POSSESSION FORMATION AND EARNINGS MANAGEMENT OF LISTED CHEMICAL AND PAINTS FIRMS IN NIGERIA

BY

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BEING A THESIS SUBMITTED TO THE SCHOOL OF POSTGRADUATE STUDIES, AHMADU BELLO UNIVERSITY, ZARIA, IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTERS OF SCIENCE DEGREE (M.Sc) IN ACCOUNTING AND FINANCE

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DECLARATION

I hereby declare that this research titled "POSSESSION FORMATION AND EARNINGS MANAGEMENT OF LISTED CHEMICAL AND PAINTS FIRMS IN NIGERIA" is a product of my research effort and to the best of my knowledge; it has never been previously submitted for the award of higher degree in any institution of learning in Nigeria. All works and articles consulted have been duly acknowledged in the bibliography. In addition, I take responsibility for any errors found in the work.

_____ **_____**

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CERTIFICATION

This is to certify that this thesis titled "POSSESSION FORMATION AND EARNINGS MANAGEMENT OF LISTED CHEMICAL AND PAINTS FIRMS IN NIGERIA" written by Farouk Adeiza MUSA with the registration number M.Sc/Admin/1366/2011-2012 meets the regulations governing the award of degree of Masters of Science in Accounting and Finance of Ahmadu Bello University, Zaria. Hence, it is approved for its contribution to knowledge and literary presentation.

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DEDICATION

This work is entirely dedicated to the one and only Almighty Allah who teaches man what he knows not, for his mercies and guidance over me through the period of my study. To my beloved Dad Alhaji Musa Muhammed Alabi, and my Mum (Mrs. Musa Ozio'oroko Sabdat), and the coolness of my eyes (Rukkayyah).

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ABSTRACT

Almost two decades after the global financial crises of 90's which was blamed on the pervasiveness of earnings management, the concept still dominates financial literature. Efforts have been made by researchers in finding out the cause and possible solution. Ownership spread and control, otherwise known as Possession Formation have been identified to have an immeasurable role in mitigating management excessiveness and opportunistic behaviour in misrepresentation of underlying economic reality of a firm, but available literature in this area are mixed and inconclusive. Therefore, the study seeks to examine the influence of Possession Formation on Earnings Management of listed Chemical and Paints firms in Nigeria. Possession Formation was proxied by managerial ownership, institutional ownership, Block-holding and Foreign Ownership, while Earnings management was represented by modified Jones (Dechow, Sloan and Sweeney, 1995) model. Using 56 firm-year paneled observations, Fixed and Random effect were estimated. Secondary data was collected from the eighth firms listed under the Chemical and Paints sectors of the Nigeria Stock Exchange for the period 2006-2012. The findings revealed that, managerial ownership is positively and significantly influencing the earnings management of listed chemical and paints firms, while Institutional ownership, and foreign ownership were found to have negative and significant influence on earnings management of listed chemical and paints firms in Nigeria. However, Block Holdings were found to have an insignificant contribution to earnings management of listed Chemical and Paints firms in Nigeria. Based on the above findings, the study concluded that Possession formation have a great influence in checkmating the opportunistic behaviours of managers in listed Chemical and Paints firms in Nigeria. It is therefore recommended that the proportion of share held by management should be reduced to an average of 15%, while the proportion of share held by both Institutional investors and foreign investors should be increased to an average of 50 and 30% as this will constrain managers from abusive accounting and guarantee great reliance by investors on the quality of financial reports.

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CHAPTER ONE
INTRODUCTION

1.1 Background to the Study

Earnings management has dominated the literature of finance since the witness of the financial scandals around the world by various institutions most especially Enron Corporation, Adelphia, Global Crossing, Cendant, Vivindi, Hollinger, Ahold, Adecco, TV Azteca, Royal Dutch Shell, Seibu, China Aviation, Tyco, HealthSouth, Parmalat, WorldCom, Cardbury, A.P. and Xerox. Similarly, the Central Bank of Nigeria's discovery on the manipulative activities of banks has aroused the interest of many among practitioners, the regulators, academicians and other stakeholders in finding out the cause and the possible solution. Most of these accounting scandals centered on earnings management due to opportunistic behaviour exhibited by managers who are at the helm of affairs in these organizations.

In Nigeria, the Security and Exchange Commission (SEC) has made it mandatory for public companies to publish and make available their audited financial statements annually which must conform with guidelines, formats, and regulations issued by the apex accounting institution and other regulatory and supervisory agencies. Yet, management of corporate organizations often embarks on earnings management in order to increase market value and thus maximize shareholders wealth (Ekoja, 2002). The regulatory inconsistency and the choice available in accounting policies have often called for the exercise of judgments in preparing financial statements. The implication of exercising such judgments is that information provided by management which invariably arouses a certain decision by different users that may make those users to take wrong decision when preparers decide to convey self-serving information.

Despite the regulation, the possibilities of judgment in accounting within the ambit of generally accepted accounting principles are not altered as managers do. It is an unimaginable situation to have accounting systems that are totally rule based without room for occasional judgments (Bello, 2002). If this unimaginable situation must be, it means providing rules for all facts and conceivable circumstances, which is totally and inhumanly impossible. Since new situation may require new accounting rules which arise regularly, then, it is not possible to wipe-out the generally accepted accounting principle (GAAP) judgment opportunities created for management in accounting. Therefore, efforts have been made by researchers to devise methods and systems in which the opportunistic behaviours exhibited by managers can be reduced or eliminated. Thus, the relevance of accounting earnings to various stakeholders cannot be overemphasized; as there is heavy reliance on it by firm and their stakeholders to know their fate.

The self-serving information provided by managers may be as a result of manager's intention to influence a particular contractual outcome amongst others that relies on reported earnings or to mislead the stakeholders about the underlying economic performance of its organization. The issue of occasional judgment in accounting has come to stay rather than its possible elimination as it has become an unimaginable situation to have accounting systems that are totally rule based (Bello, 2002).

The Nigerian governance structure is characterized by the dominance of the largest shareholders who typically exercise significant influence on management decisions directly or indirectly (Shehu, 2012). Available literature in this area suggests that Possession Formation decreases the incentives to manage earnings and also provides the opportunities and incentives to manipulate earnings. Possession Formation of a company involves distribution of control and ownership in the company. While control entails the ability to affect decisions and for shareholders, it is represented by voting power, possession is

regarded as the right to cash flows of the company which is proportionate to the shareholdings.

Separation of ownership and control in firms is common in the modern day business environment as more firms are listed on the stock exchange as public firms. In spite of this, the separation creates serious conflicts between the owners of the firm and the managers. Managers, who are in power, may have the motivation to transfer wealth in terms of bonus or other perks at the expense of the owner - the shareholders to get dividend (Watts & Zimmerman, 1986). In this regard, shareholders may incur cost to monitor the management from such unethical behaviour.

The link between Possession Formation and earnings management has been the subject of importance and ongoing debate; it is however believed that diffusion of a firm's ownership structure plausibly serves the firm's shareholders better than a concentrated ownership structure would (Isenmila & Elijah, 2012). A general belief exists among the public that abusive accounting is employed opportunistically by management of firms for their selfish private gain rather than the interest of the shareholders and other stakeholders in the industry. This misrepresentation of managers' and shareholders' interest have often been referred to as basis for suspicion of the occurrence of manipulative accounting as managers could employ the flexibility provided by the accounting standards, regulatory inconsistencies, dearth in regulations and choices available to managers in accounting to manage earnings opportunistically, thereby creating falsehood in the reported earnings.

The decision to focus on the Chemical and Paints firms stems from the fact that these firms are one of the vibrant sectors within the economy; therefore, there is paucity of studies in this area as only the financial sector of the economy is under close surveillance to check earnings management excesses. Also, the size of the Nigerian economy as measured by the country's

GDP has increased by a compound annual growth rate (CAGR) of 20.68% (in nominal terms) between 2001 and 2006. A noticeable trend in the economy's growth pattern is the increasing contribution of the non-oil sector, particularly the agricultural and manufacturing sectors to the nation's GDP within which the Chemical and Paints firms fall. There is thus, the need for adequate focus on such firms. Furthermore, the global financial scandals that have exposed many companies of their opportunistic behaviour in a bid to secure larger part of the market has really put the financial statement of companies into question of which the Chemical and Paint firms may not be exonerated. It is to this end that the study sought to establish if Possession Formation variables can assist in mitigating the opportunistic behaviour by managers.

1.2 Statement of the Problem

Earnings management is a critical issue in developed and developing countries. In Nigeria, the issue is left under the disguise of business ethics. Only the financial sector of the economy is under close surveillance to check the earning management excesses. Even though earning management does not violate accounting rules, its practice is ethically questionable (Shehu, 2012). The corporate governance culture in Nigeria has consistently failed to be responsible and accountable to the stakeholders and has no deep-rooted mechanism to maintain a balance among the major players (board of directors, shareholders, and management) in corporate governance which have resulted in poor financial reporting quality (Bello, 2005). The challenges and failure of corporate governance in Nigeria stems from the culture of corruption and lack of institutional capacity to implement the codes of conduct governing corporate governance. Company executives enjoy an atmosphere of lack of checks and balances in the system to engage in gross misconducts since investors are not included in the governing structure (Shehu, 2012).

The accounting field as a whole is not also left out in ensuring that the final product of the entire accounting process is safeguarded. On the other hand, earnings management is known to reduce the desired reliability of accounting information and hence its relevance (Bugshan, 2005). Therefore, if earnings need to maintain its importance, then, it will be necessary to employ methods that can be put in place to improve or maintain the practice of reporting quality earnings.

The empirical investigation of this relationship has produced very vast literature that used different samples, covered many time-periods and revealed mixed results. There are various divergent views about the role of Possession Formation (Managerial, Institutional, Block-holders' and Foreign ownership), Warfield, Wild and Wild (1995); Cheng and Warfield (2005); Isenmila and Elijah (2012); Bradbury, Mak and Tan (2006); Soongso (2012); Khanna and Pelapu (2000) and Choi, Jean and Park (2004) are of the view that Possession Formation to a greater extent have positive influence on Earnings Management of firms, while others such as (Sacchs & Warner, 1995; Shehu & Jibril 2012; Hadi, 2012; Koh, 2007; Omar & Hind, 2012; Salsiah *et al*., 2008; Sandra, 2012) have contrary view. Available literature in this area are mixed and inconclusive, and to the best of our knowledge, there is no study in Nigeria that has attempted to resolve the mixed result especially in listed Chemical and Paints firms in Nigeria.

In Nigeria, studies in this area have ignored the foreign ownership variable. The works of Shehu and Jibril (2012) only used one independent variable (Ownership Concentration). Similarly, the works of Sandra (2012) used three independent variables (Managerial Ownership, Institutional Ownership, Ownership Concentration). In addition, the study conducted by Isenmila and Elijah (2012) also used only three variables (Insider Ownership, Institutional Ownership and Block Holdings). The non-use of the foreign ownership variable may threaten the internal validity of their works which may bring about doubt in their

inferences and conclusions drawn. However, this study includes foreign ownership as a variable to establish its influence and direction on earnings management of listed Chemical and Paints firms in Nigeria.)

The works of Sanjar, Maryam, Nima, Jamal and Maryam (2012) study period was between 2006-2008. Apart from the fact that the study period was too short, the research work that was published in 2012 can be regarded as not too current as a lot of activity such as the changes in the corporate governance code of 2003 to the current one of 2011 by Nigeria Securities and Exchange Commission must have been overtaken by this changes. Similarly, the works of Isenmila and Elijah (2012) study period is not too current as their research stopped in 2010. Furthermore, most studies in this area were either conducted in conglomerate sector or banking sector (see Shehu & Jibril, 2012 and Isenmila & Elijah, 2012), and none has specifically covered the listed chemical and paints firms in Nigeria. The study has proven to be different because in Nigeria, researches in this area are few and also unique considering the domain of the study i.e. the listed chemical and paints firms in Nigeria.

1.3 Objective of the Study

The major objective of this study is to examine the extent to which Possession Formation influences earnings management of listed Chemical and Paints firms in Nigeria. The specific objectives are as set forth:

i. to examine the impact of managerial ownership on earnings management of listed Chemical and Paints firms in Nigeria;

ii. to ascertain the effect of Institutional ownership on earnings management of listed Chemical and Paints firms in Nigeria;

iii. to determine the impact of Block-Holding on earnings management of listed Chemical and Paints firms in Nigeria; and

iv. to investigate the influence of foreign ownership on earnings management of listed Chemical and Paints firms in Nigeria.

1.4 Research Questions

i. Does managerial ownership have influence on earnings management of listed Chemical and Paints firms in Nigeria?

ii. Does Institutional ownership have influence on earnings management of listed Chemical and Paints firms in Nigeria?

iii. Does Block holdings have influence on earnings management of listed Chemical and Paints firms in Nigeria? and

iv. Does foreign ownership have influence on earnings management of listed Chemical and Paints firms in Nigeria?

1.5 Research Hypotheses

Based on the highlighted objectives, the following hypotheses are formulated in null form:

Ho_1: Managerial Ownership has no significant impact on Earnings management of listed Chemical and Paints firms in Nigeria

Ho_2: Institutional Ownership has no significant effect on Earnings management of listed Chemical and Paints firms in Nigeria

Ho_3: Block Holdings has no significant impact on Earnings management of listed Chemical and Paints firms in Nigeria

Ho_4: Foreign Ownership has no significant influence on Earnings management of listed Chemical and Paints firms in Nigeria

1.6 Scope of the Study

The study used the entire population of Chemical and Paints firms listed in the Nigerian stock exchange as at 31st December 2012. It covers the period of seven (7) years starting from 2006 to 2012. This period under review is considered appropriate because it falls within the period when different scandals of reported accounting numbers were witnessed both in the developed and developing countries. Modified Jones model of 1991 by Dechow, Sloan and Sweeny (1995) was used to represent Earnings Management in the study while managerial ownership, Institutional ownership, Block Holding and Foreign ownership are the possession formation variables.

