# Ownership Concentration and Earnings Restatement of Listed Industrial Goods Manufacturing Companies in Nigeria

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Abstract
This study is undertaken to examine the relationship between corporate ownership concentration and earnings restatement of listed industrial-goods manufacturing firms in Nigeria, using firm size as a moderator. Based on convenience sampling, a panel data from ten industrial goods manufacturing companies that are listed on the Nigerian Stock Exchange were collected from 2012 to 2018. Inferential analyses were done using logit regression techniques, based on 5% level of significance. Firm size was used as the contextual factor. On the final analysis, it was found that ownership concentration was negatively and significantly associated with both income-increasing and income-decreasing earnings restatements and firm size was able to significantly moderate only the relationship between income-decreasing earnings restatement and ownership concentration. Therefore, based on the results obtained, we concluded that block shareholding is a strategic deterrence mechanism against earnings restatements. We therefore recommended that the Securities and Exchange Commission of Nigeria should evolve institutionalization of block shareholdings and shareholders' activism, to be championed by block shareholders to enhance their monitoring role. Also, regulatory bodies should pay close attention to small firms' high propensity to restate earnings.

**Key words: ownership concentration, earnings restatement, Nigeria**

## Introduction

For accounting earnings to be useful for commercial and economic decision-making, it must possess fundamental attributes of representational faithfulness and relevance. It is noteworthy that any material misstatement or omission of facts or figures in the financial statements will to a large extent debase these fundamental qualities. This is because earnings that lack the attribute of reliability cannot be relevant for its users, (Ijiri,*et al*, 1966). Therefore, earnings restatement is known to diminish this desirable reliability and hence its relevance (Bugshan, 2005). The choice of earnings restatements to be identified as financial reporting failure can be justified with the following reasons: restatements are an acknowledgement that prior financial statements were not in accordance with generally accepted accounting principles (GAAP) (Palmrose &Scholz, 2004);they indicate a breakdown in a firm's internal control system (Kinney & McDaniel, 1989). This explains why restatements have a material adverse effect on firm valuation such as negative market price reaction (Palmrose, Richardson, &Scholz, 2004), declining earnings response coefficients (Wu, 2002); and increasing cost of capital(Hribar & Jenkins, 2004). Restatements can also be technical in nature and not misstatements (Raghunandan, Read, & Whinesant, 2003; Palmrose, Richardson, &Scholz, 2004). These arise from routine actions such as discontinued operations or accounting profession regulatory guideline/task force rulings. Against the backdrop of curtailing opportunistically induced earnings restatements, concerns and attentions in corporate governance have developed exponentially particularly with the pioneering company scandals, e.g. BCCI, Enron, Maxwell and WorldCom, in the UK and USA. The necessity for powerful corporate governance had been highlighted through numerous amendments and standards advanced at both the international level and the country level, for example, the Combined Code in the UK, Nigerian Code of Corporate Governance Code (NCCG), the Organization for Economic Development (OECD) Code and the Sarbanes–Oxley Act in the USA. Among most of these proposed governance frameworks that is aimed at curtailing management excesses, corporate ownership structure has been identified as a key instrument of deterrence in respect of reported accounting numbers.

