

The Impact of Ownership Structure on the Financial Performance of Listed Insurance Firms in Nigeria

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Abstract This paper examines the impact of ownership structure on the financial performance of listed insurance firms in Nigeria. The study uses panel data for seventeen (17) firms for the period 2001 – 2010 (10 years). There are several aspects and dimensions of corporate governance, which may influence a firm's performance but this study focuses on two aspects of ownership structure: namely managerial and institutional shareholding. Firm's performance has been measured through Return on Asset (ROA) and Return on Equity (ROE). Findings indicate that there is a positive significant relationship between ownership structure and firm's performance as measured by ROA and ROE. This paper recommends that the code on owner's equity of listed insurance companies should be sustained and encouraged so that the firms can have a perpetual life, because the stake of this owners could serve as a check and balance mechanism to further strengthen the corporate governance of the insurance firms in order to give room for enhanced financial performance of the listed insurance companies in Nigeria.

Key words Ownership structure, Firm Performance, Institutional Shareholding, Managerial Shareholding, Listed Insurance Firms

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1. Introduction

The issue of corporate governance has become obverse and centre of the agenda for both business leaders and regulators all over the world. Shareholders are always regarded as the corporate owners, while directors are agents or representatives of shareholders who are supposed to allocate business resources in a way to increase their wealth. The motivation of many shareholders for investment in businesses is profit not control (Kadivar, 2006). The principles of corporate governance include issues like measure of management, level of control and manner of interaction between the great and little shareholders.

Ownership structure ranges from individual to collective; this causes new problems in the area of financial resource management. Berl and Moses (1932) considered it as agency problem (Morey *et al.*, 2008) opines that this may cause conflict of interest and agency problems.

A variable of corporate governance i.e. shareholders structure, and the relationship between shareholders structure (ownership structure) and the performance of firms is an important and continued subject in the field of financial management (Ezazi *et al.*, 2011) for analyzing this relationship, up to now different aspects of ownership structure are considered, for instance being managerial or non-managerial shareholders, shareholders concentration or dispersion, being whole or retail, being internal (domestic) or being foreign shareholders, being institutional or individual shareholders.

Several researches conducted on managerial shareholding and firms performance used different methodologies and report mixed result, for instance, some find positive relationship between managerial

shareholding and firms performance (Oswarld & Jahera, 1991), Mehran (1995), Houlthausen and larker (1996), Cole and Mehran (1998), while others find negative relationship (Jarell & Poulsen, 1988; Slovin & Sushka, 1993).

Institutional shareholding is also important and plays a vital role in the governance of the firm moving from good to great. Institutional shareholders can be banks, mutual funds, insurance companies, clubs, societies, churches and mosque. A number of studies have sought to evaluate the link between institutional ownership and firm performance. However, their results are mixed. For instance, some studies show that there is no relationship (Agrawal & Knoeber, 1996), Craswell *et al.* (1997), Loderer and Martin (1997) New Zealand, Navissi and Naiker (2006). In contrast, some find positive relationship between institutional ownership and firm performance (McConnell & Servaes, 1990), Chaganti and Damanpour (1991), Han and Suk (1998), Clay (2001), Hartzell and Starks (2003).

In Nigeria, it has not been clearly established as to whether or not there is any relationship between ownership structure and financial performance of listed insurance companies in Nigeria. The study considered 17 listed insurance firms on the Nigerian Stock Exchange (NSE) from 2001-2010. The remainder of the paper is structured as follows: the next section provides the review of previous related literature, and this is followed by the research methodology. The results are then discussed and the final section presents the concluding remarks.

