

# Institutional Ownership and Financial Performance of Quoted Building Materials Firms in Nigeria

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**Abstract:** - This study examines the impact of institutional ownership on financial performance of quoted building materials firms in Nigeria. The population of the study consists of six (6) firms quoted on the Nigerian stock exchange as at 31<sup>st</sup> December 2016 out of which four (4) firms were selected using two criteria which are company that made available their annual report of thirteen (13) years and company quoted on the Nigerian stock exchange before 2004. The study uses multiple regressions as a tool for analysis and secondary source of data analysis. The result of the study revealed that institutional ownership impacts positively significantly on financial performance of quoted building materials firms in Nigeria. The study concludes that institutional ownership affects financial performance of building materials firms in Nigeria and recommended that Security and exchange commission should encourage potential institutional investors in the building material industry to invest in long term investment.

**Keywords:** Institutional ownership, leverage, firm size and financial performance.

## I. INTRODUCTION

The Institutional shareholding has continued to dominate capital market. Empirical evidence on the effect of institutional shareholding and accounting issue are very limited. The result show that the presence of institutional investors lead to higher firms' financial performance. Despite the fact that institutional investors have more expertise, resource and ability to control and monitor management to enhance firms' financial performance, they try to prevent them from hiding corporate resource to opportunistically manipulate earning as corporate performance is related with institutional ownership (Abdul, 1999).

The relationship between institutional ownership and firm performance is the fact that institutional owners have greater incentive to monitor managers because of the substantial amount of shares invested by them in the company. Also, large institutional owners have the opportunity, resources, and ability to monitor, discipline, and influence managers. This corporate monitoring by institutional owners can result in managers focusing more on corporate performance and less on opportunistic or self-serving behavior.

There are two basic assumptions on institutional investors, the first one is based on the "conflict of interest" and the second one is based on the "strategic alliance". The conflicts of interest argued that institutional investors do not actively monitor management activities. They further maintain

that dual relationship between the firms and institutional investor towards investment and business would reduce monitoring. This clearly indicated that institutional investor would not exert their monitoring role since it will affect their relationship with the firms. The strategic alliance maintained that it is always mutually advantageous for the firms and institutional investors to cooperate to reduce monitoring in order to enhance corporate performance. In line with this, institutional ownership would not improve corporate performance. As institutional investors align their interest with managers they do not monitor management activities well, therefore, it reduces their ability in monitoring managers opportunistically in managing earnings, (Agrawal & Knoeber 1996).

On the other hand, institutional investors are considered as efficient monitors which aids in reducing conflict of interest between managers and shareholders. It was maintained that institutional investors are developing increasingly close relationship to firms' managers. All this contributes in reducing managers opportunistic in manipulating earnings for their own benefit (Ryan & Schneider 2002).

The study on the institutional ownership and financial performance of quoted building materials firms seem to have received very little attention in Nigeria. At the moment, we are not aware of any study on institutional ownership and financial performance of quoted building materials firms in Nigeria. In Nigeria, lack of enough study on the area have clearly showed a gap and that gap needs to be filled. Therefore, this study attempts to study the impact of institutional ownership on financial performance of quoted building materials firms in Nigeria. The main objective of the study is to examine the impact of institutional ownership on financial performance of quoted building materials firms in Nigeria. In line with the objective, only one hypothesis is formulated which is:  $H_{01}$  Institutional ownership has no significant impact on financial performance of quoted building materials firms in Nigeria.

## II. LITERATURE REVIEW

Henry and Zheng (2007) examined the impact of institutional ownership on firm performance in the restaurant industry during the period 1999 to 2003. After considering the endogeneity of ownership structure, the result of their findings showed that there was a significant and positive relationship

between institutional ownership and firm performance measured by proxy Tobin Q. Jianguo and Dar-Hsin (2007) investigated the relationship between the institutional ownership and corporate performance of New Zealand non-financial companies. They found out that total number of institutional ownership in New Zealand increased the firm values as measured by Tobin's Q and operational return on equity and the top institution's share ratio is negatively related to the firm value measures. They also found out that institutional investors can make a positive contribution by cost-effective monitoring management's behavior.

Per-Olof, *etal* (2007) examined the relationship between institutional owners and firm Performance of Swedish listed firms from an investment performance perspective. They used marginal q to measure investment performance and Marginal q was the ratio of the return on investments to the cost of capital. They found out that institutional owners positively influence the performance of firms. Prasad and Michael (2007) examined the relationship between the different classes of institutional investors and firm performance. They segmented the institutional investors into classes and recognized the joint determination of firm performance and institutional ownership. Three stages least square was used for their analysis. The result of their study showed that institutional investors with likely investment and business ties with firms have negative effect on firm performance.