1.7 Significance of the Study

The study would have contribution to literature owing to the four Possession Formation proxies used i.e. Managerial Ownership, Institutional Ownership, Block Holdings, and Foreign Ownership. This will make available, to greater extent, inclusive prove on the interdependent nature of Possession Formation and Earnings Management.

Results from this research will provide an understanding and appreciation of link between Possession Formation and earnings management. Gaining such fact will enable listed chemical and paints firms to reap the benefits of having a well structured share ownership.

This study is expected to help standard setters adjust and determine an optimal level of management judgment and discretion to ensure an effective communication between managers and investors and to discourage widespread abusive earnings management. The results of this study can be used as a consideration for investors in deciding to invest and for the creditor in making lending decisions.

The study investigates the influence of foreign ownership on earnings management. This may be first of such study in listed chemical and paints firms in Nigeria that has empirically investigated the variable of foreign ownership on earnings management. Thus, finding will be useful to management and regulators when they design the Possession formation by giving adequate attention to foreign investors.

The result would have an important policy implication for country's reformers and regulators who are striving to improve transparency and quality of financial reporting in the country. That is, the degree of ownership structure is an important determinant of a country's financial reporting quality and lower earnings manipulations.

Lastly, the study would assist the regulators and others such as the management, investors and potential investors to assess the practice of good internal mechanisms within the organization in order to ascertain whether much have to be done by putting an effective and efficient Corporate Governance mechanisms to mitigate the natural tendencies for earnings manipulation in listed Chemical and Paints firms in Nigeria.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter discusses the related and relevant literature of the study. The items discussed are as follows: Conceptualization, Techniques of earnings management, Motivation for earnings management, Proxies for earnings management, Possession Formation and earnings management, Theoretical framework and model build up.

2.2 Conceptualization

In social science researches, the use and application of concepts is of paramount importance since the way they are used in researches could be different from its general application and interpretation. Therefore, in this section the operationalized concepts used in the study are explained exhaustively so that our readers will be able to understand the meaning and value its application. The Concepts highlighted and discussed in this chapter are the Possession Formation which are; Managerial Ownership, Institutional Ownership, Block-Holdings and Foreign Ownership. In addition, the chapter explained the concept of Earnings and Earnings Management.

2.2.1 Possession Formation

Firms may be owned by a diverse mix of different types of investors. With few exceptions, these investors become owners in firms to accomplish financial objectives. However, they may differ with respect to their trading styles, clientele, legal and regulatory environments, and their ability to gather and process information (Brian, Certo, Ireland & Reutzel, 2010).

Ownership Structure of a company refers to the distribution of control and ownership in the company. Control is seen as the ability to affect decisions and for shareholders; it is represented by voting power. While ownership is regarded as the right to cash flows of the company which is proportionate to the shareholdings (Shehu, 2012). Ownership structure is one of the main dimensions of corporate governance and is widely seen to be determined by country-level corporate governance characteristics such as the development of the stock market and the nature of state intervention and regulation (La Porta Silanes, Shleifer & Vishney, 1998). Ownership structure is defined by the distribution of equity with regard to votes and capital but also by the identity of the equity owners. These structures are of major importance in corporate governance because they determine the incentives of managers and thereby the economic efficiency of the corporations they manage. A classic reference is Jensen and Meckling (1976). The concept of Possession formation otherwise known as ownership structure has been defined in so many ways but the basic features of the system remains the same in every definition. The study suggest Possession formation to mean the distribution of control and ownership in a firm in terms of the worth of shares and as such those who have more than fifty percent of the shares in the firm controls and have major influence in the firm's decisions.

i. Managerial Ownership

According to Phani, Reddy, Ramachandran, and Asish (n.d.), Insider ownership reflects the governance problem arising due to variance in the cash flow and control rights. Insider ownership as defined in the governance literature has two dimensions. In the first case, insider ownership can be defined as managerial ownership (manager-owner), where managers are assigned ownership rights as a post facto incentive mechanism by owners. In the second case, insider ownership is defined by the de facto ownership rights held by an

insider who promotes and also manages (owner-manager). But Christiawan and Tarin as cited in (Muhammad, Indra and Yunika, 2013) defined Managerial Ownership as a situation where the manager has shares, in other words, the manager of the firm and as well as the company's shareholders. The definitions above look at the possession of shares from insider perspective which is not different from the shares held by those at the helm of affairs, i.e. the managers of the company. This implies that, managerial ownership means the amount of share either in naira amount or units of shares held by those who manage the affairs of the business where they act as an agent of the public (shareholders).

ii. Institutional Ownership

Bartov *et al*. (2000) posited that institutional ownerships are professional investors who have long-term focus. With respect to the amount of their investments and their know-how, they serve to control the management. Chi-keung (2013) sees the institutional shareholders to include holders of pension funds, investment trusts, and insurance companies that are more powerful: they invest large amounts of money into a firm and thus have greater incentive to monitor their interest in the firms. When the firm performs poorly, they can place pressure on the managers of the firm and even withdraw their investment. Murwaningsari (2009) defined institutional ownership as an institution that has a great investment, including equity investments. Oehl (2000) considers Institutional ownership as an important channel via which minority shareholders are protected against expropriation of controlling shareholders in emerging markets. Institutional Investors refers to the ownership stake in a company that is held by large financial organizations, pension funds or endowments. Institutions generally purchase large blocks of a company's outstanding shares and can exert considerable influence upon its management. The definitions provided by various authorities as regards institutional ownership basically refers to institutions other than the present organization who also have

interest in the organization by subscribing to its shares and having a reasonable percentage of ownership in another organization. The definition given by Chi-keung (2013) would have been more encompassing except for its limitation to only holders of pension funds, investment trusts, and insurance companies. For the purpose of this research, the study adopted the definition given by Bartov *et al*. (2000).

iii. Block Holdings

Block Holdings is an internal governance device that allows the largest shareholders to gain control over management behaviour and decision (Omar & Hind, 2012). Under the corporate governance code released by the Securities and Exchange Commission (SEC) in 2003, SEC defined block-holding as any investor with more than a 5% equity stake in the firm. The definition given by Omar and Hind (2012) did not provide specifically what level constitutes block holdings, but as for the definition given by Nigeria Securities and Exchange Commission in its documents relating to corporate governance code sees block holdings as those who have more than 5% equity stake in a firm. Therefore, since this research is carried out in Nigeria, it was appropriate for this study to adopt the definition given by SEC.

iv. Foreign Ownership

Foreign ownership refers to the complete or majority ownership/control of a business or resource in a country by individuals who are not citizens of that country, or by companies whose headquarters are not in that country (Wikipedia, 2013). Foreign ownership means more than 50 percent of the outstanding voting securities of the firm are owned by one or more foreign persons. Foreign control means one or more foreign persons having the authority or ability to establish or direct the general policies or day-to-day operations of the firm. Foreign control is presumed to exist where foreign persons own 25 percent or more of

the outstanding voting securities unless one U.S. person controls an equal or larger percentage (Encyclopedia, 2013). The definition proffered by Wikipedia is found to be more appropriate to suit our research.

2.2.2 Earnings management

Earnings in Accounting are the excess of revenue over expenses. Earnings are also referred to as Income or profit. Income is regarded as an indicator of management's effectiveness in utilizing the resources belonging to the external users. Income tends to provide the basic standard by which success is measured. Thus, income is a measure to evaluate the quality of management's policy making, decision making and controlling activities.

Earnings management may be defined as reasonable and legal management decision making and reporting intended to achieve stable and predictable financial results (Rahman, Mohammad & Jamil, 2013). Earnings management is the deliberate dampening of fluctuations about “some level of earnings considered to be normal for the firm” (Barnea, Ronen & Sandan, 1976, P. 4).

Healy and Wahlen (1999, P. 365) stated that: "earnings management occurs when managers use judgment in financial reporting in structuring transactions to alter financial reports, to either mislead some stakeholders about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting". It is any action on the part of management which affects reported income, thereby providing no true economic advantage to the organization, which may infact, in the long-term, be detrimental (Merchant & Rockness, 1994).

Earnings Management ‘Involves the repetitive selection of accounting measurement or reporting rules in a particular pattern, the effect of which is to report a stream of income with

a smaller variation from trend than would otherwise have appeared' (Copeland, 1968, p. 19). Earnings Management is also defined as: "an intentional structuring of reporting or production/investment decisions around the bottom line impact" (Hui & Fatt, 2007, p. 196).

Schipper (1989, p. 92), defined EM as: "the process of taking deliberate steps within the constraints of Generally Accepted Accounting Principles to bring about a desired level of reported income". Income smoothing is defined as the "process of manipulating the time profile of earnings or earnings reports to make the reported income stream less variable" (Fudenberg & Tirole, 1995, P. 75). 'Creative accounting is the transformation of financial accounting figures from what they actually are to what preparers desire by taking advantage of the existing rules and or ignoring some or all of them' (Naser, 1993, P. 2).

All the definitions given above have the same thing in common, which is the intentional misrepresentation of accounting figures. But the definition given by Schipper (1989) and Naser (1993) was able to identify the fact that these statements are prepared within the constraints of Generally Accepted Accounting Principles (GAAP) except the fact that Naser feels that some of the existing rules may be ignored. Hence, for the purpose of this study the last definition given by (Naser, 1993) is considered the best that suit this research work.

2.3 Techniques of Earnings Management

The likelihood for earnings management was found in six key areas as cited in the works of Oriol and Catherine, (n.d.), which they listed as follows: regulatory flexibility, a dearth of regulation, a scope for managerial judgment in respect of assumptions about the future, the timing of some transactions, the use of artificial transactions and finally the reclassification and presentation of financial numbers. Each of the six areas is discussed in turn:

i. Regulatory flexibility / Changing Accounting Methods: In many areas of business book-keeping, accounting standards allow companies to choose the reporting method that works best for them. Examples include the system the company uses to account for the value of its inventory and the schedule it uses to depreciate its capital assets. Over the long term, different methods for doing the same thing should produce the same end result - the same total value will go into and out of inventory, for example, or the same amount of value will get depreciated. In the short term, however, a company's choice of methods can significantly affect its earnings from one period to the next. If a company switches from one accounting method to another, primarily to affect earnings, it is engaging in earnings management. Accounting regulation often permits a choice of policy; for example, in respect of asset valuation (International Accounting Standards No. permits a choice between carrying non-current assets at either revalued amounts or depreciated historical cost). Business entities may, quite validly, change their accounting policies. As Schipper (1989) points out, such changes may be relatively easy to identify in the year of change, but are much less readily discernible thereafter.

ii. Dearth of regulation: Some areas are simply not fully regulated. For example, there are (as yet) very few mandatory requirements in respect of accounting for stock options. In the majority of countries, like Spain, accounting regulation in some areas is limited. For example, the recognition and measurement of pension liabilities and certain aspects of accounting for financial instruments.

iii. Discretionary use of Accruals: Management has considerable scope for estimation in discretionary areas. McNichols and Wilson (1988) examine the discretionary and nondiscretionary elements of the bad debts provision.

iv. Timing of Genuine transaction/ Revenue and Expenses Recognition: "Earnings" is just another word for profit, and profit is simply revenue minus expenses. So, the simplest way for a company to manage earnings is by changing the dates on which it enters certain revenues and expenses in its books. To increase earnings in the current period, the company can recognize future revenue prematurely - before that revenue has been fully earned - or delay recognizing expenses. Similarly, if it wants to shift "extra" earnings from the current period to the next, it could delay the recognition of revenue that has been earned, or recognize expenses prematurely, before they are actually incurred. Genuine transactions can also be timed so as to give the desired impression in the accounts.

v. Engaging in or avoiding transactions: Artificial transactions can be entered into both to manipulate balance sheet amounts and to move profits between accounting periods. This is achieved by entering into two or more related transactions with an obliging third party, normally a bank. For example, an arrangement may be made to sell an asset to a bank then lease that asset back for the rest of its useful life. The sale price under such a 'sale and leaseback' can be pitched above or below the current value of the asset, because the difference can be compensated for, by increased or reduced rentals.

vi. Reclassification and presentation of financial numbers are relatively under-explored in the literature. However, the study by Gramlich *et al*. (2001) suggests that firms may engage in balance sheet manipulation to reclassify liabilities in order to smooth reported liquidity and leverage ratios. A special type of creative accounting relates to the presentation of financial numbers, based on cognitive reference points. As explained by Niskanen and Keloharju (2000): ‘the idea behind this behaviour is that humans may perceive a profit of, say, 301 million as abnormally larger than a profit of 298 million’. Their study and others (e.g. Van Caneghem, 2002) have indicated that some minor massaging of figures does take place in order to reach significant reference points.