2. Literature review

2.1. Managerial shareholding and firm's financial performance

Berle and Means (1932) pointed out that potential conflicts of interest arise between corporate managers and dispersed shareholders when managers do not have an ownership interest in the firm. As such shares held by the managers in a firm helps to align the interests between shareholders and managers. When the manager's interests coincide more closely with those of shareholders, the conflicts between the shareholders can 'entrench' the controlling power over the firm's activities, leaving external or small shareholders with difficulty in controlling the actions of such ownership. Short (1994) supports this notion and suggests that implicitly assuming the 'linear' relationship between managerial ownership and firm performance in the previous research possibly brings misleading results. This is because there may be the opposite relationship between managerial shareholding at a certain level and firm performance. Morck *et al.* (1988) investigate that whether or not there is a non-linear relationship between managerial ownership and firm performance (as measured by firm's market value and a profit rate) for 456 of the Fortune 500 firms in 1980. To capture this relationship, they categorize managerial shareholding into three different levels: 0% -5%, 5%-25%, and beyond 25%. The results reveal that there is a positive relationship between managerial ownership holding at 0% to 5% and the firm's value. After that, a negative relationship is found at 5% to 25% of managerial shareholding, and then the relationship becomes positive again (but not significant) beyond 25% of shareholding. In the profit rate regression, they report that there is only a significant positive relationship between managerial ownership holding at 0% - 5% and the profit rate.

McConnell and Servaes (1990) investigate the effects of managerial ownership on the firm's value. In their study, instead of fixing the level of managerial ownership, as had been conducted in Morck *et al.* (1988) study, they adopt managerial shareholding and managerial shareholding square as ownership variables. To do so, they draw upon a sample of 1,173 firms in 1976 and 1,093 firms in 1986. The results report that a positive relationship exists between managerial ownership holding at 0% to approximately 50% of shareholding and firm performance. Beyond 50%, a negative relationship between them is found. McConnell and Servaes (1990) therefore suggest that the impact of managerial ownership on the firm's value is nonlinear. Short and Keasy (1999) also investigate whether there is a non-linear relationship between managerial ownership and firm performance, based on return on shareholders' equity and market value, in the case of UK. Their study adopts the cubic model to investigate this relationship. With this model, the coefficients of managerial ownership variables (DIR, DIR2, and DIR3) will be able to determine their turning points (indicating the maximum and the minimum points of the managerial performance). Short and Keasy (1999) also suggest that the performance (as measured by return on shareholders' equity) is positively related to managerial shareholding in the 0% to 15.58% range, negatively related in the 15.58% to 41.84% range, and becoming positively related again beyond 41.48%. In the market return (as measured

by Tobin's Q) regression, they suggest that Tobin's Q is positively related to managerial shareholding in the 0% to 12.99% range, negatively related in the 12.99% to 41.99% range, and turning positive again when managerial shareholding exceeds 41.99%.

Han and Suk (1998) examine the non-linear relationship between insider ownership of 301 firms and average stock returns during 1988 to 1992. To capture the potential of the non-linear relationship, the inside ownership and inside ownership squared variables were applied. The inside ownership in this study consists of not only the board members, but also the officers, beneficial owners and principal stock holders owning ten percent or more of the firm's stock. The results show that the inside ownership is positively related to the stock returns. In the case of Thailand, Wiwattanakantung (2000) examines the relationship between managerial shareholders and firm performance in 1996. Managerial shareholding is classified into three levels (25% -50%, 50%-75% and beyond 75%). This study compares these three levels of managerial shareholders with non-managerial controlling shareholders. The study reports that there is a non-linear relationship between managerial shareholders and firm performance based on the return on assets and the sales-asset. That is, managerial shareholders who control between 25%-50% of outstanding shares have poorer returns on assets compared to non-managerial controlling shareholders. Kesner (1987) also investigates the relationship between members of the board of directors and six performance measures (profit margin, return on equity, return on assets, earning per share, stock market performance, and total return to shareholders). The results illustrate that a proportion of shares held by board members is positive and significant to only two of the performance measures (the profit margin and return on assets).

