terms of R-Squared, this study found an R^2 of 0.15%, indicating that the extent to which the independent variables (Institutional ownership, Managerial ownership and Ownership Concentration) influenced the dependent variable (Earnings Quality) is 0.15%. F-Statistics which is an indicator of the overall model fitness, proved that the model of the study is fit with f-value significance at less than 1%; the p- value is 0.000.

Policy Implications

The study is on the distribution of company's ownership and its influence on the earnings of Insurance companies. Empirically, studies on this aspect revealed positive, negative or inconclusive inference between ownership structure and earnings quality. Whichever way, it has some implications on policy. The findings of this study are useful to insurance companies operators on their share composition, and to understand whether the earnings quality reported depends on these compositions. It will also expose to both the shareholders and the management of the insurance companies the true reflection of the earnings quality reported, that is, whether or not it is being manipulated

This discovery is expected to inform management decision in dealing with the internal situation of earnings manipulation, so that the confidence of the investors is not eroded, which has the implication of the investors adjusting or even withdrawing their shareholdings. Furthermore, the stakeholders can intervene in terms of the composition of the shareholding structure and how it influences earnings manipulation. This can be done by ensuring that policies are made to checkmate these excesses, as well as curtailing the power of any ownership structure to influence management negatively.

5.1 Conclusion and Recommendations

After testing and analyzing the hypotheses of the study on ownership structure and earnings quality of quoted insurance companies in Nigeria, the researcher therefore infer that Institutional ownership does influence the earnings quality of Nigerian insurance companies. Managerial ownership has a significant negative influence on earnings quality. Ownership concentration does not improve earnings quality. Leverage and firm size as control variables have no significant relationship with earnings quality. Following the findings of the study the researcher recommends that the Nigerian Insurance Companies should carefully study their institutional investors in order to find out the best way to make them long term institutional investors, who will never sell their ownership stake even if something unsatisfactory comes up due to the confidence they have in the firm, since long term institutional investors have more power to monitor the affairs of managers, as such the earnings reported is expected to be high.

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