Of specific interest of corporate ownership structure dimensions in this study is ownership concentration. According, to Ramsey & Blair (1993) and Usman&Yero (2012), managers of firms that are highly concentrated stand the chance to be highly monitored. A firm is said to be highly concentrated if a significant portion of its equity is in the hands of few individuals (Roodposhti & Chasmi, 2010). 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. Ramsay & Blair, 1993, Usman&Yero, 2012). However, other studies documented evidence suggesting that ownership concentration induces earnings management (e.g. Halioui & Jerbi, 2012). The argument here is that, large shareholder have the capacity to coerce managers to improve earnings so that their market value may improve, and due to this excessive pressure, managers will then have to resort to earnings manipulation. In view of these mixed and inconclusive results, which are of foreign origin, it will be interesting to investigate the extent to which corporate ownership structures impact on earnings restatement using Nigerian data. Though there is preponderance of studies on earnings restatement, to the best of the author's knowledge, no study has examined its link with ownership concentration, using Nigerian data. Besides, most of the studies on earnings restatement view earnings restatement as one phenomenon without disaggregating it into income-increasing restatement and income-decreasing restatement components, each of which explains different behaviour of the restating firm. Income-decreasing restatements suggest that prior accounting was aggressive or is prospectively being tax evasive, whereas income-increasing restatements, though still improper accounting, suggest either conservative accounting or "big-bath" behavior. Prior studies suggest that it is important to distinguish between these types of restatements (Callen, Linat, & Segal, 2002; Myers et al., 2003) which have never been done before in Nigeria. Hence this study is undertaken with a view to close these gaps in literature. Therefore, the purpose of this study is to evaluate the relationship between corporate ownership concentration and earnings restatement of publicly listed companies (industrial goods manufacturing firms) in Nigeria. Accordingly the objectives of this study are in two-folds: to ascertain the impact of ownership concentration on earnings restatement tendencies of listed industrial goods manufacturing firms in Nigeria; to determine the moderating influence of firm size in the relationship between corporate ownership structure and earnings restatement tendencies of listed Nigerian industrial goods manufacturing firms.

The rest of this paper will be organized as follows: section two reviews literature on earnings restatement and corporate ownership concentration. The third section focuses on the research methodology, section four presents the results and section five provides the conclusion and recommendations.

## Theoretical Framework

This study is underscored by the agency theoretical underpinnings.

### Agency Theory

Agency theory suggested that ownership and control separation causes a convergence in the search for owners' interests as opposed to managerial interests (Jensen &Meckling, 1976), and consequently, monitoring management resolutions start to be crucial in ensuring that interests of shareholders are safeguarded, and to assure complete and reliable financial reporting. Corporate governance produces a number of restraints to diminish the agency costs, which arise from the contract relationship within a company or a framework to ensure that company finance suppliers attain their investment return (Shleifer & Vishny, 1997). In terms of financial reporting, the corporate governance role is to confirm acquiescence by the financial accounting system, as well as to uphold financial statement credibility (Cohen *et al.*, 2004). Therefore, adequately structured mechanisms of corporate governance would predictably decrease opportunistic earnings restatement tendencies, as they produce active management monitoring, particularly in the process of financial reporting. Corporate ownership structure is deemed a significant monitoring mechanism for managers; hence, it may possibly have a monitoring role in curtailing restatement practices. Thus, since properly structured corporate governance mechanisms are expected to reduce earnings management because they provide effective monitoring of management in the financial reporting process, the notion of active monitoring hypothesis is clearly implied to be the underlying postulation. However, a number of other documented studies suggest that different corporate ownership structures might mean different motivations to control and monitor a firm's management (Morck, Shleifer&Vishny 1988; Shleifer&Vishny, 1986). For example, the level of information asymmetry between managers and investors may be influenced by ownership concentration, which by extension also influences the quality of earnings and managers' accounting choices (Donnelly & Lynch 2002; Fan & Wong 2002). Ownership concentration measures the existence of large shareholders in a firm (Thomsen & Pedersen, 2000, as cited in Roodposhti&Chasmi, 2010). The expectations for firms with highly concentrated ownership are of two differing views. While some scholars are of a view that ownership concentration is negatively related to earnings management, others concluded with evidence that positive relationship exists as it indeed induces managers to engage into earnings management. Research that documented the negative relationship include the work of Ramsay and Blair (1993); Zhong, Gribbin and Zheng (2007), Chen, Elder and Hung (2010); Roodposhti and Chasmi (2010), and so on. On the other hand, studies that documented positive relationship between ownership concentration and earnings management includes the works of Halioui and Jerbi (2012); Morck, Scheifer, and Vishny (1988); McConnell and Servaes (1990); and the work of Aharony, Lee and Wong (2000). Thus, from agency theory perspective, either direction of relationship (i.e. negative or positive) can be explained.