2.2. Institutional shareholding and Firm Performance

A number of studies have sought to evaluate the link between institutional ownership and firm performance. However, their results are mixed and unclear. For instance, Agrawal and Knoeber (1996) find no significant association between institutional ownership and firm performance based on a list of 383 firms. Craswell *et al.* (1997) examine the relationship between two cross-sectional Australian samples firms for 1986 and 1989 respectively, the study reveal no significant correlation between institutional ownership and firm performance. In examining a sample of 867 acquisitions of publicly traded firms in the US between 1978 and 1988, Loderer and Martin (1997) find no significant relationship between institutional ownership and firm performance. By partitioning institutional investors into institutions that have appointed a representative to the board of directors of the firms in which they have a block investment and institutions with a similar holding but without a representative on the board of directors in the New Zealand, Navissi and Naiker (2006) finds that institutions with board representation have greater incentives to monitor management. Therefore, their presence should have a positive influence on firm performance. However, at high levels of ownership, institutional investors with board representation may induce boards of directors to make sub-optimal decisions. Namazi and Kermani(2008) analyzed the impact of ownership structure on corporate performance of listed companies in Tehran Stock Exchange.the findings of this research indicates that there is a negative relationship and meaningful relationship between institutional ownership and firm performance. In contrast, McConnell and Servaes (1990) find a positive relationship between institutional ownership and firm performance using a cross-sectional sample of 1173 firms listed on NYSE/AMEX in 1976 and another 1093 firms in 1986. They further claimed that such a relationship reveals an efficient monitoring role assumed by institutional investors. Similarly, Chaganti and Damanpour (1991) provide evidence of a positive relationship between institutional ownership and return on equity in the US manufacturing sector continuously surveyed by the Value Line between 1983 and 1985. Han and Suk (1998) also find that stock returns are positively related to institutional ownership for 301 NYSE/AMEX firms during 1988–1992. They attributed this observed significant relationship to effective management monitoring by institutional investors. In the same vein, Clay (2001) finds a positive impact of institutional ownership on firm performance in which a percentage increase in institutional ownership translates into a 0.75 percent firm performance enhancement. Selecting the 1,914 firms included in Standard & Poor's from 1992 through 1997, Hartzell and Starks (2003) find that institutional ownership concentration is positively related to the pay-for-performance sensitivity of executive compensation, while it is negatively related to the level of compensation even after controlling for firm size, industry, investment opportunities, and performance. They suggest that institutions serve a monitoring role in mitigating the agency problem

between shareholders and managers. Examining the relationship between institutional ownership and firm performance in the North American casino industry from 1999–2003, Tsai and Gu (2007) reveals that investing institutionally in casino firms may help casino industry investors mitigate the agency problem caused by the separation of management from ownership. Finally, Mahoney and Roberts (2007) examine the relationship between corporate social performance and financial performance and institutional ownership for publicly held Canadian firms. They find a significant relationship between firms’ corporate social performance and the number of institutions investing in firms’ stock.

3. Methodology of research

The study sought to determine the impact of owners’ equity on the firm performance of Nigerian listed insurance companies, using 17 firms as at December 2010. The study consider two performance measures from two categories: return on assets (ROA) and return on equity (ROE). Data were derived from the audited financial report of the insurance firms listed on the Nigerian Stock Exchange (NSE) between 2001 and 2010. The samples of seventeen (17) listed insurance firms were selected using Yamane (1972) sampling technique. The type of data and available statistical method are considered when choosing a statistical method of data analysis for any study. This study used regression analysis to investigate the relationship between ownership structure and firm’s financial performance, dependent and independent variables are investigated.

3.1. Model specification and variable measurement

A mathematical model was developed based on the proxies specified for the dependent variable, financial performance (FP) i.e. Return on assets (ROA) and Return on Equity (ROE). The independent variables are managerial shareholding (MS) and Institutional shareholding (IS).

It is important to state that this study employs two financial ratios (ROA and ROE) to measure the firm's performance as mention above. In the empirical literature, Tobin's Q (the market value of equity plus the market value of debt divided by the replacement cost of all assets) has been used by so many scholars as a proxy for measuring firm's performance. It is very difficult to get the required information relating to the market value of debts issued by Nigerian insurance firms, since these are not always disclosed in their financial reports.