Marcia, Alan, Anthony and Hassan (2007) examined the relationship between institutional investor and the operating performance of large firms in the United States. They found a significant relationship between a firm operating cash flow returns and both the percent of institutional stock ownership and the number of institutional stockholders. However, this relationship was found only for those less likely to have a business relationship with the firm. These results suggested that institutional investors with potential business relationship with the firms in which they invest were compromised as monitors of the firm.

Hamadi and Heinen (2009) examined the effect of very large controlling shareholders who are mostly organized in voting blocks and business groups on performance in a sample of Belgian firms. They used a non-parametric panel data analysis that does not impose functional restrictions on the relationship between ownership structure and performance. The findings of their study indicated a negative effect of large shareholders on firm performance for non-family firms and non-parametric analysis showed that the effect of performance varies depending on the size of ownership stakes. Jean and Hidayat (2010) examined the relationship between institutional ownership and firm performance. They proposed a new typology of institutional investors based on their behaviors (active or passive) and the principal factors that may influence them. Their sample consisted of 121 French firms for the period 2006-2008 and using panel data. Globally, their results showed a positive

impact of institutional owners' activities on firm performance. Specially, they confirmed that the effects of institutional owners on firm performance depend on their behaviors and that institutional active behavior is more apparent with the grouping of its influential factors. They also found out that the relationship between institutional ownership and firm performance was bilateral.

Charfeddine and Abdelaziz (2011) examined the relationship between institutional ownership and firm performance for 35 companies listed on the French Financial Market from 2002 to 2005. The result of their findings showed that there was a significant negative relationship between institutional ownership and firm performance measured by a proxy Tobin's Q. Richard and Jesper (2016) investigated the relationship between firm performance and institutional ownership in Sweden. Panel data analysis and a fixed effects model estimated with generalized least squares was employed. Institutional owners were further divided into pressure resistant and pressure-sensitive owners. This study indicates that institutional ownership has no impact on firm performance.

#### *Theoretical Frame Work of Institutional Ownership and Firm Performance*

There are several theories that explain the relationship between variables under study in the literature of accounting. There are three theories that are related to the study namely stewardship theory, stakeholders theory and agency theory. However for the purpose of this study agency theory will be preferred.

The Agency theory view directors as the agent of the shareholders and therefore there is a need for them to act in the best interest of the shareholders. In this situation the agent sometime may not act in the best interest of the shareholders which result to an agency loss situation. The agency theory stress the separation of ownership (principal) and managers (agent) in an organization, therefore it is believed that managers may sometime pursue opportunistic behaviour which may conflict the goal of the owners (principals) and therefore destroyed the wealth of the shareholders. Advocates of the agency approach viewed the manager (directors) as an economic institution that will mitigate the problems and serves as the guardian to shareholders (Hermalin and Weisbach 2000, Fama and Jensen 1988).

This study adopts agency theory due to its relevance in resolving conflict that may arise between managers (agent) and shareholders (principal) of the companies, its empirical evidence by the study conducted by several scholars on Institutional Ownership and firm's financial performance in Nigeria and patterns of Nigeria's companies captures the key postulations of agency theory which serves as bases for the adoption.

### III. METHODOLOGY

This study has adopted correlation research design. The variables of study were not controlled since the phenomenon of the study has already occurred. The study consist of all 6 building materials manufacturing firms quoted on the Nigerian Stock Exchange as at 31<sup>st</sup> December 2016 as the population. The study covered a period of six years (2004-2016). The sample size of the study was derived using simple criteria that constituted (4) companies using purposeful random sampling technique. The sample of the study is (4) building materials manufacturing firms quoted on the Nigerian stock exchange before 2004. The second criterion was the companies that are quoted and their data is available in the annual report and Fact Book. We employed a two-point-filter to eliminate the company considered not suitable for the study, the filters are: the company that made available their annual report of thirteen (13) years on the Nigerian stock exchange and Fact Book and the company must be listed on the Nigerian Stock Exchange before the period of the study that is 2004-2016. This study employed secondary sources of data collection. The data are obtained from the annual reports and accounts of the sample companies and Nigerian stock exchange (NSE) Fact Book in order to achieve the objectives of the study.

#### *Model Specification*

The model that was used to test the hypothesis formulated for this study is presented below. The null Hypothesis is tested considering the results for the P-values at 1%, 5% and 10% level of significance. The first model is the functional model from which the second model Ordinary Least Square (OLS) was derived that is firm performance model.

$$ROE = f(\beta_1 INSTOWN + \beta_2 LEV + \beta_3 FSIZE)$$

$$ROE = \alpha + \beta_1 INSTOWN + \beta_2 LEV + \beta_3 FSIZE + \epsilon_i$$

Where

$\alpha$  = the intercept

ROE = Return on Equity measured by profit after tax divided equity in book value

INSTOWN = Institutional Ownership measured as percentage of shares owned by Institutional investors

LEV = Leverage measured by the total liabilities divided by total assets

FSIZE = Firm Size measured as natural log of total assets

$\epsilon_i$  = error term

Firm size and leverage are control variables.