## Hypotheses Development

### *Ownership Concentration and Earnings Management*

The notion of ownership structure being a potent instrument of deterrence mechanism against managerial opportunism is founded on *effective monitoring hypothesis*. Small shareholders will not be concerned with monitoring, as they would have to tolerate the costs of monitoring; thus, they only take part in a small portion of the welfare (Zhong, Gribben&Zheng, 2007). Large shareholders play an important role in firms' internal control, as the participation extent would motivate them to influence and monitor the firm strategy in which they have invested (Gabrielsen, Gramlich&Plenborg, 2002; Shleifer&Vishny, 1997; Yeo, Tan, Ho & Chen, 2002). This indicated that larger shareholders should, consistent with the hypothesis of efficient monitoring (Jensen &Meckling, 1976), lower opportunism in managerial behaviour and cause higher inclination to increase company value (Fama, 1980; Fama& Jensen, 1983; Shleifer&Vishny, 1997), thereby having a positive effect on Financial Reporting Quality, as maximizing monitoring by shareholder participation decreases the motives by the owners to expropriate minority shareholder wealth (Boubakri*et al.*, 2005). In this sense, evidence of prior studies emphasize that raised ownership is an active mechanism of corporate governance in controlling management accounting decisions and results in a higher Financial Reporting Quality, (Klein, 2002; Wang, 2006). Yeo *et al.* (2002) reported that the monitoring mechanism role played through ownership concentration diminishes earnings management activities. On the other hand, as soon as the large shareholder level is excessively high, it may cause agency problems because of the expropriation interest of minority shareholders (Boubakri, Cosset &Guedhami, 2005). Large shareholders may practice their control rights to generate special advantages, occasionally expropriating minority shareholders (hypothesis of expropriation). Indeed, controlling shareholders can enforce their private predilections even though those penchants run against those of minority shareholders (Jensen &Meckling, 1976; Shleifer&Vishny, 1997). Consequently, larger shareholders may get involved in the company's management and may cause managers to be involved in earnings management to make best use of their private welfare (Habbash, 2010; Zhong*et al.*, 2007). However, some authors did not highlight any relationship (Peasnell*et al.*, 2005; Sharma &Kuang, 2014).

However, it is the informed opinion of the author that efficient monitoring hypothesis is unlikely to prevail over minority share expropriation. Accordingly, we hypothesize as follows:

$H_{01}$: *Ownership concentration in Nigerian listed industrial goods manufacturing firms does not significantly influence their tendency to pursue income-increasing restatement objectives.*

$H_{02}$: *Ownership concentration in Nigerian listed industrial goods manufacturing firms does not significantly influence their tendency to pursue income-decreasing restatement objectives.*

## Firm Size and Earnings Management

Empirical evidence has been documented that large firms are prone to "big-bath" behaviour, but good corporate governance can mitigate the effect on the average (Shen&Chih, 2007). Contrastingly, Naz, Bhatti, Ghafoor, & Khan, (2011) investigated the impact of firm size on earnings manipulation and find no statistical significance between firm size and earnings manipulation. Sun &Rath (2009) analyzed earning manipulation activities in Australia by analyzing a sample of 4844 firms for the period 2000 to 2006. The outcome of the result suggests that small companies give in to earning management pressure more than larger firms. The study of Burgstahler&Dichev (1997), show that, both small and large sized firms manage earnings to circumvent the small negative or small decrease in earnings. From the foregoing therefore, the following hypotheses are proposed:

$H_{03}$: *Firm size does not significantly moderate the relationship between corporate ownership concentration and income-increasing earnings restatement tendencies of listedNigerian industrial goods manufacturing firms*

$H_{04}$: *Firm size does not significantly moderate the relationship between corporate ownership concentration and income-decreasing earnings restatement tendencies of listed Nigerian industrial goods manufacturing firms.*