2.4 Motivation for Earnings Management

Many researchers have identified several factors that motivate management of organization to engage in earnings management. Amongst them are: Contractual motivations, political motivations, taxation motivation, initial public offering, communicating information to investors, CEO changes or threat to management displacement. Here are some factors that motivate managers to smooth earnings as cited in the works of Musfiqur, Mohammad & Jamil, (2012).

i. Stock market incentives

The interaction between accounting numbers and stock markets reaction can indeed push management towards earnings management. Investors often rely on the views and forecasts of stock market analysts to put together a portfolio of potentially successful firms. Meeting or beating the analysts' forecasts seems to be of enough importance for companies to engage in earnings management. Meeting the analysts' expectations is important because firms that meet or beat expectations enjoy higher returns, even when it is likely that this is achieved through earnings management or expectations management. Missing an earnings benchmark has negative implications for stock returns as well as CEO compensation. To be able to meet or beat the forecasts, managers turn to earnings management. If pre-managed earnings are below the forecast, managers use income increasing earnings management. If pre-managed earnings are higher than the forecast, managers can choose between income decreasing earnings management (saving it for a rainy day) or not managing the earnings (hoping for an increase in stock return).

ii. Signaling or concealing private information

Earnings management is, by definition, a process of altering financial information in order to achieve certain goals. Failing firms engage in earnings management and alter their annual accounts to conceal their financial struggle without immediately measuring the consequences on stock price or CEO compensation. The growth signal combined with another signal such as a stock split might be an effective way of communicating private information.

iii. Personal incentives

There might be other than financial motives for the CEO to manage earnings. A new CEO can be tending to downwards earnings management in the year of change and upwards earnings management in the following years. Retiring CEO's use upwards earnings management to leave in style and keep a seat on the board.

iv. Internal motives

There are motives for earnings management that are not linked to external stakeholders (such as shareholders, government or unions) but are intra-company. Within a company, it might also be useful to alter financial reports or to structure transactions in such a way that budget ratcheting is avoided or performance standards are met. Managers will choose to use income-decreasing unexpected accruals when the earnings innovations are transitory. Companies using externally determined standards (i.e. relatively unaffected by participants such as peer group standards, fixed standards or cost of capital) are less likely to smooth earnings than those companies that use internal standards (budget goals, prior year, subjective standards).

v. Management compensation contract motivations

The management compensation theory, also known as the bonus plan hypothesis contends that managers are motivated to use earnings management to improve their compensation, as

management bonuses are often tied to the firm's earnings. It is thus expected that earnings management is used to increase income. Managers are more likely to choose to report accruals that defer income when the cap on bonus awards were reached, as they had no more to gain from extra earnings and would be better off increasing income for the following year at that point. These ties in with the 'big bath' hypothesis, which suggests that if managers are unable to manipulate earnings to reach a particular target, they will have the incentive to use earnings management to decrease current earnings in favour of future earnings and, therefore, future bonuses. Dechow and Sloan (1995) found that managers decrease research and development expenditure in the final year of their terms in order to increase earnings and thus their payout upon leaving the company.

vi. Lending contracts motivations

Another major hypothesis is the debt covenant hypothesis. This theory is based on the fact that creditors often impose restrictions on the payment of dividends, share buybacks and the issuing of additional debt in terms of reported accounting figures and ratios in order to ensure the repayment of the firm's borrowings. Hence, the hypothesis is that firms that have a lot of debt have an incentive to manage earnings so that they do not breach their debt covenants.

vii. Regulatory motivations

Some industries, in particular the banking, insurance and utility industries are monitored for compliance with regulations linked to accounting figures and ratios. Banks and insurance firms especially, are often subject to requirements that they have enough capital or assets to meet their liabilities. Such regulations may give managers incentives to use earnings management. Research has shown that banks which are close to minimum capital requirements use earnings management techniques such as overstating loan loss provisions,

understating loan write-offs and recognizing abnormal realized gains on their investment portfolios, presumably so as not to breach the regulatory requirements.

viii. Political costs

Firms can also manage reported earnings by changing financial statements in order to influence shareholders' opinions and decisions. Governmental regulations and tax laws, when company make use of financial reports, are obvious candidates to be analyzed as possible sources of earnings management motives. It can be valuable to companies to seem more/less profitable to escape from governmental interference. When accounting numbers are the basis for tax calculation, there might be large tax avoidance incentives for earnings management. In summary, political costs seem to be a strong incentive for firms to manage their earnings. This is even proven in economies where there exist no efficient stock markets and CEOs are appointed by the government.

2.5 Measures for Earnings Management

There exist various measures for Earnings management which may be use to proxy the extent of earnings manipulation by management of corporations. Many of the measures used here rely heavily on the existing literature on earnings management, such as review of proxies by Healy and Wahlen (1999) and the works of Dechow and Skinner (2000); Leuz, Nanda and Wysocki (2002) and Dechow and Schrand (2009). Based on this, the study limits the measures to four basic different ways as cited in the works of the above authorities.

i. Smoothing reported operating earnings using accruals

Management can hide changes in the firm's economic performance using both real operating decisions and financial reporting choices. To focus on insiders' reporting choices, the first smoothing measure captures the degree to which insiders alter the "accounting" component

of earnings, namely accruals, to reduce the variability of reported earnings. The measure is computed as the country's median ratio of the firm-level standard deviation of operating earnings divided by the standard deviation of cash flow from operations. A low value of this measure, ceteris paribus, indicates insiders' exercise of accounting discretion to smooth reported earnings. Cash flow from operations is computed indirectly by subtracting the accrual component from earnings because direct information on firms' cash flows is not widely available in many countries.

ii. Smoothing and the correlation of accounting accruals and operating cash flows

Managers wishing to conceal firm performance can use accounting discretion to offset economic shocks to the firm's operating cash flow. They can undo negative shocks to hide poor performance or offset positive shocks to create "hidden reserves" for the future. In both cases, the use of accounting accruals to buffer cash flow shocks results in a negative correlation between changes in accruals and operating cash flows (see Skinner & Myers, 1999). While a negative correlation is also a "natural" result of accrual accounting, the magnitude of this negative correlation, ceteris paribus, indicates opportunistic smoothing of reported earnings that does not reflect a firm's underlying economic performance. Therefore, the contemporaneous correlation between the change in accounting accruals and the change in operating cash flows is the second measure of earnings smoothing. The correlation is computed over the pooled set of firms in each country and the accrual and operating cash flow components of earnings are computed as in equation (1).

iii. Discretion in reported earnings: The magnitude of accruals

Apart from dampening fluctuations in firm performance, managers can use their reporting discretion to simply misstate the firm's economic performance. For instance, insiders can overstate reported earnings to achieve certain earnings targets or report an extraordinary

performance in specific instances, such as an equity issuance (see, e.g., Dechow & Skinner, 2000). The third measure uses the magnitude of accruals as a proxy for the amount of discretion exercised by managers. It is computed as the firm's median ratio of the absolute value of accruals scaled by the absolute value of the firm's cash flow from operations. Scaling controls for differences in firm performance (and size).

iv. Discretion in reported earnings: Small loss avoidance

Evidence was presented by Degeorge *et al*. (1999) and Burgstahler and Dichev (1997) that US managers use accounting discretion to avoid reporting small losses. While one may argue that managers have an incentive to avoid losses of any size, they have limited reporting discretion and hence are unable to report profits in the presence of large losses. Small losses, however, are more likely to lie within the bounds of insiders' reporting discretion and can be avoided at relatively low cost. Thus, in each firm, the ratio of small reported profits to small reported losses reflects the extent to which firm insiders exercise discretion to avoid reporting losses. Following Burgstahler and Dichev (1997), the ratio of "small" profits to "small" losses is computed, for each country, using after-tax earnings scaled by total assets. Small losses are defined to be in the range [-0.01, 0.00) and small profits are defined to be in the range [0.00, 0.01]. In order to reliably compute this ratio, at least 5 observations of small losses for a firm are required to be included in the sample.

2.6. Review of Empirical Studies on Possession Formation and Earnings Management

Academic literature extensively studied earnings management in response to incentives to achieve specific objectives. Properly structured corporate governance mechanisms are expected to reduce earnings Management because they provide effective monitoring of management in the financial reporting process. Some studies recorded that the managers'

incentives to manage earnings is limited by certain corporate governance mechanisms (Dechow *et al*., 1996 and Jiambalvo, 1996). The corporate ownership structure of a firm is considered as an essential managers' monitoring mechanism, so it may have a monitoring role in constraining the occurrence of earnings management. Existing studies suggests that the different Ownership Structures entails different incentives or motivation to control and monitor a firm's management (Morck, Shliefer & Vishney, 1988 and Shleifer & Vishney, 1986). The following section is a review of the link between the selected variables (managerial ownership, institutional ownership, block holding and foreign ownership of the study and the earnings management.

2.6.1. Managerial Ownership and Earnings Management

Managers with high ownership interest in the firm are less likely to alter earnings for short term private gains at the expense of outside shareholders. Managers whose interest is consistent with shareholders are more likely to report earnings that reflect the underlying economic value of the firm (Dhaliwal, Salamon & Smith, 1982). Jensen and Meckling (1976) theorized that as management ownership increases, their interests will be more closely aligned with owners and the need for intense monitoring by the board should decrease.

The analysis of Salsiah, Salleh and Hassan (2008) showed that managerial ownership is negatively associated with the magnitude of accounting accruals after examining the association between the level of managerial ownership and earnings management activities. The research was conducted in Malaysia though using a reasonable sample size of 1,001 out of 1484 firms listed, the period is considered too short as it only investigated two years between 2002 to 2003. Sandra (2012) in her research which was conducted in Portugal documented that, in all models, the managerial ownership is significantly negatively related with earnings management which is consistent with the alignment of interest hypothesis. The

negative relationship suggests that the higher managerial ownership, the lower the magnitude of discretionary accounting accruals. Zhao *et al*. (2008); Petra (2002) and Vafeas (2000) provide an evidence that firms with a higher share ownership by management report earnings numbers of higher quality, which support the agency theory and the alignment hypothesis contentions that both managers and shareholders' interests will be converged when management own a higher stock of shares. Bradbury *et al*. (2006) and Saleh *et al*. (2005) provide similar findings in which they indicate that the reliability of financial information improves as managerial ownership increases. Sanchez-Ballesta and Garsa-Meca (2007) examine the relationship between managerial ownership and discretionary accruals for a sample of Spanish non-financial companies. Their results support the hypothesis that insider ownership contributes to the constraining of Earnings Management when the proportion of shares held by insiders is not too high.

The level of managerial ownership affects both the informativeness of earnings and the magnitude of discretionary accounting accruals. Results from empirical works show that managerial ownership is positively associated with earnings explanatory power for returns. For example, managerial ownership could have negative effect on earnings management (Warfield, Wild & Wild, 1995) or a positive effect due to entrenchment or expropriation effects (Cheng & Warfield, 2005). Also, Isenmila and Elijah (2012) in their research observed that the relationship between managerial ownership and earnings management is positive and statistically significant at 5% level. When there is little separation between owners and managers, management face less pressure from capital market to signal the firm value to the market and they pay less attention to the short-term financing report (Jensen, 1986 and Klassen, 1997) therefore, highly invested managers are more likely to manipulate earnings, since this lack of market discipline may lead insiders to make accounting choices that reflect personal motives rather than firm economies. In this situation, the entrenchment

hypothesis states that high levels of insider ownership can become ineffective in aligning insiders to take value maximizing decisions, which may lead to earnings management to increase (Morck *et al*., 1988).

From another dimension, other researchers documented that managerial ownership has no significant effect on increasing the integrity of the financial reporting (Abd Al Naseer, 2012). In a similar vein, empirical studies on the relationship between managerial ownership and the reporting quality of earnings numbers have reported insignificant findings. Such as a research conducted by Korczak (2004); Velury and Jenkins (2006), while Chang and Sun (2008) also reveals that management ownership and Earnings Management is not significantly correlated. In line with the above, Hafiza and Susela (2005) in their study, failed to find any significant association between managerial ownership and earnings quality. Liu and Lu (2007); Gabrielsen *et al*. (2002) do not find any significant impact of managerial ownership on the reliability of earnings information.

2.6.2. Institutional Ownership and Earnings Management

Given the considerable sums of money that institutions invest, it is not surprising that they tend to be much more knowledgeable than the average investor when it comes to the companies and industries in which they have invested. Institutional portfolio managers often meet personally with a company's top executives, and in many cases the research they conduct is further supported by equity analysts known as "buy side" analysts who evaluate prospective companies and industries in great depth before making specific investment recommendations.

It is important to note that institutional ownership is not governed solely by a particular security's fundamental prospects. Internal policies or objectives, SEC regulations, time horizon, and a variety of other factors can have a major impact on a particular institution's

investment decisions and thus its ownership positions. For example, some institutions may be restricted from investing in certain companies or industries, and others may make decisions based on future cash needs (as is often the case with pension funds). Considering the vast amount of resources, talent, and research capacity these large institutional investors have at their disposal, their investing decisions tend to carry a great deal weight with smaller investors, many of whom scrutinize institutional trading patterns carefully. For this reason, institutional trading can have an enormous impact on the price of individual securities and can even influence the direction of the broader markets.

Empirical evidence supports the hypothesis of increased institutional investors' ownership as an effective corporate governance mechanism in constraining earnings management. It is considered as an important channel through which minority shareholders are protected against expropriation of controlling shareholders in emerging markets (Oehl, 2000). These literatures argue that institutions have greater resources, are more sophisticated than individual investors and have more relevant expertise and experience to monitor management; and therefore, they are able to compel effective disclosure of information. The advocates of the strategic alliance hypothesis argue that Earnings Management of firms with high institutional shareholdings is low. This argument is premised on the fact that institutional investors are expected to force firms' management to focus on current earnings, rather than long-term earnings, to avoid reporting disappointing earnings to interested parties.

Abd Al-Naseer (2012) in his study, found a significant negative relationship between institutional investors' ownership and the likelihood of earnings management. This research did not mention the techniques and tools adopted for the research to ascertain the appropriateness and otherwise of the findings. The active monitoring hypothesis views institutional investors as long-term investors with raving incentives and motivations to closely monitor management action (Jung & Kown, 2002). This idea is consistent with that of

Velury and Jenkins (2006) whose study provides evidence that firms' with high stock ownership by institutions experience earnings numbers of high quality. Hadi (2012) findings suggest that the proportion of institutional investor's ownership negatively affect the magnitude of earnings management while Park and Shin (2004); Koh (2007); Omar and Hind (2012) documented similar findings and concluded that active institutional investors are more likely to effectively constrain unethical behaviour of earnings management, thereby enhancing the credibility and reliability of financial reporting. Jean and Zhang (2002) found that institutional shareholding has a negative coefficient and it is significantly related with the positive discretionary accruals, and, this effect has increased significantly in the post-code period. The result implies that institutional investors are more effective in reducing positive discretionary accruals. In the same vein, Hamdi *et al*. (2005); Omar and Hind (2012) and Hafiza and Susela (2005) also found a negative relationship which they argue may be as a result of superior skills of institutional investors.

