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Board Ownership and Going-concern of Nigerian Listed Banks: The Role of Audit Committee Financial Expertise

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Abstract

This study empirically analyses the interactive role of audit committee financial expertise on the relationship between ownership structure and going-concern. The study is carried out based on the panel data analysis. Data were generated from the yearly reports and accounts of listed firms on Nigerian Stock Exchange from 2011 to 2015. The population of the study consists of all fifteen (15) listed banks on the stock exchange. Descriptive statistics, Pearson correlation, as well as fixed-effect and random-effect generalised least square (GLS) regression techniques together with Hausman Specification Test as the decision rules were utilised as tools of analysis. The findings establish that CEO and executive directors' ownership are significantly and negatively related to going concern of listed banks in Nigeria. However, with the existence of audit committee members that have financial expertise, this negative relationship is overturned to positive. It also recommended that banks should nominate and appoint members with sound financial knowledge into audit committee, which increases the business performance and prevents any going-concern problem.

Keywords: Going-concern, board ownership, audit committee, banks, Nigeria

1. INTRODUCTION

Managerial ownership is considered as a crucial characteristic of ownership structure which may limit going concern problem in a company (Zureigat, Fadzil & Ismail, 2014). Managerial ownership is a fraction of the executive directors' ownership of shares of the total number of shares issued (Bekiris, 2013). Managerial ownership can align the interest between management as agent and owners as principal, hence; reduce the total agency costs. According to the agency theory, it is anticipated that management equity ownership has a significant negative relationship with the going-concern problem. It is then likely that the larger the level of management ownership in the business, the lesser the degree of conflict of interest (Jensen & Meckling, 1976). This sequentially would, increase the performance of the firm and avoid companies from facing the going-concern problem.

The equity ownership of a CEO is an essential mechanism in supporting the interest of the CEO and other owners (Alves, 2012). In line with agency theory, there is always a clash of interests between CEO and other equity owners that innate from the separation of control and ownership; this interest is anticipated to be brought into line as the level of CEO ownership rises. CEOs that have a substantial ownership in a company are unlikely to mix up in the devious act that will lead to the going-concern problem (Jensen & Meckling, 1976). Similarly, executive directors have the influence to impact company decisions. Likewise, they are more take part in the operations of

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the company compared to non-executive directors (Ali, Salleh, & Hassan, 2008). The separation of control and ownership may capture the role of executive directors who have a direct relationship in handling a company's business activities. Once managerial concern is in the same vein to that of the owners, earnings management behaviour is anticipated to be curtailed which will reduce the possibilities of the going-concern problem (Ali, Salleh, & Hassan, 2008). Likewise, according to agency theory, a non-executive directorship is a monitoring mechanism aims to build up the control capability of the board and to decrease agency cost related to management (Cho & Kim, 2007). According to Hillman, Canella and Paetzold, (2000), non-executive directors convey resources to the company access to essential elements that are fundamentals to the business's survival.

In Nigerian banking sector, Mohammad (2012) posits that weak governance practices and agency problems contributed to the failure of Nigerian financial institutions. Therefore, the perpetual existence of the companies can be linked to good corporate governance. At a basis glance, the Nigerian economy has undergone this financial crisis. Likewise, recently in July 2016, Central Bank of Nigeria (CBN) has sacked top executives of Skye Bank over failure to meet capital adequacy which is evident corporate governance and going-concern problem in Nigerian Financial institutions (Nweze, 2016).

Empirically, most of the studies on the relationship between board ownership structure and going-concern problems more focuses either on earnings management (Alves, 2012; Alzoubi, 2016; Ramadan, 2016) or profitability (Davidson, Jiraporn, Kim, & Nemec, 2004; Ogega, 2014) with very few on bankruptcy (Iskandar et al, 2011; Parker, Peters, & Turetsky, 2005; Zureigat et al., 2014) as a determination of going-concern status. This study analyses the effect of board ownership on the overall combination of all three determinates of going-concern (bankruptcy, earnings management, and profitability). Thus, there is a need to address this gap created by the above studies.

With regards to board ownership, scholars such as Alves, (2012); Amran and Ahmad (2013); Iskandar et al., (2011); and Ramadan (2016) are of the opinion that managerial ownership is inversely associated with firm going-concern variables. Whereas, Chou (2015); Darko, Aribi, and Uzonwanne (2016); and Farouk and Hassan (2014) claim that an increase of managerial ownership of the company will increase its going-concern variables. Thus, there is a need to address this gap by introducing a moderating variable so as to discover a specific effect of board ownership variables on going-concern.

Based the agency theorist, inside board committees such audit committees reduce the agency conflict. The committee is necessary for checking the important activities of the corporation which are critical to the firm's going-concern. In addition, Section 359 (3&4) of the Company and Allied Matter Act (CAMA) 1990 mandates that public company in Nigeria establish an audit committee. An audit committee has a vital observing role to guarantee company's financial reporting quality and responsibility (Al Daoud, Al-Sraheen, & Alslehat, 2015). In the light of the preceding problems, the current study empirically tests the interactive role of audit committee financial expertise on the relationship between ownership structure and going-concern.