## Methodology

In the current study, a quantitative study approach was the dominant theme, and our input was limited to mostly data collection, analyses, and discussion of inferences. We adopted a deductive approach, in line with the positivism philosophy, whereby the principal objective is to obtain reliable and conclusive evidence that inferences result from a credible data source and generally acceptable procedure, and that the conclusions reached with a representative sample can be rationally generalized to a larger population. The population of the current study is industrial goods manufacturing firms in Nigeria and the study period covers from 2012 to 2018, both years inclusive. Logit regression technique was utilized to test the hypotheses of the study. Ten (10) firms were selected using convenience sampling technique due to possible data availability constraint. Convenience sampling gives flexibility of choice of samples that are accessible and near to the researcher (Saunders*et al*, 2003). Published annual financial statements of the sampled firms constituted the major source of data for the study. Following in the footsteps of prior scholarly works (e.g. Palmrose, Richardson &Scholz, 2004 and Junrui& Ma, 2011); earnings restatement was operationalized using a dummy variable. Since it is a dependent variable, and in line with the traditional dichotomous nature of its operationalization, the most suitable form of model is a logit model, (Dabo and Laux, 2012). Accordingly, in any financial year if the reporting entity restates or adjusts reported earnings in relation to prior period activity, the manifestation of the variable is confirmed. Hence the dummy variable, taking value equal to 1 whenever its manifestation is confirmed, otherwise it is assigned zero {0} value, (Junrui& Ma, 2011). Likewise, corporate ownership concentration was operationally defined as the number of equity shares owned by shareholders who own 5% or more shares (Alzoubi, 2015) while firm size was operationalized as natural logarithm of total assets.

### Model Specification and Operationalization

In line with the operational framework of the study, the functional relationships required to test our hypotheses is presented as follows:

$$EARN_j = \lambda_0 + \lambda_1 COWN_j + \lambda_2 FSZ + U \text{ ------ (1)}$$

Where$\lambda_0$is the intercepts of the regression, and $\lambda_n$ isthe response coefficients of corporate ownership concentration?

To account for moderating impact of firm size on earnings restatement, the contextual factors was sequentially added in the equations. Interaction terms were then formulated by multiplying FSIZE to *COWN* followed by a stepwise estimation procedure. The equation that was tested is presented as follows:

$$EARN_{it} = \beta_0 + \beta_1 COWN_{it} + \beta_2 FSIZE + \beta_3 (COWN_{it} * FISZE_{it}) + e. . . . . . . . . . .. . . . \text{ (2)}$$

According to Fairchild and Mackinnon (2009), moderating effect of a variable in multivariate regression analysis is confirmed if the coefficient of any of the interactions is significant at 5% level, leading to improvement in the explanatory capacity of the model. This means moderating effect is confirmed if the inclusions of the interaction terms lead to significant improvement in the coefficient of determination (i.e. adjusted $R^2$). Note that the goal in using the logit regression technique is to objectively estimate the tendency for the focal industry to restate earnings with a view to observing the extent to which ownership concentration influences this tendency. To this end, the empirical model is transformed further as follows:

$$p(EARN = 1) = \frac{1}{1 + 10^{-(\lambda_0 + \lambda_1 COWN_{it} + U)}}$$

where the left hand-side measures the probability of restatement.

## Results

### Univariate Analysis

According to table 1, the distribution of the data on each of the variables across manufacturing firms sampled in the study is asymmetric, with high Jarque-Bera Statistics and associated probability value of each data set less than 5% level of significance. The asymmetric shape of the data distributions is further supported by the inequality of their respective measures of central tendencies.

**Table 1: Descriptive Statistics**

| | COWN | INCR | DECR | FSIZE |
|---|---|---|---|---|
| Mean | 0.100985 | 0.257143 | 0.085714 | 14.47461 |
| Median | 0.054977 | 0.000000 | 0.000000 | 14.44037 |
| Maximum | 0.756708 | 1.000000 | 1.000000 | 14.68220 |
| Minimum | 0.001632 | 0.000000 | 0.000000 | 14.32155 |
| Std. Dev. | 0.127105 | 0.440215 | 0.281963 | 0.130659 |
| Skewness | 2.731259 | 1.111325 | 2.959800 | 0.375308 |
| Kurtosis | 12.16766 | 2.235043 | 9.760417 | 1.636150 |
| Jarque-Bera | 332.1651 | 16.11555 | 235.5060 | 7.068577 |
| Probability | 0.000000 | 0.000317 | 0.000000 | 0.029180 |
| Sum | 7.068979 | 18.00000 | 6.000000 | 1013.223 |
| Observations | 70 | 70 | 70 | 70 |

The average values disclose quite a lot about the extent to which the variables manifest in the industry. For instance 0.101 (or 10.1%) implies that, although block shareholders in the Nigerian industrial-goods manufacturing industry constitute about 10.1% of existing stakes in the industry, there is statistical reason to believe that many of the block shareholders who own far above or below this average percentage exist. This is indicated by the positive skewness (2.731) which means that block holders who own far below the average are in overwhelming majority. As for earnings restatement, the average incidence of earnings restatement in the Nigerian industrial-goods manufacturing firms is 0.343 (or 34.3%), divided into 0.257 (or 25.7%) for income-increasing type and 0.086 or (8.6%) for income-decreasing type. with a standard deviation of 0.438.