On the other hand, empirical study's findings revealed that the quality of financial reporting is impaired as institutional ownership of equity increases (Bradbury *et al*., 2006). Soongso (2004) empirically revealed that a positive relationship exist between outside institutional shareholdings and earnings management. Therefore, the magnitude of discretionary accruals and the standard deviations of Dechow-Dichev residuals decrease in the level of institutional ownership after controlling for firm size, book-to-market, risk, leverage, sales growth and regulatory environment. In the same vein, Sandra (2012) investigation suggests that the coefficient of institutional ownership variable is positive and significant, consistent with hands-off hypothesis which suggests that institutional investors may increase managerial incentives to engage in earnings management. However, the result obtained does not corroborate in one of the models used as the coefficient of institutional ownership is negative

and but statistically significant. Thus, it is not possible to conclude that firms having institutional ownership have higher flexibility to use accruals to manage earnings.

Hong-Bok (2009) investigated the percentage of shareholdings by institutional investors to test whether this factor has a monitoring effect on opportunistic behaviour by CEOS. The result shows no significant relationship between the percentages of shares held by institutional investors and earnings management. Monitoring variable (Institutional Investors Shareholding) is not linearly related to opportunistic behaviour. In addition, existing studies on the relationship between institutional ownership and financial reporting quality have reported insignificant results. This is evidenced in the research conducted by Betra (2002) which do not provide any significant effect of institutional ownership of equity on reported Earnings Management. Sirger and Utama (2008) and Lin *et al*. (2009) document similar findings in which they provide no empirical support of the high equity holdings by institutions in enhancing the reliability of financial information.

Mohtari and Makerani (2013) investigated the relationship of institutional ownership with firm value and earnings quality of 50 firms listed on the Tehran Stock Exchange between 2009-2011. The result indicated that there is a positive and significant association between institutional ownership and earnings quality which implies that when there is an increase in the number of institutional investors, the earnings management of the listed companies will reduce. Roodposhti and Chasmi (2011) examined the impact of corporate governance mechanisms on earnings management using sample of 196 listed firms of Tehran stock exchange in Iran. They found firms with higher institutional holdings manage earnings more. This implies that, the higher the level of share held by institutional investors, the higher the earnings management.

2.6.3. Block-Holder Ownership and Earnings Management:

Block holder ownership may take the various form including individual investors, private equity firms, banks and trusts. Shleifer and Vishney (1986) argued that large shareholders have a strong incentive to actively monitor and influence firm management to protect their significant investments. Large shareholders are expected to monitor managerial behaviour actions effectively, which reduce the scope of managerial opportunism to engage in earnings management (Dechow, Sloan & Sweeney, 1996). In addition, there will be less pressure on management to meet short-term earnings expectations because controlling shareholders focus more on the long-term. Shehu and Jibril (2012) concluded in their research that ownership concentration indeed moderates the practice of earnings management as their result shows a significant negative relationship between ownership concentration and earnings management. Sandra (2012) found in all models, a negative relationship between ownership concentration and earnings management, suggesting that earnings management is significantly lower for firms with higher ownership concentration. The period of the two studies above are not too current as events after their study period must have overtaken their research. Bolton *et al*. (2006) found that higher ownership concentration is associated with higher earnings management. This thread of literature argues that ownership concentration is associated with introduction of agency problem between majority shareholders and minority shareholders.

On one hand, Isenmila and Elijah (2012) finds that the analysis of the slope coefficients of the explanatory variables indicative of the direction of relationship and their respective t-values or P-values indicative of their statistical significance reveal the existence of a positive relationship between external block ownership and earnings management. Also, prior literature found a strong link between Ownership Structure and earnings management. Bolton *et al*. (2006) found that higher ownership concentration is associated with higher earnings management. Roodposhti and Chasmi (2011) examined the impact of corporate governance

mechanisms on earnings management using sample of 196 listed firms of Tehran stock exchange in Iran. Their findings revealed that firms with higher ownership concentration manage earnings less. Aksu, Moradoglu and Cetin (2012) investigated the influence of ownership concentration, IFRS adoption and earnings quality: evidence from an emerging market. They found strong evidence that ownership concentration impede earnings quality which implies that earnings management in those emerging market were high.

Concentrated ownership may however lead to conflicts of interest between majority and minority shareholders. Large shareholders can exercise their control rights to create private benefits, sometimes expropriating minority shareholders (expropriation hypothesis). Controlling shareholders may force their personal preferences even if those preferences are contrary to those of minority shareholders (Shleifer & Vishny, 1997). Therefore, large shareholders may intervene in the firm's management, and may encourage managers to engage in earnings management to maximise their private benefits (Jaggi & Tsui, 2007). As managers fear negative repercussions for declining performance from large shareholders, they may also have a strong motivation to engage in earnings management. Choi, Jean and Park (2004) and Kim and Yoon (2008) documented that earnings management is positively related with ownership concentration, while Joseph and Ching (2005) found an insignificant relationship between ownership concentration and earnings management.

Many other studies have suggested that external block-holders could effectively monitor management of firms (Koch 1981, Mikkelson and Ruback 1985 and Barclay and Holderness 1991). The higher incentive of outside block-holders in monitoring managers' actions potentially reduces earnings management by restricting managers' discretion with financial reporting and/or mitigating their incentive to manage earnings. Yeo *et al*. (2003) showed a strong positive relationship between external unrelated block-holdings and earnings informativeness. However, McEachern (1975); Holderness and Sheehan (1988) and Barclay

and Holderness (1991), amongst others, argued that outside block-holders may create extra pressure for their firms' managers to engage in income-increasing earnings management. Zhong *et al*. (2007) study the association between outside block-holder ownership and earnings management for New York Stock Exchange firms. Their results indicated that outside block-holder ownership is positively associated with discretionary accruals for firms that face declining pre-managed earnings. Thus, this evidence, which is consistent with the second view, suggests that outside block-holders are not effective monitors of income-increasing earnings management that is generally within the bounds of GAAP.

2.6.4. Foreign Ownership and Earnings Management

As a result of the ongoing globalization, foreign ownership has subsequently become major institutional shareholders in Nigeria and the world at-large (Farouk and Shehu 2012). The role of foreign shareholders as an institutional shareholder has often been categorized by two conflicting views: i. Active monitoring and ii. Transient hypotheses. As posited by the advocates of active monitoring hypothesis, they regards institutional investors as long-term investors with significant incentives to actively oversee managers. Sachs and Warner (1995) contended that foreign investors plays important roles in monitoring management similar to the roles played by large outside shareholders in developing countries because foreign investors have positive incentive to protect their wealth. It is believed that external monitoring by foreign investors can restrain the opportunistic tendencies by managers for discretionary choices of management in providing financial accounting information, thus, increasing their earnings quality.

Khanna and Palepu (2000) found that interest held by foreign investors in an organization is positively correlated with firm value, which therefore connotes that the foreign investors have incentives to monitor a firm’s activities and also have an advanced firm monitoring

mechanism. Choi *et al*. (2004) also found a significant positive association between foreign ownership and the earnings response coefficient, suggesting that foreign shareholders consider earnings quality (measured as discretionary accruals) in their investment decisions. The role of foreign investors as external monitors of corporate activities may even be bigger because foreign investors are less likely to be related to controlling shareholders. Also, foreign investors are saddled with higher liability of monitoring costs as a result of greater information asymmetry (Kang & Stulz 1997 and Choe, Koh, & Stulz 2005); and as a result, the foreign investors positively strengthen their monitoring role to resolve information asymmetry. Ahn, Shin, and Chang (2005) found that foreign investors prefer firms with lower discretionary accruals and forecast errors and larger analyst coverage. In order to protect their wealth and to reduce monitoring costs, foreign shareholders have stronger incentives and expertise to independently monitor firms. Thus, higher proportions of foreign ownership induce firms to improve transparency and to decrease opportunistic managerial accounting choices and decisions.

Guo *et al*. (2014) wrote on foreign ownership and real earnings management: evidence from Japan spanning the period of 2004-2008 using a sample size of 15,212 firm year observations. They found that firms with greater foreign ownership engage in less real earnings management which is in line with the knowledge spillover hypothesis which predict that the superior knowledge of foreign investors can curtail real earnings management. Aksu Moradoglu and Cetin (2012) investigated the influence of ownership concentration, IFRS adoption and earnings quality: evidence from an emerging market. They found that foreign ownership enhances earnings quality which implies that earnings management in those emerging market were low.

2.7 Theoretical Framework and Model Development:

There exist many theories that underpin Possession Formation and Earnings Management which includes amongst others: the agency theory, stakeholder theory and signaling theory. This section discusses each of these theories and relates it to the study.

Given that firms' financial statement as required by law (CAMA 2004), certain quality can be compromised by the management to achieve a given desired results. Thus, to measure the level of Earnings management we posit that Earnings Management as represented by Discretionary accruals is a function of Managerial Ownership and Block Holdings. This can be symbolized as follows:

DACC = F (MGOS, BLOS)..... (i)

The firm Managerial Ownership and Block Holdings represent Possession formation variables which could have an effect on Earnings Management as explained by the Agency theory. Despite the enactment of corporate governance whose aim is ideally to control the behaviour of top corporate executives and also to protect the interest of company owners (Shareholders), problem still arises as a result of the separation between ownership and company management. The authority to use corporate resources is entirely at the disposal of the executive because the supplier of capital has delegated their authority of the management of the company to professional managers. Therefore, shareholders expect management to act in a professional manner to manage the company such that any decision taken by management should be centered on the interests of shareholders. However, most often than not, decisions taken by management are not solely for the benefit of the company but the

interest of the executives themselves. Moreover, in several situations, decisions and actions taken only often become the benefits but also harms for the corporate executives.

The use of earnings management, business failures, limited roles of auditors, the absence of a clear relationship between compensation and the performance of the system, emphasis on performance (accounting profit) at the expense of short-term economic profits and so on are some examples of the behaviour deviations of managers (Keasey, Sacchs & Warner, 1995; Shehu & Jibril, 2012; Hadi, 2012; Koh, 2007; Omar & Hind, 2012; Salsiah *et al*., 2008; Sandra, 2012; Wright, 1997). It is believed that, the nature and type of managerial ownership and block holdings maintained by firms can play a significant role in monitoring firm's management, increasing quality of financial reporting. Therefore, the study adopts the agency theory to underpin the managerial ownership and block holding due to its importance in resolving conflicts that may arise between manager (agent) and shareholders (principal) of the companies.

In addition, the firm Institutional ownership variable is posited to be function of Earnings Management because they are believed to be capable of checkmating manipulative accounting activities by management. This can be symbolized mathematically below:

DACC = F (INOS)..... (ii)

A study on Institutional Ownership as a determinant of earnings quality documents that larger institutional shareholding is associated with lesser earnings management (Farber, 2005). Corporate monitoring by institutional investors can constrain managers' behaviour. Large institutional investors have the opportunity, resources, and ability to monitor, discipline and influence managers. Corporate monitoring by institutional investors can force managers to focus more on corporate performance and less on opportunistic or self-serving behaviour. If

institutional ownership enhances monitoring, it might be associated with lower use of discretionary accruals.

This Possession formation (Institutional ownership) is anchored by the stakeholders' theory. According to Donaldson and Preston (1995), the concept of agency theory is narrow. This is because it identifies shareholders as the only interest group of a corporate entity, thereby necessitating further exploration. By expanding the spectrum of interested parties, Mitchel, Wood and Agle (1997) argued that, the stakeholder theory stipulates that, a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholder in order to ensure that each interest's constituency receives some degree of satisfaction. In separate contribution, Elkington (2002) corroborated the fact that stakeholder theory appears better in explaining the role of corporate governance than the agency theory by highlighting the various constituent; employees, banks, governance, relevant stakeholders.

Related to the above discussion, Freeman and Evan (1990) provided a comprehensive review of the stakeholders' theory of corporate governance which points out the presence of many parties with competing interests in the operations of the firm. Stakeholder theory has become more prominent because many researchers have recognized that the activity of a corporate entity impact on the external environment requires accountability of the organization to a wider audience than simply its shareholders. One must however point out that large recognition of this fact has rather been a recent phenomenon. Indeed, it has been realized that economic value is created by people who voluntarily come together and co-operate to improve everyone's position (Freeman, 2004).

Furthermore, the foreign ownership variables which could have an impact on the quality of financial reports as explained by signaling theory associates managers to exercising accounting discretion in an efficient manner such that in the long-run firm value is

maximized and as such will attract the foreign investors. Thus, financial reporting quality is posited to be function of foreign ownership.

This is also symbolized mathematically below:

DACC = F (FROS) ……..……..... (iii)

Signaling theory in finance is a term used to describe the behaviour of two parties that have different information. It states that, corporate financial decisions are signals that are sent by managers to investors so as to shake them up. Signaling theory is useful for describing behaviour when two parties (individuals or organizations) have access to different information. Typically, one party, the sender, must choose whether and how to communicate (or signal) that information, and the other party, the receiver, must choose how to interpret the signal. Accordingly, signaling theory holds a prominent position in a variety of management literatures, including strategic management, entrepreneurship, and human resource management. While the use of signaling theory has gained momentum in recent years (Brian, Certo, Ireland, & Reutzel, 2011).