Sanda *et al.* (2005), Adenikinju and Ayorinde (2001) used a modified form of Tobin's Q in order to solve the above problem. In short this study does not follow their school of thought, because the modifications made on the original Tobin’s Q are considered to be subjective, and which may influence the outcome of the study. Unlike Demsetz and Villalonga (2001), Cho (1998), and Palia (2001) that use managerial compensation as the only corporate governance variable; that examines board characteristics only, this study examines two ownership structure i.e. (managerial shareholding and institutional shareholding) together. The following mathematical models were developed to answer the null hypotheses which state that managerial shareholding and institutional shareholding has no significant impact on the financial performance of listed insurance companies in Nigeria.

$$\text{Performance}_{it} = f(\text{owner's equity})_{it} \quad (1)$$

$$\text{Performance}_{it} = \alpha + \beta_1 (\text{Managerial shareholding})_{it} + \beta_2 (\text{Institutional shareholding})_{it} \quad (2)$$

$$\text{ROA}_{it} = \alpha + \beta_1 (MS)_{it} + \beta_2 (IS)_{it} \quad (3)$$

$$\text{ROE}_{it} = \alpha + \beta_1 (MS)_{it} + \beta_2 (IS)_{it} \quad (4)$$

Variable	Measurement
Managerial shareholding	Percentage of owner equity held by managers
Institutional shareholding	Percentage of owner equity held by institutions
Return on Asset	Net income divided by total assets of the firm
Return on Equity	Net income divided by shareholders equity of the firm.

3.2. Statistical tools employed

This study employs basic statistical tools which include; Correlation and the simple linear regression. Simple regression is adopted to test the strength of relationship between the ownership structures and firm performance (Return on assets and Return on equity). The simple regression values were calculated using the Statistical Program for Social Sciences (SPSS).

4. Presentations of results

Table 1 below presents the summary of the descriptive statistics of the dependent and independent variables. The minimum, maximum, mean and the standards deviations are presented in order to provide an insight into the distribution of the underlying variables. The mean ROA of the sampled firms is about 45% and the mean of ROE is 44%. The results indicate that, on the average, for every 100% shares of these firms, about 44% is owned by either managerial or institutional shareholders.

Table 1. Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
MS	170	.44	.45	.4458	.00495
IS	170	.44	.45	.4442	.00496
ROA	170	.44	.45	.4458	.00496
ROE	170	.44	.45	.4442	.00495
Valid N (listwise)	170				

4.1. Correlation

The outcome of inter correlation between variables of the study, as shown in Table 1 indicated that, the strength of correlation between most of the variables is slightly weak and, subsequently produced a small effect. Actually, of all the variables, ROA is weakly correlated with managerial shareholding at ($r = 0.169$, $p < 0.01$), it is also negatively correlated with institutional shareholding at ($r = -0.299$, $p < 0.05$). On the other hand, ROE is negatively moderately correlated with managerial shareholding at ($r = -0.371$, $p < 0.05$) and moderately correlated with institutional shareholding at ($r = 0.334$, $p < 0.05$) respectively. Specifically, the dependent variables (ROA and ROE) moderately correlated with one another at ($r = -0.336$, $p < 0.05$). In terms of independent variables, managerial shareholding showed a moderate correlation with the institutional shareholding at ($r = -0.415$, $p < 0.05$). In total, the result of the correlation analysis revealed that, there was a slightly fair magnitude of association among the variables as shown in Table 2 below.

Table 2. Correlation among the variables

Correlation	MS	IS	ROA	ROE
MS	1			
IS	-.415**	1		
ROA	.169*	-.299**	1	
ROE	-.371**	.334**	-.336**	1

Note: *, ** represents the significance at 0.01 and 0.05 levels.

4.2. Regression result

Table 3 shows the result of the regression analysis of the variables. With F- values of 8.442 (sig 0.000) and 17.969 (sig 0.000) for ROA and ROE as performance proxies respectively, it clearly shows that there is a strong relationship between the dependent variables (ROA and ROE) and the independent variables. The main hypotheses determines whether owners equity (managerial shareholding and institutional shareholding), which represent the corporate governance mechanism have impact on the dependent variables which reflects the firm performance. For this general hypothesis, the probabilities value of each of

the variable is used to either reject or accept it. In order to determine whether to reject the null hypotheses or accept it, the following condition should be applied to the regression results: $P. < 0.05$, if this condition is achieved, then there is a significant relationship between the independent variable and the dependent variable. By implementing this condition on the regression results, we reached the statistical results shown in Table 3 below.