**Multivariate Analysis of Earnings Restatement Equations**

The estimated parameters for income-increasing and -decreasing earnings restatements are presented in tables 3& 4. The equation parameters are estimated under two assumptions of relationships; where the relationship is moderated by firm size and where there is no moderating influence of firm size. The column: "*Un-moderated*" presents the regression result without controlling for the contextual factor, while "*Moderated*" presents the same regression equation for earnings restatement but after controlling for the moderating effect of the contextual factor.

**Table 3: Regression Results of Income-Decreasing Earnings Restatement**

| | Un-moderated | | | Moderated | | |
|---|---|---|---|---|---|---|
| **Variable** | **Coeff.** | **Z-Stats** | **Prob.** | **Coeff.** | **Z-Stats** | **Prob.** |
| COWN | 12.6395 | 4.1677 | 0 | -1489.5 | -2.1778 | 0.0294 |
| FSIZE | | | | -11.813 | -2.7696 | 0.0056 |
| FSIZE*COWN | | | | 103.941 | 2.1882 | 0.0287 |
| C | -4.5515 | -5.2338 | 0 | 166.118 | 2.7179 | 0.0066 |
| McFadden R-squared | | 0.4031 | | | 0.5279 | |
| S.E. of regression | | 0.2283 | | | 0.1942 | |
| LR statistic | | 16.5056 | | | 21.6179 | |
| Prob(LR statistic) | | 0.0000 | | | 0.0001 | |

**Table 4: Regression Results of Income-Increasing Earnings Restatement**

| | Un-moderated | | | Moderated | | |
|---|---|---|---|---|---|---|
| **Variable** | **Coeff.** | **Z-Stats** | **Prob.** | **Coeff.** | **Z-Stats** | **Prob.** |
| COWN | -8.7422 | -3.325 | 0.0009 | -53.188 | -0.1895 | 0.8497 |
| FSIZE | | | | 4.33284 | 1.5910 | 0.1116 |
| FSIZE*COWN | | | | 3.09308 | 0.1601 | 0.8728 |
| C | -0.4081 | -1.1673 | 0.2431 | -63.21 | -1.5988 | 0.1099 |
| McFadden R-squared | | 0.0680 | | | 0.1219 | |
| S.E. of regression | | 0.4333 | | | 0.4223 | |
| LR statistic | | 5.42887 | | | 9.7290 | |
| Prob(LR statistic) | | 0.0198 | | | 0.0210 | |

According to Gujarati (2004), moderating influence of a moderator variable in a multiple regression analysis is confirmed if its inclusion in the regression equation and consequent interaction term(s) are significant, such that the explanatory capacity of the equation is enhanced. Apparently for income-decreasing restatement, "*Moderated*" equation has a higher explanatory capacity (i.e. the Mcfadden-$R^2$ is greater under "*moderated*" than under "*un-moderated*"), therefore we can conclude that income-decreasing earnings restatement is better represented under "*moderated*" column than under "*un-moderated*", while hypothesis $H_{01}$is better represented under "*un-moderated*". Hence according to table 3 ("*Moderated*"), all independent variables, including the interaction terms and the intercept, are significant at 5% level. The constant (or intercept) of the logit regression equation is approximately equal to 166.118. The constant term measures the log-odds of the event that income-decreasing earnings restatement in the industrial-goods manufacturing industry will occur if there were no concentrated ownership in the industry. Concentrated ownership is significant with a coefficient of -1,489.5 and associated p-value of 0.0294. This means, increasing theproportion of concentrated ownership in the industrial-goods manufacturing industry will decrease the probability of restating earnings by $10^{1,489.5}$ factors. By implication therefore, increasing tendency of concentrated ownership significantly reduces the chance of income-decreasing earnings restatement in the Nigerian industrial-goods manufacturing industry. Likewise, each of the interaction terms is significant at 5% level, thus confirming the moderating role of firm size in the relationship. By substituting all the parameters into the log-odd function, our estimated log-odd function for income-decreasing earnings restatement is thus presented as:

DECR = 1/ [1+10exp(-(166.118 -1,489.5*COWN - 11.813*FSIZE + 103.9*FSIZE*COWN ))]

The joint significance of the explanatory variables is confirmed by the LR-statistic (9.729) and associated probability value of 0.021. Given the peculiarity of logit regression, the MacFadden-$R^2$ (instead of the normal correlation $R^2$) is used since it is more accurate (Allison, 2013). According to the estimated MacFadden $R^2$, the joint variability of the explanatory variables can account for 52.8% of the observable changing frequencies of income-decreasing earnings restatement. Therefore in the light of the foregoing analyses, we reject hypotheses $H_{04}$fail to accept $H_{02}$. With respect to income-increasing earnings restatement under “un-moderated” column, the results show that concentrated ownership consistently associates negatively (-8.744; p-value = 0.0009) with income-increasing earnings restatement. This consistency is crucial because it shows that block shareholders show similar discouraging disposition against income-increasing earnings restatement. Though the McFadden-$R^2$ indicates that income-increasing tendencies of firms in the industry are influenced by many other intervening variables other than corporate ownership concentration, the response coefficient is statistically significant enough to support the notion that, block shareholders exert considerable degree of influence on income-increasing tendencies in the industry. Again, by substituting all the parameters into thelog-odd function, our equation for estimating probability of income-increasing earnings restatement is presented thus:

INCR = 1/ [1+10exp (-(-0.4081 - 8.7422*COWN))]

Similarly, the significance of the explanatory variables is confirmed by the LR-statistic of 5.43with a probability value of 0.0198. According to the estimated McFadden-$R^2$, the joint variability of the explanatory variables can account for only 6.8% of the observable changing frequencies of income-increasingearnings restatement. Hence in the light of the foregoing analyses, we reject$H_{01}$ and accept $H_{04}$. Thus the results can be interpreted to mean that *effective monitoring hypothesis* prevails over *minority expropriation hypothesis* in the Nigerian industrial-goods manufacturing industry. The findings clearly suggest that block shareholders tend towards effective monitoring over the reporting framework against tendencies that make firms to restate earnings. In other words, block shareholders are effective in monitoring and disciplining managers in order to ensure the accounts prepared are not misstated.Also according to the result, bigger firms tend to have lower frequency of income-decreasing restatement than smaller firms do. This makes sense because bigger firms stand to lose more if their questionable accountings practices are made public, block shareholders who are more exposed than minority shareholders, tend to suppress any public knowledge of such potentially scandalous misdeeds, leading to lower frequency of restatement than their smaller counterparts. Therefore the findings corroborate the results of Gabrielsen*et al* (2002) and Yeo *et al* (2002) and contradict more recent works of Habbash (2010) and Zhong*et al* (2007).

## Conclusion

Despite the increasingly strict regulatory environment, earnings restatement still exists and do not seem to be effectively curbed. The persistence of these corporate misconducts and misreporting has been attributed to failure of control environment (popularly referred to as "*tone-at-the-top*"), such as ownership structure, (Keune & , 2012; Price, Sharp, & Wood, 2012; Romanus et. al., 2008). It is the conclusion of this study that, having an appropriate ownership structure in place and some institutional reforms, can mitigate corporate misconducts and misreporting.

## Recommendations

In accordance with the findings, the following recommendations are made:

1. Block-shareholding should be encouraged through institutionalized collective ownerships such as Unit Trust Funds so as to concentrate equity ownership in the hands of institutions rather than in the hands of individuals. It is hoped that regulations to curtail opportunistic motives would be easier when institutions are involved than when individuals are involved.
2. Shareholders' activism should be institutionalized by regulatory bodies, and such activism should be championed by block shareholders to enhance their monitoring role.
3. Regulatory bodies should pay closer attention to smaller firms who are more susceptible to restate their earnings than do big firms.

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