Consequently, since Earnings Management is posited to be function of Possession Formation in equations one, two and three, it can therefore be described to be a function of Possession formation variables. This is mathematically represented below:

DACC = f (MGOS, INOS, BLOS, FROS)……..…….. (iv)

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This Chapter presents details on the research design and methodology adopted in this study. The chapter describes the population of the study. Furthermore, various sources and methods through which the data are collected were discussed. The techniques employed in the analysis with the justification for the method and techniques used were explained. Finally, the variable measurement, model specification and justification for use of control variables were explained in detail.

3.2 Research Design

In choosing a particular design for a research work, it is usually based on the nature and the problem of the research and how best the research objectives can be achieved. The study adopts the causal-comparative design. Causal-comparative design which is otherwise called the Ex-post facto design according to Denga and Ali (1983) is a design which helps to investigate possible cause and effect relationship by first identifying some existing consequence and searching back by analyzing data to establish possible causal factors. The design for the study is considered appropriate, in that, it is better in determining the relationship and degree of Possession Formation influence on earnings management in our study which may permit prediction.

3.3 Population and Sample Size of the study

The study was limited to Chemical and Paints firms listed on the Nigerian Stock Exchange as at 31st December, 2012. The number of listed Chemical and Paints firms as at 2012 in Nigeria Stock Exchange (NSE) Factbook were eight (see Appendix A). The justification for choosing

chemical and Paints firms to the best of our knowledge is premised on the fact that, it is still an area with paucity of studies.

3.4 Source and Method of Data Collection

This study used secondary sources of data so that the set out objectives highlighted in chapter one were achieved, and hence the problem of the study solved. The use of secondary data has been adjudged a better source as it makes available all needed for the empirical investigation in this type of research. Data was extracted from the Published Audited Annual Reports and Accounts of the selected firms from 2006-2012. This period under review is considered appropriate because it falls within the period when different scandals of reported accounting numbers were witnessed. The data was quantitative and panel in nature.

3.5 Data Analysis Technique and Justification

Panel Fixed effect and Random effect model were conducted to test the model of the study. Longitudinal panel data was used to account for individual heterogeneity of the sample firms. Two steps regression was used in determining the level of earnings management of listed Chemical and Paints firms adopting modified Jones Model by Dechow, Sloan and Sweeney (1995). The residuals for the modified Jones model after inserting the sampled firms' data was used to represent earnings management in the second regression model specified for the study. However, the residual determines the accrual quality; the larger the residuals, the higher the earnings management and the lower the earnings quality, while the smaller the residuals, the lower the earnings management and the higher the earnings quality.

Fixed and Random effect Regression model was estimated using Stata 9.1 as a tool of analysis. Various tests were conducted, ranging from multicolinearity test, normality test, heteroscedasticity test, hausman specification test, langrange multiplier test. The choice of

this was based on the fact that both the technique and tool are more informative (i.e. more variability, less collinearity, more degrees of freedom), as estimates were more efficient under it. Also they allow the study of individual dynamics (e.g. separating cohort effects). While this technique and tool gives information on the time-ordering of events, they also allow for control of individual unobserved heterogeneity.

3.6 Variable Measurement and Model Specification

3.6.1 Earnings Management

This study used accounting accruals to measure earnings management since accruals include a wide range of earnings management techniques available to managers when preparing financial statement as cited in Abd-Nasser (2012). In order to get the estimate for discretionary accruals, the modified Jones was adopted, which is shown below.

$$DACC_{it} = TACC_{it}/TA_{it-1} - [\alpha_1 (1/TA_{it}-1) + \alpha_2 [(\Delta REV_{it} - REC_{it} /TA_{it-1})] + \alpha_3 (PPE_{it}/TA_{it-1})]$$

Where $DACC_{it}$ i= discretionary accruals of firm i at time t

$TACC_{it}$ = total accruals of firm i at time t

Where TACC = EARN - CFO

TA_{it-1} = the book value of total asset of firm i at the end of year t-1,

$\Delta REV_{it}/TA_{it-1}$ = sales revenues of firm i in year t less revenues in year t-1 scaled by TA_{it-1}

$\Delta REC_{it}/TA_{it-1}$ = sales receivables of firm i in year t less receivables in year t-1 scaled by TA_{it-1}

PPE_{it}/TA_{it-1} = gross property, plant and Equipment of firm I at the end of year t scaled by TA_{it-1} and e_{it} = the residual or error term.

The study made use of the absolute measure of discretionary accruals as a proxy for the extent of opportunistic earnings management.

3.6.2 Explanatory Variable Measurement

Table 3.1 Explanatory Variable

Variable	Nature of Variable	Proxy (ies)	Measurement
Possession Formation	Independent Variable	Managerial Ownership	% of Total Shares held by Directors
„		Institutional Ownership	% of Total Shares held by Institutions
„		Blockholder Ownership	% of Total Shares held by High Blockholdings
„		Foreign Ownership	% of Total Shares held by Foreigner(s)
Control Variable	Independent Variable	Firm Size	Measured as the natural log of total asset
„		Firm Growth	Measured as ratio of market-to-book value of share
„		Leverage	Measured as ratio of total debt to total asset
„		Performance (ROA)	Profit after tax divided by total asset

Source: Computed by Author

Managerial ownership is the percentage of total shares in issue held by those with a substantial position in a company that provide significant voting power at an AGM.

Institutional ownership is the percentage of total shares in issue held as long term strategic holdings by investment banks or institutions seeking a long term return.

Blockholders' ownership is the percentage of total shares in issue held by high block holding in the firm.

Foreign ownership is the percentage of total shares in issue held by foreigners in the board either representing self or an Institution.

3.6.3 Control Variable Measurement and Justification

i. Return on assets (ROA) = NI/TA.

Where:

NI = Net income

TA = Total assets

ii. Firm Size (SIZE) = Natural logarithm of total assets.

iii. Firm Growth (GROWTH) = MK/BK.

Where:

MK = Market value of Share

BK = Book value of Share

iv. Leverage (LEV) = TOTAL DEBT/TOTAL ASSET

Where:

TOTAL DEBT = Long term debt plus short term debt

TOTAL ASSET = Total asset of the firm

It has been observed in various literatures that there are other firm features that have effect on the degree of earnings management and should be controlled for, in the estimations of discretionary accruals. Some have argued from different perspective that large firms have more potentials and possibilities for earnings management (Bartov, 1993). Higher political costs are associated with larger firms and therefore have stronger incentives to manipulate earnings in order to reduce the possibilities of political risk (Watts & Zimmerman, 1990).

Corporate size (as measured by total asset) and firm performance (as measured by return on assets) were introduced as control variables since these variables may affect the degree of earnings manipulation as tests related to accounting discretion that do not control for the effect of performance are most often mis-specified (Kothari, Leone & Wasley, 2002; Roodposhti & Chasmi as cited in Shehu & Jibril, 2012).

This is also in line with the work of Matsumoto (2002) who posited that firms with high growth rate are more likely to manage their earnings and thus he measured Growth by the market-to-book ratio (MKTBK).

Furthermore, Bartov (1993) and the work of Wasimullah as cited in Shehu and Jibril (2012) posited that financial difficulties provides firms with more motivation to engage in earnings management, the former control for financial difficulties using book to market ratios and financial leverage while the later measures financial leverage as long term financial liabilities plus debt included in the current liabilities. Therefore, the firm features were built into the study model as displayed above.

3.7 Model Specification

The equation four of the model build-up under chapter two forms the basis of arriving at the model of the study using balanced panel data of Fixed and Random Effect model. This equation is represented as follows:

$$DACC_{it} = \beta_{0it} + \beta_1 MGOS_{it} + \beta_2 INOS_{it} + \beta_3 BLOS_{it} + \beta_4 FROS_{it} + \mu_{it}$$

Control variables were therefore introduced into the model to avoid model mis-specification (see Justification in item 3.9). The control variables are introduced below.

$$DACC_{it} = \beta_0 + \beta_1 MGOS_{it} + \beta_2 INOS_{it} + \beta_3 BLOS_{it} + \beta_4 FROS_{it} + \beta_5 PERF_{it} + \beta_6 SIZE_{it} + \beta_7 GRWTH_{it} + \beta_8 LEV_{it} + \mu$$

Where:

DACC = Discretionary Accruals

MGOS = Managerial Ownership

INOS = Institutional Ownership

BLOS = Block-Holder Ownership

FROS = Foreign Ownership

PERF = Firm Performance

SIZE = Firm Size

GRWTH = Firm Growth

LEV = Leverage

$\beta_{1-}\beta_{8}$ = Coefficient of explanatory variables

β_{o} = Constant or Intercept

μ = Error Term

CHAPTER FOUR
DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.1 Introduction

This chapter first deals with the preliminary analysis of data using descriptive statistics and correlation analysis. This was followed by the presentation and discussion of regression analysis for the purpose of estimating the model used in this study. Also, findings and policy implications therefrom were discussed. The chapter ends with a discussion on the various robustness test conducted for the dependent and independent variables of the study.

4.2 Descriptive Statistics

The sample descriptive was first presented in Table 4.1 where the minimum, maximum, mean, standard deviation, skewness and kurtosis of the data for the variables used in the study were described.

Table 4.1: Descriptive Statistics of the Variables

Variables	Min	Max	Mean	Std. Dev.	Skewness	Kurtosis	N
DACC	0.38	30.55	4.311	6.280	2.554	9.146	56
MGOS	0.01	0.65	0.232	0.213	0.595	1.937	56
INOS	0.00	0.78	0.431	0.189	-0.658	2.904	56
BLOS	0.16	0.96	0.701	0.193	-0.926	3.679	56
FROS	0.00	0.39	0.029	0.096	3.116	10.972	56
PERF	-2.76	5.92	0.128	1.014	2.779	21.480	56
SIZE	9.00	20.39	13.806	2.470	0.799	3.961	56
GRWTH	-55.83	58.17	4.391	12.792	-0.097	16.198	56
LEV	0.13	0.97	0.576	0.235	-0.034	2.035	56

Source: Descriptive Statistic Results Using STATA 9.1

Table 4.2.1 shows the detail account of the descriptive statistics for the dependent and independent variables respectively (DACC = Discretionary Accruals, MGOS = Managerial ownership, INOS = Institutional Ownership, BLOS = Block-holder's Ownership, FROS = Foreign Ownership, SIZE = Firm Size, PERF = Firm Performance, GROWTH = Firm Growth, LEV = Leverage). The most prominent among the result in the descriptive statistics

was the higher standard deviations of firm performance (1.014) and firm growth (12.792) relative to the standard deviation of other independent variables used in the study model which ranges from 0.096 to 0.235. The high standard deviation of firm performance and firm growth indicate that our sample firms were of varying performances and maturity. This was further substantiated by their average values of 13.806, 0.128 and 4.391 respectively. Hence, this justified the inclusion of size, profitability and growth in the study model.

Table 4.1 shows that on average, during the period of the study, the Managerial Ownership have a mean value of 0.232, Institutional Ownership have an average of 0.431, also the Block-Holder Ownership recorded an average value of 0.701 while foreign ownership mean stood at 0.029. This indicates that majority of the shareholders in the sector was the Block-Holders, while the Foreigners had the least of shares in the listed Chemical and Paints sector. The average leverage for the listed Chemical and Paints firms in Nigeria was about 58%. This shows that the listed Chemical and Paints firms in Nigeria largely depend on debt than equity which is covering about 42%. This implication is that this may be one of the motives why firms embark on earnings management as a result of their debt covenant. Amongst the Independent variables, the firm growth had the highest standard deviation of 12.792 signifying its low contribution in constraining earnings management in listed Chemical and Paints firms in Nigeria. While Foreign Ownership had the lowest standard deviation among the independent variables which indicated its highest contribution in restraining earnings management in listed Chemical and Paints firms in Nigeria.

Finally, the skweness and kurtosis statistics revealed that the data obtained for all the variables including dependent and independents were not abnormal. Then, the study is considered valid when it is based on valid data or information, and this information is considered valid if obtained from the data quality. Therefore, the result from the normality

test signified the normality of the data and further substantiated the validity of the regression result.

4.3 Correlation Matrix

Table 4.2 displays the correlation values between dependent and the independent variables and also the relationship between the independent variables themselves. The values were gotten from the Pearson correlation of two-tailed significance. It shows the correlation matrix with the top values displaying the Pearson correlation coefficient between all pairs of variables and the asterisk beside the Pearson correlation coefficient showing the two-tail significance of these coefficients. Therefore, looking at the pattern of correlation between the regressor and the regressand, it is observed that four of the variables (Managerial ownership, Performance, Firm size and Firm growth) correlate perfectly, while four of them (Institutional ownership, Block holding and Foreign ownership) are not too correlated with earnings management. On the other hand, the relationships between most of the explanatory variable are less minimal and could be neglected.