2. LITERATURE REVIEW

Board ownership can align the interest between management and shareholders, hence; reduce the total agency costs (Jensen & Meckling, 1976). That is to say the higher the board ownership, the lower the agency conflict, hence the lower the going concern problem. Based on the agency theory, it is anticipated that board equity possession has a significant negative relationship with the going-concern problem (Parker et al., 2005; Iskandar et al., 2011). Once a board member turns into part of the business holders, they will have the similar amount of motivation as that of the shareholder. Such board members will not take risks that will not benefit the shareholder. Hence it is anticipated that the greater the level of board ownership in the firm, the lesser is the level of conflict of interest. This would, in turn, increase the performance of the company and avoid companies from facing going-concern.

Empirical studies on the effects of board ownership on the going-concern variables (bankruptcy, earnings management, and profitability) have revealed a diverse outcome. For instance, Parker et al., (2005) found that managerial ownership is inversely associated with repeated going-concern modifications. Likewise, in Malaysia, Ali, Salleh and Hassan (2008) and Iskandar et al., (2011) result show that both board shareholdings have a significant negative relationship with earnings management which will sequentially decline a going-concern problem. Furthermore, in Portugal, Alves, (2012), Alzoubi (2016) and Ramadan (2016) reveal that managerial ownership relates inversely to earnings management practices which will subsequently decrease the going concern problem possibility.

However, Elsayed (2007) discloses a significant positive association concerning executive director ownership and firm performance which will minimise the risks of the going-concern problem. Likewise, Hashim (2009) stated that ownership by the executive directors is significantly and negatively connected to the quality of earnings which automatically increases earnings management and in turn, leads to a going-concern problem. However, Mohamad et al., (2012) found that non-executive director shareholding is significantly and positively linked to the quality of earnings which usually decreases earnings management and reduce the going-concern problem. Likewise, Zureigat et al., (2014) found that there is a positive relationship between executive ownership and going-concern problem. In Nigerian setting, Isenmila and Afensimi (2012) and Farouk and Hassan (2014) confirms that there is a positive connection between managerial ownership and earnings management.

With regards to audit committee members' financial expertise, from the perspective of internal audit; the presence of financial experts on the audit committee reduces the likelihood of internal control weaknesses (Naike & Sharma, 2009), hence, reduces going-concern uncertainties. Previous studies support the view that audit committee members' financial expertise can increase the efficiency of a company's internal control (Wan Ismail & Kamarudin, 2012). Conversely, Mohamad et al., (2012); and Sallouma et al., (2014) discover the absence of relationship concerning audit committee financial skills and going-concern. Based on the agency theory as well as resource dependence theory, it is argued that financial expertise of audit committee reduces earnings management and enhances profitability and going-concern status.

3. METHODOLOGY

The study covered the period from 2011 to 2015 for the reason that this is the period that the banking sector has experienced numerous changes in Nigeria, and some of the expected effects are visible identified in the reports. It is at this time that the Nigerian Security Exchange Commission issued the Corporate Governance Code in 2011 and the revised Corporate Governance Code in 2014, forced the Nigerian companies to comply with the requirements of the governance code. More so, it is in this era that the Central Bank of Nigeria (CBN) issued a revised Code of Corporate Governance for Banks and Discount Houses in 2014 so as to address the ambiguities including that of ownership structure. The population of the study consists of all fifteen (15) banks listed on the Nigerian Stock Exchange as at 2015/2016. The annual reports are the primary sources of data for this study.

3.1 Variables of the Study

The variables of the study comprise of dependent variables, independent variables, and control variables and their measurements. The going-concern (GC) as the dependent variable, CEO Ownership (CO); Executive Director Ownership (EO); Non-Executive Director Ownership (NO) as independent variables. While the control variables include the company size (SZ); and tangibility (TANG).

- **Going-Concern (GC):** to measure the GC, this study consolidates the 3 known measures of GC which includes Altman's Z-Scores Model (Altman, Iwanicz-Drozdowska, Laitinen, & Suvas, 2017; Sajjan, 2016); discretionary loan loss provisions (Cohen, Cornett, Marcus, & Tehranian, 2014; Norden, & Stoian, 2013); and return on asset (Mohammad, 2012; Ogega, 2014) to arrive at a more robust measure of variable. The idea of combining multiple measures to arrive at new one is not new in accounting literature (Cohen & Zarowin, 2010; Zang, 2012). A consolidated matrix is applied to combine all three going-concern indicators into one model, the study firstly multiplies Discretionary accruals by negative one (so that the higher amount, the better the going-concern) and add it to Z-Score and ROA (which all have a direct relationship with better going-concern). The higher the amount of this aggregate measure, the more likely, the healthier the going-concern of the firms. Thus:

  GC = Z-Score + ROA – DLLP **Model 1**

  Where:
  GC denotes Going-concern; Z-Score denotes Altman's bankruptcy model; DLLPs denotes the absolute value of accruals loan loss provisions to total liabilities, and ROA denotes return on net assets.