Table 3. Regression result

	Model 1	Model 2
Constant	0.535	0.485
Managerial shareholding	0.016	0.000
Institutional shareholding	0.001	0.005
R^2	0.192	0.177
Adjusted R^2	0.081	0.167
F – statistics	8.442	11.969
Prob. (F - statistics)	0.000	0.000

Table 4. Statistical results

Null Hypotheses	Reject /Accept
H0: Managerial shareholding has no significant impact on the financial performance of Nigerian listed insurance companies	Reject
H0: Institutional shareholding has no significant impact on the financial performance of Nigerian listed insurance companies	Reject

5. Discussion of findings

Results indicate that, there is a significant relationship between managerial shareholding and firm performance as measured by ROA and ROE, as the probability value is less than 0.05. Not many previous studies have studied this independent factor in relation to firm performance. However, this result is consistent to the study conducted by Kesner (1987) who investigates the relationship between members of the board of directors and six performance measures (profit margin, return on equity, return on assets, earning per share, stock market performance, and total return to shareholders). The results illustrate that a proportion of shares held by board members is positive and significant to only two of the performance measures (the profit margin and return on assets). The result is also consistent to the findings of Pfeffer (1972) who finds that, managerial shareholding is positively related to profit margin and return on equity. The study posits that, managerial shareholders have very good returns on assets and equity compared to non managerial controlling shareholders in Nigeria.

Similarly, the result revealed a significant relationship between institutional shareholding and the two financial performance measures (ROA and ROE), as the probability value is less than 0.05, similar results were arrived at by Mitra and Cready (2005), and Ho (2005), who studied the impact of institutional shareholding as one of the governance factors affecting firms performance, their study reveals that, institutional shareholding help to prevent managerial opportunistic behavior which in turn improves firm performance. In the same vein, the finding is also consistent to McConnell and Servaes (1990) who finds a positive relationship between institutional ownership and firms' performance using a cross-sectional sample of 1173 firms listed on NYSE/AMEX in 1976 and another 1093 firms in 1986. They further claimed that such a relationship reveals an efficient monitoring role assumed by institutional investors. This result is also similar to the result of Chaganti and Damanpour (1991) which provides evidence of a positive relationship between institutional ownership and return on equity in the US manufacturing sector continuously surveyed by the Value Line between 1983 and 1985. Han and Suk (1998) also find that stock returns are positively related to institutional ownership for 301 NYSE/AMEX firms during 1988–1992. They attributed this observed significant relationship to effective management monitoring by institutional investors. In the same vein, Clay (2001) finds a positive impact of institutional ownership on firm

performance in which a percentage increase in institutional ownership translates into a 0.75 percent firm performance enhancement.

6. Conclusions

There is no doubt that several studies have been conducted so far to examine the relationship between firm performance measures and ownership structure, but startlingly the conclusions of these studies are varied. They seem to depend quite heavily on the kind of methodology that is used, including how the measurement is defined and the time horizon over which it is measured (Cole *et al.*, 2001). In this study, the authors examine the relationship that exists between firm performance, using two proxies (ROA and ROE) and two ownership structure (managerial shareholding and Institutional shareholding). A sample size of 17 listed insurance firms on the Nigerian Stock Exchange (NSE) between 2001 and 2010 is used. The method of analysis is linear regressions analysis. The study reveals the following results:

1. There is a significant relationship between firm performance (ROA & ROE) and owners' equity (managerial shareholding and institutional shareholding).
2. Each of the two ownership structures has significant influence on the performance of listed insurance firms in Nigeria.

Arising from the conclusions, we recommend that the code on owner's equity of listed insurance companies in Nigeria should be sustained and be promoted for full implementation so that the firms can have a perpetual life. This is because the stake of the owners could serve as a check and balance to further strengthen the corporate governance of the insurance firms in order to give room for enhanced financial performance of the firms in Nigeria. This result, however stresses the importance of strengthening the code of corporate governance in order to further assess the impact of ownership structures on the performance of the firm's in the long run.

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