Table 4.2: Correlation Matrix of the Dependent and Independent Variables

	DACCR	MGOS	INOS	BLOS	FROS	PERF	SIZE	GRWTH	LEV
DACC	1								
MGOS	.35764*	1							
INOS	.0819	.0889	1						
BLOS	.0323	.6759*	.3529*	1					
FROS	-.1554	.5338*	-.0788	.4077*	1				
PERF	-.2687**	-.1299	-.2154	-.0138	.0300	1			
SIZE	-.5538*	.0001	-.4424*	.1204	.1560	0.0354	1		
GRWTH	.4447*	.1493	.2195	-.0060	-.0491	-.7744*	-.1401	1	
LEV	-.0926	-.3847*	.0173	-.2318	.0762	.1082	-.0756	-.2205	1

Source: Correlation Matrix Results Using STATA 9.1
*. Correlation is significant at 0.01 level (2-tailed)
**. Correlation is significant at 0.05 level (2-tailed)

Table 4.2 indicates that Earnings management is 36%, and 45% positively correlated with managerial ownership and firm growth, while performance, and firm size is 27%, and 55%

negatively correlated with the Earnings management. This signifies that the firm size and performance was negatively related to earnings management, while managerial ownership and firm growth was positively and significantly related to earnings management. The relationship between institutional ownership, block holdings, foreign ownership, firm leverage and earnings management was not too strong. The relationship between the independent variables themselves were found to be insignificantly related except few of them that were significantly related, though this may not be enough to conclude that multicolinearity exist among the independent variables of the study until the variance inflation factor and tolerance values are far and above the limits expected. Therefore, the tolerance value and the variance inflation factor (VIF) are two advanced measures of assessing multicolinearity between the explanatory variables. The variance inflation factor and tolerance are computed using Stata and were found to be consistently smaller than ten and one respectively, indicating absence of multicolinearity (Neter, Kutner, Nachtsheim, & Wasserman, 1996; Cassey & Anderson, 1999; Tobachnick & Fidell, 1996). This shows the appropriateness of fitting the study model with four independent variables and four control variables.

4.4 Presentation and Interpretation of Regression Result

This session presents the regression result of the dependent variable (DACC) and the independent variables of the study (Managerial ownership, Institutional ownership, Block-holder ownership, foreign ownership and also the control variables which are firm size, firm performance, firm growth and leverage). The presentation was followed with the analysis of the association between the dependent variable and each individual independent variable and also the cumulative analysis was also captured.

The summary of the regression result obtained from the model of the study ($DACC_{it}$ = $\beta 0 + \beta 1MGOS_{it} + \beta 2INOS_{it} + \beta 3BLOS_{it} + \beta 4FROS_{it} + \beta 5PERF_{it} + \beta 6SIZE_{it} + \beta 7GRWTH_{it} + \beta 7LEV_{it} + e$) is presented in Table 4.3

Table 4.3: Summary of Regression Result

Variables	Coefficient	Z-Statistics	P-values
Constant	*19.83736*	4.59	0.000
MGOS	*19.23274*	5.01	0.000
INOS	*-11.85258*	-3.45	0.001
BLOS	*1.171667*	0.29	0.775
FROS	*-30.13375*	-4.71	0.000
PERF	*0.6227488*	0.83	0.404
LN_SIZE	*-1.437107*	-6.03	0.000
GRWTH	*0.2251383*	3.73	0.000
LEV	*6.817187*	2.86	0.004
R^2 Within			0.3339
R^2 Between			0.9768
R^2 Overall			0.7426
Wald Chi^2			135.57
Wald-Significance			0.0000

Source: Result output from STATA 9.1

The cumulative R^2 Overall (0.7426) which is the multiple coefficient of determination gave the proportion of the total variation in the dependent variable explained by the independent variable jointly. Hence, it signified that 74% of the total variation in earnings management of listed Chemical and Paints firms in Nigeria was caused by their total asset, profitability, changes in market share, level of leverage, proportion of managerial ownership, proportion of institutional ownership, proportion of block-holder ownership, and the proportion of foreign ownership.

The Wald chi^2 of 135.57 which is significant at one percent indicates that the Earnings management and ownership structure model is fit. This indicates that the independent variables are properly selected, combined and used. It implies that for any change in Possession Formation of listed Chemical and Paints firms in Nigeria; their Earnings

management will be directly affected. The value of Wald Chi^2 which is statistically significant at a level of 0.000 means that there is a 99.9 percent probability that the relationship among the variables was not due to mere chance.

i. Managerial Ownership and Earnings Management

From the Table 4.3, it was observed that the z-value for managerial ownership (MGOS) was 5.01 and a coefficient value of 19.23274 with significant value of 0.000. This signifies that managerial ownership is positively, strongly and significantly influencing earnings management of listed Chemical and Paints firms in Nigeria. This also implies that for every one percent increase (1%) in managerial ownership, the earnings management of listed Chemical and Paints firms in Nigeria will increase by 19.23. This may be as a result of the argument put forward by the advocate of the entrenchment hypothesis, that, high levels of insider ownership can become ineffective in aligning insiders to take value maximizing decisions, which may lead earnings management to increase. Secondly, when there is little separation between owners and managers, management face less pressure from capital market to signal the firm value to the market and they pay less attention to the short-term financing report (Jensen, 1986; Klassen, 1997). Therefore, highly invested managers are more likely to manipulate earnings, since this lack of market discipline may lead insiders to make accounting choices that reflect personal motives rather than firm economies. Third, the Self-serving information provided by managers may be as a result of manager's intentions to influence a particular contractual outcome that relies on reported earnings or to mislead the stakeholders about the underlying economic performance of its organization.

This finding is in line with those of Cheng and Warfield (2005); Isenmila and Elijah (2012); Morck *et al*. (1988); Jensen. (1986); Klassen (1997) but contrary to those of Dhaliwal,

Salamon and Smith (1982); Jensen and Meckling (1976); Salsiah *et al*. (2008); Sandra (2012).

ii. Institutional Ownership and Earnings Management

The regression results revealed that Institutional ownership as depicted in Table 4.3 have a z-value of -3.45 and a coefficient value of -11.85258 which is significant at 1%. This indicates that institutional ownership has negatively, strongly and significantly impacted on earnings management of listed Chemical and Paints firms in Nigeria. Also, this implies that for every one percent (1%) proportionate increase in the institutional ownership of the firms, the earnings management of the listed chemical and paints firms in Nigeria will decrease by 11.85. This may be as a result of the vast amount of resources, more knowledgeable, have greater resources, powerful, and the fact that institutional investors are more sophisticated than individual investors and have more relevant expertise and experience to monitor management. Also, their investing decisions tend to carry a great deal of weight than smaller investors, many of whom scrutinize the activities of the managers in a bid to protect their huge amount of investment. The proponent of the strategic alliance hypothesis argues that Earnings Management of firms with high institutional shareholdings is low. This argument is premise on the fact that institutional investors are expected to force firms' management to focus on current earnings, rather than long-term earnings, to avoid reporting disappointing earnings to interested parties. Finally, institutions wield tremendous influence in other matters as well. Since these major organizations are often a company's largest shareholders, they are not shy about offering suggestions or opinions from time to time - often publicly. For example, institutional owners may sometimes pressure management into restructuring the company, divesting certain business segments, selling off assets, or even putting the firm itself up for sale. Occasionally, they may even express their disapproval by launching a proxy

battle. All of this actions put together is in an attempt to discourage the managers from manipulating their earnings.

This finding is in line with the study of Naseer (2012); Jung and Kown (2002); Hafiza and Susela (2005) while other research such as Bradbury *et al*. (2006); Soongso (2004); Sandra (2012); Hong-Bok (2009); Betra (2002); Sirger and Utama (2008); Lin *et al*. (2009) were in contrast with our findings.

iii. Block-Holding Ownership and Earnings Management

The Block-Holder Ownership has a z-value of 0.29 and a coefficient value of 1.171667 with an insignificant value of 0.775. This shows that Block-Holder Ownership (BLOS) do not significantly influence earnings management of listed Chemical and Paints firms in Nigeria. This may have suggested that when there is an increase or decrease in the Block-holder ownership, the earnings management may change either by increasing or decreasing the opportunistic tendencies exhibited by the managers. This may be as a result of the argument that ownership concentration is associated with introduction of agency problem between majority shareholders and minority shareholders. Finally, the insignificant contribution of block-holders to earnings management of listed Chemical and Paints firms in Nigeria may be as a result of the poor performance recorded by those firms included in the sample of the study. The block-holder may want the firms to take a big bath in anticipation of a better performance in the future rather than exerting pressure on those firms to report good accounting numbers which may eventually spell doom for the investors in the long run.

This finding is however in contrast to those of Shleifer and Vishney (1986); Dechow, Sloan and Sweeney (1996); Shehu and Jibril (2012); Sandra (2012); Bolton *et al.* (2006); Isenmila and Elijah (2012).

iv. Foreign Ownership and Earnings Management

The Foreign ownership shows a z-value of -4.71 and a beta value of -30.13375 with significant value of 1%. This means that Foreign Ownership (FROS) is negatively, strongly and significantly influencing earnings management of listed Chemical and Paints firms in Nigeria. It connotes that when there is an increase in foreign ownership by one percent (1%), the earnings management of listed Chemical and Paints firms will decrease by 30.13. This may be as a result of the fact that foreign investors play an important role in monitoring management similar to the roles played by large outside shareholders in developing countries because foreign investors have positive incentive to protect their wealth. Also, the finding is a confirmation of the knowledge spillover hypothesis which predicts that the superior knowledge of foreign investors can curtail real earnings management. In addition, it is argued that, in order for foreign investors to protect their wealth and to reduce monitoring costs, foreign shareholders have stronger incentives and expertise to independently monitor firms. Thus, higher proportions of foreign ownership are expected to induce firms to improve transparency and to decrease opportunistic managerial accounting choices and decisions.

This finding is in line with those of Khanna and Palepu (2000); Cheon (2003); Kang and Stulz (1997); Choe, Koh, and Stulz (2005) and Ahn, Shin, and Chang (2005).

v. Firm Performance and Earnings Management

The result of the firm performance vis-a-vis earnings management of listed Chemical and Paints firms in Nigeria is contrary to our expectation that performance may influence managers' tendencies for opportunistic behaviours in reporting favourable earnings where the accounting figures are not too impressive. Thus, firms with higher profitability are less likely to engage in earnings manipulation than those whose profitability is low. However, the performance output in the regression result shows that performance does not have any

significant impact on the earnings management of the listed Chemical and Paints firms in Nigeria.

Thus, firms with higher or lower performance may not necessarily engage in earnings management as indicated by the insignificant coefficients of performance at 40% level of significance. This positive but insignificant relation is not strange as it is consistent with findings of Alsaeed (2006), and Abbott, Parker and Peters (2004), while it contradicts the findings of Singhvi (1968), Singhvi and Desai (1971), Raffournier (1995) and Wallace and Naser (1995).

vi. Firm Size and Earnings Management

The expectation is based on the argument that large firms have more potentials and possibilities for earnings management. Also, higher political costs are associated with larger firms and therefore, they have stronger incentives to manipulate earnings in order to reduce the possibilities of political risk. The result in respect of firm size and earnings management shows that the firm size is negative and significant at 1% in explaining earnings management of listed Chemical and Paints firms in Nigeria. This implies that the larger the size of the listed Chemical and Paints firms in Nigeria, the lower the reported earnings is manipulated.

In line with this finding are studies conducted by (Singvi & Desai, 1971; Buzby, 1975; Firth, 1979; Wallace & Naser, 1995; Raffournier, 1995, Inchausti, 1997, and Owusu-Ansah, 1998).

vii. Firm Growth and Earnings Management

Firm growth as measured by market to book value of share is positively and significantly influencing the earnings management of listed Chemical and Paints firms in Nigeria. This implies that, the higher the firm growth, the higher the earnings management, i.e. Proportionate increase in market value of share to book value of share may affect the

tendencies of firms to manage earnings. This may be as a result of the fact that firm's whose growth rate is at an increasing rate may want to keep the trend in growth rate by manipulating their earnings. Though, firms may not necessarily manipulate earnings as a result of proportionate increase in the market value of share to book value of share just to report changes in earnings or positive earnings through earnings management, those firms with low growth rate may have more tendencies to engage in earnings management to increase their earnings or portray good changes in earnings.

This positive and significant relation is not strange as it is consistent with findings of Beaver, Kettler and Scholes (1968), Pincus and Rajgopal (2002) and Firth, Fung and Rui (2007).

viii. Leverage and Earnings Management

The regression result revealed that leverage has significant influence at 1% on earnings management of listed Chemical and Paints firms in Nigeria with a positive coefficient. This implies that the more levered the listed Chemical and Paints firms, the higher the reported earnings are manipulated. This positive association supports the research result by Klein (2002b) and Davidson, Stewart and Kent (2005).

4.5. Robustness test of dependent and independent variables

In order to make better the validity of all statistical inferences to be drawn for the study, this section presents the result of robustness test conducted. The robustness test included multicolinearity test and serial correlation test.

i. Multicolinearity test: This was conducted to check whether there was a correlation between the independent variables which will mislead the result of the study. Table 4.2.2 above presents the matrix of the linear relationships among the independent variables of the study. From the observation, variables with higher correlation above 0.50 were managerial

ownership and Block Holdings at (0.6759), Managerial ownership and foreign ownership (0.5338), managerial ownership and leverage at (-0.3847), Institutional Ownership and Block Holding at (0.3529) and Institutional ownership and firm size at (-0.4424), Block Holding and Foreign Ownership at (0.4077), performance and firm growth (-0.7744). Despite this result, the threat is considered not too grievous because the correlations between the Independent variables were all positive while that of control variables were negative. Furthermore, the low magnitude of the correlations amongst the explanatory variables implies that multicolinearity was not a problem in the sample of the study. In a bid to prove and substantiate the absence of serious multicolinearity between the exogenous variables, colinearity diagnostics tests are observed as the tolerance values and the variance inflation factors (VIF) values portrays no multicolinearity in the data.