### IV. RESULTS AND FINDINGS

This part presents the results of the descriptive statistics and regression results on the impact of Institutional ownership on financial performance of building material firms in Nigeria. An explanatory variable and two control variables are employed for the purpose of explaining and predicting the impact of institutional ownership on financial performance of quoted building material firms in Nigeria.

#### *Test of Normality*

The normality tests are supplementary to the graphical assessment of normality. For this study, Z skewness and Z Kurtosis are used to test for normality of the one (1) independent variable; namely Institutional ownership. The Z skewness was computed as skewness divided by standard error of skewness and the Z kurtosis was computed as kurtosis divided by standard error of kurtosis.

Table 1 shows the skewness, kurtosis and Z skewness and Z kurtosis.

TABLE 1 DESCRIPTIVE STATISTICS TABLE FOR THE VARIABLES

Variables	Skewness	Standard Error	Z Skewness	Kurtosis	Standard Error	Z Kurtosis
INSTOWN	1.119	0.330	3.390	0.419	.650	0.644

*This table shows the normality test for institutional ownership.*

In small samples like that of this study which the number of observations is 52, values of Z skewness and Z kurtosis greater or lesser than 1.96 are sufficient to establish normality of the data. The result of Skewness for Institutional ownership is 1.119. The Z skewness of Institutional ownership is 3.390 which is greater than 1.96 shows that the data is normal which indicates that the data for Institutional

ownership relates linearly to the dependent variable (Return on Equity). The results of the Kurtosis for Institutional ownership is 0.419 and the Z kurtosis of Institutional ownership is 0.644 is less than 1.96 and therefore, is normal which indicates that the data for Institutional ownership relates linearly to the dependent variable (Return on Equity). Ghasemi and Zahediasl (2012).

TABLE 2 INSTITUTIONAL OWNERSHIP IMPACT ON FIRM PERFORMANCE

Variable	Coefficient	T – value	P – value
Constant	0.111	0.090	0.281
INSTOWN	0.178	4.054	0.000
LEV	0.196	2.219	0.031
FSIZE	0.017	-0.729	0.469
R	0.598		
R <sup>2</sup>	0.357		
Adj R <sup>2</sup>	0.317		
F stat	8.902		
F-Sig	0.000		
DW	1.967		

Source: Author's computation using SPSS 25

The estimated equation of the study is presented as follows:

$$ROE = 0.111 + 0.178 (\text{INSTOWN}) + 0.196 (\text{LEV}) + 0.017 (\text{FSIZE})$$

The performance of firms measured by Return on Equity would be equal to 0.111 when all other variables are held to zero. A one unit change of Institutional ownership all other variables remain constant, would increase Institutional ownership by 0.178. The regression result of the study shows that the beta coefficient in respect of Institutional ownership is (0.178) and the t-value is (4.054) and it is significant at 1%. This means that, Institutional ownership has a positive significant impact on the performance of quoted building material firms in Nigeria. The implication of this is that, the higher the Institutional ownership the better the financial performance of the firm as a result of minimal misappropriation of shareholders fund managed by managers in quoted building materials firms in Nigeria. This provides an evidence of rejecting the only hypothesis stating that Institutional ownership has no significant impact on performance of quoted building materials firms in Nigeria. The total impact of the Institutional ownership is able to explain the dependent variable up to (60%). This shows a strong positive relationship as indicated by the R value and the remaining (40%) are controlled by other factors. Similarly, the result of the F- statistic shows the overall fitness of the model. The F- statistic has a value of (8.902) and is significant at 1% which implies that the model is fit because it is significant at all levels of significant. Durbin Watson of (1.967) shows that there is no problem of autocorrelation in the data set (Gujarati, 2004).

#### Findings of the Study

Institutional ownership has a strong positive significant impact on financial performance of quoted building materials firms in Nigeria. This result indicates that the presence of institutional investors in the building materials

firms led to improved earnings and can also attract more potential shareholders to them. This finding is consistent with that of Henry and Zheng (2007), Per-Olop *et al* (2007) and Jean and Hidayat (2010).

#### V. CONCLUSION

This study has contributed to findings on corporate governance issues in Nigeria. The study concludes that Institutional ownership improves financial performance of quoted building material firms in Nigeria. Our study differs from most foreign studies on Institutional ownership. The acquisition of shares by institutional investors is seen as a monitoring device that helps to prevent misappropriation of funds by Non-managers and Managerial owners of the firms.

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