The tolerance value and the variance inflation factor (VIF) are two advanced measures of assessing multicolinearity between the explanatory variables. The variance inflation factor and tolerance are computed using STATA and were found to be consistently smaller than ten and one respectively, indicating absence of multicolinearity (Neter, Kutner, Nachtsheim, & Wasserman, 1996; Cassey & Anderson, 1999). This shows the appropriateness of fitting the study model with four independent variables and four control variables. In addition, the absence of multicolinearity between the explanatory variables were further substantiated by the tolerance values which were consistently smaller than 1.00. (Tobachnick & Fidell, 1996).

ii. The Hausman test: In order to decide the more effective model between the fixed effect and Random effect researchers often rely on the Hausman (1978) specification test. The Hausman test is designed to detect violation of the random effects modeling assumption that the explanatory variables are orthogonal to the unit effects. If there is no correlation between the independent variable(s) and the unit effects, then estimates of β in the fixed

effects model should be similar to estimates of β in the random effects model. The Hausman test statistic H is a measure of the difference between the two estimates. Under the null hypothesis of orthogonality, H is distributed chi-square with degrees of freedom equal to the number of regressors in the model. A finding that $p < 0.05$ is taken as evidence that, at conventional levels of significance, the two models are different enough to reject the null hypothesis, and hence to reject the random effects model in favor of the fixed effects model. If the Hausman test does not indicate a significant difference ($p > 0.05$), then, it does not necessarily follow that the random effects estimator is "safely" free from bias, and therefore to be preferred over the fixed effects estimator. Therefore, the result obtained from the Hausman specification test conducted indicates, that ($p > 0.05$) and as such the random effect model should be used in favour of the fixed effect model.

iii. Heteroscedasticity Test: Breusch-Pagan / Cook-Weisberg is used to test the null hypothesis that the error variances are all equal versus the alternative that the error variances are a multiplicative function of one or more variables. The alternative hypothesis states that the error variances increase (or decrease) as the predicted values of Y increase, that is, the bigger the predicted value of Y, the bigger the error variance is. A large chi-square would indicate that heteroscedasticity was present. In the result obtained from the heteroscedasticity test conducted in this work, the chi-square value (12.15) was large and the p-value (0.0005) is small, indicating heteroscedasticity was present and this shows violation of assumption number four of classical linear regression model which states that there must be constant variance, that is, the disturbances u_i appearing in the population regression function are homoscedastic. Therefore, as a result of the presence of heteroscedasticity, the researcher decided to conduct Fixed and Random effect model which will take care of the individual differences within units. This will enable whatever conclusions drawn or inferences made to be free of mislead.

iv. Cross-Sectional Dependence Test: This is called the contemporaneous correlation used to check whether the individual chemical and Paints firms specific characteristics in the panel are dependent on each other or not. Also, whether the residuals are correlated across firms in the panel. Cross-sectional dependence can lead to biasness in the overall results of the study. Breusch-Pagan Lagrange multiplier (LM) test was used to ascertain the presence of cross section dependence. The result of the test revealed the absence of cross-sectional dependence in the panel of the study samples because the chi square probability was not significant (see Appendix B).

4.6 Hypothesis Testing

This section presents the analysis carried out in order to test the hypotheses stated in chapter one. Also, robustness checks were conducted to examine the outputs under varying circumstances. The robustness test gave greater reliability and credibility to the overall findings of the study. The regression result used for the hypotheses test is presented in Table 4.4.

Table 4.4: Variable Coefficients

Variables	Z-Values	P. Values	Tolerance/VIF
Managerial Ownership	5.01	0.000	0.322197 / 3.10
Institutional Ownership	-3.45	0.001	0.506038 / 1.98
Block-Holder Ownership	0.29	0.775	0.348162 / 2.87
Foreign Ownership	-4.71	0.000	0.576838 / 1.73
Firm Performance	0.83	0.404	0.376770 / 2.65
Firm Size	-6.03	0.000	0.623776 / 1.60
Firm Growth	3.73	0.000	0.362402 / 2.76
Leverage	2.86	0.004	0.685404 / 1.46

Source: Result output from STATA 9.1

Table 4.4 shows that the majority of the variables are positive, which are inclusive of both independent variable (Managerial ownership, Block-Holder ownership) and the control variables (Firm performance, Firm Growth and Leverage) while two of the independent variables (Institutional ownership, Foreign ownership) and one control variable (Firm size)

are negative. All the independent variables and the control variables are significant at 1% level except for Block-Holder ownership and Firm performance which are statistically insignificant. This revealed that all the Possession formation and control variables used in the study explain the attitude of earnings management of listed Chemical and Paints firms in Nigeria to a large extent except for Block-Holder ownership and Firm Performance.

The results for each hypothesis are presented below:

Hypothesis 1

H_{01}: Managerial ownership has no significant impact on earnings management of listed Chemical and Paints firms in Nigeria

Managerial ownership measured as the proportion of shares held by managers to the total shares is found to be significant and positively associated with the earnings management at 1% level of significant indicating that larger managerial ownership increases the earnings management of listed Chemical and paints firms in Nigeria. Therefore, managerial ownership has significantly affected the earnings management.

In view of the above result reported in respect of managerial ownership showing that the variable is statistically significant in influencing the earnings management, there is therefore, sufficient evidence of rejecting null hypothesis one of the study.

H_{02}: Institutional ownership has no significant influence on earnings management of listed Chemical and Paints firms in Nigeria

Institutional ownership measured as the proportion of shares held by institutions to the total shares held is found to be negatively significant at 1% level, which means that it is associated with the earnings management of listed Chemical and Paints firms in Nigeria. Therefore, Institutional ownership has significantly affected the earnings management.

In line with the above result reported as regards Institutional ownership, it shows that the variable is statistically significant in influencing the earnings management, and this therefore, provides evidence of rejecting null hypothesis 2 of the study.

H_{03}: Block-Holder ownership has no significant effect on earnings management of listed Chemical and Paints firms in Nigeria

Block-Holder ownership measured as the proportion of shares held as block-holdings, i.e those that have share up to 5% and more in the firm to the total shares held was found to be statistically insignificant which means that it is not significantly associated with the earnings management of listed Chemical and Paints firms in Nigeria. Therefore, Block-Holder ownership has not significantly affected the earnings management.

Owing to the above outcome reported as regards Block-Holder ownership showing that the variable is statistically insignificant in influencing the earnings management, thus providing an evidence of failing to reject null hypothesis three of the study.

H_{04}: Foreign ownership has no significant contribution on earnings management of listed Chemical and Paints firms in Nigeria

Foreign ownership measured as the proportion of shares held by foreigners on the board to the total shares held was found to be negatively significant at 1% level which means that it is associated with the earnings management of listed Chemical and Paints firms in Nigeria. Therefore, foreign ownership has significantly affected earnings management of the firms.

With respect to the result displayed above as regards foreign ownership showing that the variable was statistically significant in constraining earnings management, there is enough evidence to rejecting the null hypothesis four of the study.

4.7 Implications of Findings

The study has numerous theoretical, practical and regulatory implications. These implications represent the contributions to knowledge in the study which are expected to benefit the Chemical and Paints firms, existing body of knowledge within the accounting research, accountants in practice, investors, regulators and providers of accounting services as the outcome of our study would serve as a stimulant to them to realize how effective and the extent to which Possession Formation is to the organization in area of reducing opportunistic tendencies by management who are at the helms of affairs in various organizations.

Our findings have important policy implication since they suggest and will also assist the regulators in areas where there is need to improve on the corporate governance principles with respect to Possession Formation, in order to put the listed Chemical and paints firms in Nigeria on the right direction, which will eventually curtail the opportunistic behaviour of management as the Possession Formation provides effective monitoring of earnings management.

Our analysis revealed that Managerial ownership is positively and significantly influencing earnings management. This implies that, managers in the listed Chemical and paints firms play a significant role in increasing the manipulation of reported accounting numbers. This implication provides some support for the entrenchment hypothesis which states that, high levels of insider ownership can become ineffective in aligning insiders to take value maximizing decisions, which may lead to increase in earnings management. Since the firms operate in an environment where managers have opportunity of allotting higher numbers of shares to themselves, thereby having dominance and control, then, the implication is that a greater motivation and opportunity should be expected from the managers to manage earnings to maximize their private benefits.

Also, the analysis revealed that institutional ownership is negatively and significantly influencing earnings management of listed Chemical and Paints firms in Nigeria. This implies that the institutional investors play a vital role in constraining and monitoring management to reduce their opportunistic tendencies in managing earnings. This implication provides some support to the proponents of the strategic alliance hypothesis who argue that Earnings Management of firms with high institutional shareholdings is low.

In addition, our analysis reveals that block-holder ownership was found to be statistically insignificant in contributing to earnings management of listed Chemical and Paints firms in Nigeria. This implies that, block-holder ownership does not play any significant role in monitoring management to either reduce or increase their opportunistic behaviours in managing earnings. This implication provides some support in favor of the argument that block-holder ownership is associated with introduction of agency problem between majority shareholders and minority shareholders.

Furthermore, the effect of foreign ownership on earnings management of listed Chemical and Paints firms in Nigeria as shown by empirical evidence may find here a reasonable explanation. This has significant policy implications for the proportion of shares held by foreign investors as this implies that, in order for foreign investors to protect their wealth and to reduce monitoring costs, foreign shareholders have stronger incentives and expertise to independently monitor firms.

The above findings can have implications for users of financial statements and regulatory bodies. Therefore, various users of financial statement who have interest in the earnings reported by the managers should be aware of earnings manipulations by firms' management and also the fact that some factors may affect such tendencies when they rely heavily on the financial statements to help them make investment decisions or decision regarding its

reliability. In particular, users should take note of the influence of the institutional ownership and foreign ownership on such behaviours. Also, firm size, firm growth and leverage are found to have influence on earnings management most especially the size as it reduces earnings management.

Lastly, for standard setters and researchers, the study will no doubt re-introduce the Possession Formation construct and present it in a different direction as this would add to the existing literatures on this subject matter and also ensure that abusive earnings management is not encouraged, such that standard setters may consider adjusting policies as regards the managerial and block-holder ownership in the listed Chemical and paints firm and also building on the existing strong evidence of institutional and foreign ownership that have served as a good monitoring for managers opportunistic tendencies.

CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The study investigates the impact of Possession formations on Earnings management of listed Chemical and Paints firms in Nigeria. A multiple regression model was used with the aim of explaining and predicting empirically the opportunistic behaviours of management as a result of changes in Possession Formations. The model used for the study examined the association between four explanatory variables (managerial ownership, Institutional ownership, Block-Holders ownership and Foreign ownership) and four control variables (Firm size, firm Performance, Firm growth and Leverage) and one dependent variable (Earnings management) through the use of generalized least square technique.

The study is premise on the fact that the issue of occasional judgment in accounting has come to stay rather than its possible elimination as it has become an unimaginable situation to have accounting systems that are totally ruled based. Thus, the need for us to begin look up for indicators to base earnings reliability arise. Therefore, the study seek to investigate to what extent does Possession Formations influences the level of earnings management of listed Chemical and Paints firms in Nigeria.

The explanatory variable of this study constitute Possession Formations which are managerial ownership, Institutional ownership, Block-holder ownership and foreign ownership. The four Possession Formation forms the bases of our hypotheses one to four of the study. While the earnings management was proxy with discretionary accruals using modified Jones model by Dechow *et al*. (1995). Control variables (firm size, firm performance, firm growth and leverage) were also introduced since these variables may affect the degree of earnings

manipulation as tests related to accounting discretion that do not control for the effect of size, performance, growth and leverage are most often mis-specified.

The findings of this study are based on panel data collected for the period of 2006-2012 from a population of 8 listed Chemical and Paints firms in Nigeria stock exchange as at 31st December 2012. The result revealed that three of the explanatory variables except Block-holders ownership were significant in explaining the earnings management of the firms. Among the three significant explanatory variables, the institutional ownership and foreign ownership have significant negative relationship with earnings management while the managerial ownership has a positive significant relationship with earnings management. Also, amongst the control variables, three of them were significant (Firm size, Firm growth and Leverage). While the firm size was negative and significant in influencing earnings management, firm growth and leverage were positive and significant in influencing earnings management.

5.2 Conclusions

As a result of the foregoing discussion and analysis in the previous chapter, the study concludes as stated below:

The positive influence of managerial ownership on earnings management which may lead to increase in earnings management of listed Chemical and Paints firms in Nigeria is supported by the entrenchment hypothesis. Therefore, the study concluded that managerial ownership has impact on earnings management of listed chemical and Paints firms in Nigeria. The negative effect of institutional ownership, foreign ownership on earnings management is surprising as these two investors have superior knowledge, expertise and experience to monitor the management.

The insignificant impact of block-holders on earnings management is an indication that firms with a higher numbers of block-holders may not necessarily influence the earnings management as this could be attributed to the fact that block-holder ownership is associated with introduction of agency problem between majority shareholders and minority shareholders. Therefore, the study concluded that block holdings has not impacted on earnings management of listed chemical and paints firms within the study period and as such the percentage of ownership can still be improved upon.

On the whole, the study concludes that Possession Formations has significantly reduced the opportunistic behaviours of managers except for managerial and Block-holder ownership that were found to be significantly positive.

5.3 Limitations of the Study

Like any other research, the result of the study is subjected to some limitation due to the following factors.

The study is only limited to a particular sector, that is, the listed Chemical and Paints firms in the Nigerian Stock Exchange. Therefore, the findings and recommendation is only applicable to Chemical and Paints firms as the Possession formations may vary in other sectors.

5.4 Recommendations

The recommendation of this study are made based on variety of people/organizations that are involved directly or indirectly with Possession Formation and earnings management processes in Nigeria.

The responsibility for monitoring the compliance of Corporate Governance practiced by listed companies in the Nigerian stock exchange is vested with the Nigerian Securities and Exchange Commission (SEC). Therefore, SEC should ensure as much as possible that:

i. The managers who are the helm of affairs do not control up to 50% or more in shares allotted in the company, as it gives them too much power and control over other shareholders which may be responsible for the opportunistic behaviours exhibited by the managers in a bid to get short-term private gains.

ii. The institutional ownership has been identified to be an important monitoring mechanism in the listed Chemical and Paints firms. More room should be given to the institutional investors to own shares so that the higher their interest, the more they will be willing to monitor the activities of the firm. Also, since the firms are aware of the vast knowledge owned by institutional investors about how the accounting system works, the managers will be more careful in manipulating the accounting numbers.

iii. The block-holders inability to constrain earnings management may be as a result of the poor corporate governance practice. Therefore, emphasis should be laid on the number of block-holders an organization should have. Proper checks and balance should be done regularly by the Securities and Exchange Commission to ensure strict adherence especially on the percentage of shares the block holders should hold.

iv. The foreign ownership is one of the identified Possession formation that has been proven empirically in our study, to serve as monitoring mechanism to constraining the abusive accounting practice by the firms. Therefore, more of the foreigners should be allowed to have more investment and possibly be given a role to be part of the board because their presence only may serve as restriction to managers in manipulating reported earnings.

5.5 Suggestions for Further Research

This work investigates the impact of Possession Formation on earnings management of listed Chemical and Paints firms in Nigeria and is believed to have paved way for further research in the following areas.

i. The study only made use of four Possession formations (Managerial ownership, Institutional ownership, Block-Holders ownership and foreign ownership). Therefore, the study suggest to future researchers who might be interested in this area to include family ownership and state ownership in their Possession formation.

ii. The study made use of modified Jones model by Dechow *et al*. (1995). We therefore suggest that further studies in this area should make use of other models such as Francis *et al*. (2005), Jones (1991), Chang *et al*. (2008) to proxy earnings management.

iii. As this research is only limited to Chemical and Paints firms, it is recommended that further studies in this area should add more companies from manufacturing sector or concentrate on the entire manufacturing sector to make the findings and recommendations more amenable to generalization.

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Appendix A: Population of the Study

1. African Paints (Nigeria) Plc
2. Berger Paints Plc
3 Chemical and Allied Products Plc
4. DN Meyer Plc
5. IPWA Plc
6. Paints and Coatings Manufacturers Nigeria Plc
7. Portland Paints and Products Nigeria Plc
8. Premier Paints Plc

Appendix B: STATA 9.1 Results

```
. xtset id year, yearly
       panel variable:  id (strongly balanced)
        time variable:  year, 2006 to 2012
                delta:  1 year

. su dacc mgos inos blos fros perf size grwth lev, detail
```

dacc

Percentiles		Smallest		
1%	.38	.38		
5%	.85	.66		
10%	.94	.85	Obs	56
25%	1.155	.87	Sum of Wgt.	56
50%	1.675		Mean	4.311071
		Largest	Std. Dev.	6.280426
75%	3.725	18.76		
90%	14.33	19.46	Variance	39.44375
95%	19.46	24.66	Skewness	2.553825
99%	30.55	30.55	Kurtosis	9.146106

mgos

Percentiles		Smallest		
1%	.01	.01		
5%	.01	.01		
10%	.01	.01	Obs	56
25%	.05	.01	Sum of Wgt.	56
50%	.135		Mean	.2323214
		Largest	Std. Dev.	.2131324
75%	.4	.61		
90%	.59	.62	Variance	.0454254
95%	.62	.63	Skewness	.5946646
99%	.65	.65	Kurtosis	1.937265

inos

Percentiles		Smallest		
1%	0	0		
5%	0	0		
10%	.11	0	Obs	56
25%	.35	.11	Sum of Wgt.	56
50%	.485		Mean	.4307143
		Largest	Std. Dev.	.189946
75%	.56	.7		
90%	.64	.72	Variance	.0360795
95%	.72	.72	Skewness	-.6577565
99%	.78	.78	Kurtosis	2.904272

blos

Percentiles		Smallest		
1%	.16	.16		
5%	.33	.16		
10%	.45	.33	Obs	56
25%	.595	.33	Sum of Wgt.	56
50%	.745		Mean	.7005357
		Largest	Std. Dev.	.1925845
75%	.84	.96		
90%	.96	.96	Variance	.0370888
95%	.96	.96	Skewness	-.925504
99%	.96	.96	Kurtosis	3.679517

fros

Percentiles		Smallest		
1%	0	0		
5%	0	0		
10%	0	0	Obs	56
25%	0	0	Sum of Wgt.	56
50%	0		Mean	.02875
		Largest	Std. Dev.	.095557
75%	0	.35		
90%	0	.35	Variance	.0091311
95%	.35	.35	Skewness	3.116316
99%	.39	.39	Kurtosis	10.9717

perf

Percentiles		Smallest		
1%	-2.76	-2.76		
5%	-1.25	-2.03		
10%	-.71	-1.25	Obs	56
25%	-.07	-.91	Sum of Wgt.	56
50%	.13		Mean	.1275
		Largest	Std. Dev.	1.013927
75%	.315	.84		
90%	.7	.86	Variance	1.028048
95%	.86	1.35	Skewness	2.779418
99%	5.92	5.92	Kurtosis	21.48028

size

Percentiles		Smallest		
1%	9	9		
5%	9.81	9.6		
10%	10.81	9.81	Obs	56
25%	12.865	10.27	Sum of Wgt.	56
50%	13.795		Mean	13.80571
		Largest	Std. Dev.	2.470015
75%	14.155	18.62		
90%	18.17	19.7	Variance	6.100974
95%	19.7	20.1	Skewness	.7991922
99%	20.39	20.39	Kurtosis	3.96148

grwth

Percentiles		Smallest		
1%	-55.83	-55.83		
5%	.35	-10.12		
10%	.54	.35	Obs	56
25%	1.015	.5	Sum of Wgt.	56
50%	2.315		Mean	4.39125
		Largest	Std. Dev.	12.79203
75%	6.11	13.42		
90%	12.77	20.86	Variance	163.6361
95%	20.86	40.86	Skewness	-.0965314
99%	58.17	58.17	Kurtosis	16.1978

lev

Percentiles		Smallest		
1%	.13	.13		
5%	.17	.17		
10%	.25	.17	Obs	56
25%	.395	.19	Sum of Wgt.	56
50%	.55		Mean	.57625
		Largest	Std. Dev.	.2353609
75%	.78	.95		
90%	.92	.96	Variance	.0553948
95%	.96	.96	Skewness	-.0340543
99%	.97	.97	Kurtosis	2.034582

```
. pwcorr dacc mgos inos blos fros perf size grwth lev, star (0.05) sig
```

	dacc	mgos	inos	blos	fros	perf	size
dacc	1.0000						
mgos	0.3574*	1.0000					
	0.0068						
inos	0.0819	0.0889	1.0000				
	0.5485	0.5146					
blos	0.0323	0.6759*	0.3529*	1.0000			
	0.8134	0.0000	0.0076				
fros	-0.1554	0.5338*	-0.0788	0.4077*	1.0000		
	0.2527	0.0000	0.5638	0.0018			
perf	-0.2687*	-0.1299	-0.2154	-0.0138	0.0300	1.0000	
	0.0452	0.3402	0.1109	0.9197	0.8262		
size	-0.5538*	0.0001	-0.4424*	0.1204	0.1560	0.0354	1.0000
	0.0000	0.9996	0.0006	0.3769	0.2509	0.7956	
grwth	0.4447*	0.1493	0.2195	-0.0060	-0.0491	-0.7744*	-0.1401
	0.0006	0.2720	0.1040	0.9647	0.7191	0.0000	0.3030
lev	-0.0926	-0.3847*	0.0173	-0.2318	0.0762	0.1082	-0.0756
	0.4973	0.0034	0.8990	0.0855	0.5768	0.4271	0.5796

	grwth	lev
grwth	1.0000	
lev	-0.2205	1.0000
	0.1025	

```
. reg dacc mgos inos blos fros perf size grwth lev
```

Source	SS	df	MS		
Model	1610.93023	8	201.366279	Number of obs =	56
Residual	558.476242	47	11.8824732	F(8, 47) =	16.95
				Prob > F =	0.0000
Total	2169.40647	55	39.4437541	R-squared =	0.7426
				Adj R-squared =	0.6987
				Root MSE =	3.4471

dacc	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
mgos	19.23274	3.842042	5.01	0.000	11.50355	26.96193
inos	-11.85258	3.439935	-3.45	0.001	-18.77284	-4.932327
blos	1.171667	4.090343	0.29	0.776	-7.057042	9.400376
fros	-30.13375	6.404473	-4.71	0.000	-43.01789	-17.24961
perf	.6227488	.7468396	0.83	0.409	-.8796986	2.125196
size	-1.437107	.2382638	-6.03	0.000	-1.916432	-.9577818
grwth	.2251383	.0603583	3.73	0.001	.1037131	.3465636
lev	6.817187	2.385417	2.86	0.006	2.018347	11.61603
_cons	19.83736	4.324011	4.59	0.000	11.13857	28.53615

```
. hettest

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
         Ho: Constant variance
         Variables: fitted values of dacc

         chi2(1)      =    12.15
         Prob > chi2  =   0.0005
. vif
```

Variable	VIF	1/VIF
mgos	3.10	0.322197
blos	2.87	0.348162
grwth	2.76	0.362402
perf	2.65	0.376770
inos	1.98	0.506038
fros	1.73	0.576836
size	1.60	0.623776
lev	1.46	0.685404
Mean VIF	2.27	

```
. xtreg dacc mgos inos blos fros perf size grwth lev, fe

Fixed-effects (within) regression               Number of obs      =        56
Group variable: id                              Number of groups   =         8

R-sq:  within  = 0.3837                         Obs per group: min =         7
       between = 0.6849                                        avg =       7.0
       overall = 0.5831                                        max =         7

                                                F(8,40)            =      3.11
corr(u_i, Xb)  = -0.0061                        Prob > F           =    0.0079

------------------------------------------------------------------------------
        dacc |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
        mgos |   20.14187   9.669928     2.08   0.044     .5982192    39.68552
        inos |  -17.79523    6.65397    -2.67   0.011     -31.2434   -4.347051
        blos |   6.038109   6.763866     0.89   0.377    -7.632175    19.70839
        fros |   -24.8566   9.564296    -2.60   0.013    -44.18676   -5.526432
        perf |   .5996494   .8987196     0.67   0.508    -1.216731    2.416029
        size |  -1.076351   .3450952    -3.12   0.003    -1.773815   -.3788877
       grwth |   .1663689   .0734104     2.27   0.029      .018001    .3147368
         lev |   11.17959   4.995008     2.24   0.031     1.084302    21.27488
       _cons |   11.39159   8.442844     1.35   0.185    -5.672033    28.45522
-------------+----------------------------------------------------------------
     sigma_u |  3.0391302
     sigma_e |   3.360697
         rho |   .44988038   (fraction of variance due to u_i)
------------------------------------------------------------------------------
F test that all u_i=0:     F(7, 40) =      1.35                 Prob > F = 0.2532

. est store fixed

. xtreg dacc mgos inos blos fros perf size grwth lev, re

Random-effects GLS regression                   Number of obs      =        56
Group variable: id                              Number of groups   =         8

R-sq:  within  = 0.3339                         Obs per group: min =         7
       between = 0.9768                                        avg =       7.0
       overall = 0.7426                                        max =         7

Random effects u_i ~ Gaussian                   Wald chi2(8)       =    135.57
corr(u_i, X)       = 0 (assumed)                Prob > chi2        =    0.0000

------------------------------------------------------------------------------
        dacc |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
        mgos |   19.23274   3.842042     5.01   0.000     11.70247      26.763
        inos |  -11.85258   3.439935    -3.45   0.001    -18.59473   -5.110435
        blos |   1.171667   4.090343     0.29   0.775    -6.845258    9.188593
        fros |  -30.13375   6.404473    -4.71   0.000    -42.68628   -17.58121
        perf |   .6227488   .7468396     0.83   0.404    -.8410298    2.086528
        size |  -1.437107   .2382638    -6.03   0.000    -1.904095   -.9701182
       grwth |   .2251383   .0603583     3.73   0.000     .1068382    .3434385
         lev |   6.817187   2.385417     2.86   0.004     2.141855    11.49252
       _cons |   19.83736   4.324011     4.59   0.000     11.36246    28.31227
-------------+----------------------------------------------------------------
     sigma_u |           0
     sigma_e |   3.360697
         rho |           0   (fraction of variance due to u_i)
------------------------------------------------------------------------------

. est store random

. hausman fixed random

                 ---- Coefficients ----
             |      (b)          (B)            (b-B)     sqrt(diag(V_b-V_B))
             |    fixed       random       Difference          S.E.
-------------+----------------------------------------------------------------
        mgos |   20.14187     19.23274       .9091351        8.873906
        inos |  -17.79523    -11.85258      -5.942643        5.695802
        blos |   6.038109     1.171667       4.866442        5.386927
        fros |   -24.8566    -30.13375       5.277154        7.103414
        perf |   .5996494     .6227488      -.0230995        .4999276
        size |  -1.076351    -1.437107       .3607554        .2496419
       grwth |   .1663689     .2251383      -.0587695        .0417846
         lev |   11.17959     6.817187       4.362404         4.38861
------------------------------------------------------------------------------
                           b = consistent under Ho and Ha; obtained from xtreg
            B = inconsistent under Ha, efficient under Ho; obtained from xtreg

    Test:  Ho:  difference in coefficients not systematic

                  chi2(8) = (b-B)'[(V_b-V_B)^(-1)](b-B)
                          =          5.38
                Prob>chi2 =        0.7164
                (V_b-V_B is not positive definite)
```

```
. xttest0

Breusch and Pagan Lagrangian multiplier test for random effects

        dacc[id,t] = Xb + u[id] + e[id,t]

        Estimated results:
                 |       Var     sd = sqrt(Var)
        ---------+-----------------------------
            dacc |  39.44375        6.280426
               e |  11.29428        3.360697
               u |         0               0

        Test:   Var(u) = 0
                            chi2(1) =     0.98
                        Prob > chi2 =     0.3223
```