- **CEO ownership (CO):** Proportion of shares held by the CEO of the company at the end of the financial year. This comprises direct and indirect equity holding of the CEO in the firm (Alves, 2012; Farouk & Hassan, 2014).

- **Executive Directors Ownership (EO):** The proportion or percentage of equity ownership of executive directors. This consists of direct and indirect equity holding of the executive directors in the company (Ali et al., 2008; Alzoubi, 2016; Elsayed, 2007).

- **Non-Executive Directors Ownership (NO):** The proportion or percentage of equity ownership of non-executive directors. This includes direct and indirect equity holding of the non-directors in the company (Ali et al., 2008; Alzoubi, 2016; Darko et al., 2016).

- **Audit Committee Financial Expertise (ACE):** Audit Committee Financial Expert is the proportion of audit committee directors who qualify as accounting financial expert to the total number of members of the audit committee (Miko & Kamardin, 2015; Sallouma et al., 2014).

In addition to the board ownership variables, this study takes into consideration two control variables relating to the companies. First, control for firm size by means of the natural logarithm of the firm's total assets (Ben-Nasr, Boubakri & Cosset, 2012). Such control is necessary because of the argument that larger firms have small probabilities of having going-concern problems. Secondly, tangibility is used as another control variable, and it is measured as the ratio of a fixed asset to total assets (Goh, Krishnan & Li, 2013). The reason behind the use of tangibility is that tangible assets are easily monitored and tend to lessen agency conflicts between shareholders and creditors in the event of bankruptcy.

3.2 Model Specification

The functional relationships among these variables are therefore be defined as:

$$GC_{it} = f\,(CO, EO, NO, SZ, Tang)_{it} + \epsilon_{it}$$

The interaction effect between the independent and moderating variables will be established on the dependent variable. Audit committee financial expertise as a moderator is introduced in the function of the model 2.

$$GC_{it} = \alpha_0 + \beta_1 CO_{it} + \beta_2 EOit + \beta_3 NO_{it} + \beta_4 ACE_{it} + \beta_5 CO_{it} * ACE_{it} + \beta_6 EO_{it} * ACE_{it} + \beta_7 NO_{it} * ACE_{it} + \beta_8 SZ_{it} + \beta_9 Tang_{it} + \epsilon_{it} \qquad \textbf{Model 1}$$

Where:

GC = Going-concern; CO = CEO Ownership; EO = Executive Director Ownership; NO = Non-Executive Director Ownership; ACE = Audit committee financial expertise; SZ = Size; Tang = Tangibility; i represents the number of companies of the panel data t represents the time periods of the panel data; $\alpha 0$ represents the fixed intercept element; and $\boldsymbol{\beta}_{1\text{-}9}$ represents the ratio of change in DV to a unit change in each substituted explanatory variable; and ϵit is the error term that is factored to satisfy the linear regression model assumption.

4. DATA ANALYSIS AND DISCUSSION OF RESULTS

Table 1 provides summary statistics for the variables of the study. All the variables were computed from the relevant balance sheets and income statements of the sampled companies. The statistical software STATA 12.0 is used to check the relationship between the dependent and the independent variables using regression analytical tool. It also presents the descriptive statistics results which provide summary statistics for the variables of the study.

Table 1. Descriptive Statistics of the Variables

Variables	OBS	MEAN	STD DEV	MIN	MAX	Skewness	Kurtosis	VIF
GC	75	4.1984	0.5217	2.1832	5.0583	-1.5457	7.2961	
CO	75	0.0066	0.0142	0.0000	0.0531	2.4205	7.4723	1.12
EO	75	0.0017	0.0026	0.0000	0.0101	2.0739	6.6124	1.17
NO	75	0.1146	0.1577	0.0000	0.7159	1.8944	6.5299	1.11
ACE	75	3.6533	1.2357	1.0000	7.0000	0.5526	3.0415	1.39
SZ	75	20.9517	0.7764	19.1081	22.2639	-0.2630	2.3380	1.49
Tang	75	0.0350	0.0116	0.0129	0.0678	0.4365	2.8473	1.37

Table 1 discloses that the overall banks have an average GC of 4.1984 which is above the safe. Likewise, the minimum GC of 2.1832, as well as the maximum GC of 5.0583. On the side of board ownership variables, the CEO ownership has an average of 0.66% with a variation of 1.42% among them with a minimum level of 0.00% and maximum level of 5.31% of ownership. Whereas, the Executive Directors' ownership has an average of 0.17%

with a variation of 0.26% among them as well as the minimum level of 0.00% and maximum level of 1.01%. While for the Non-Executive Directors' ownership has an average of 11.46% with a variation of 15.77% among them with the minimum level of 0.00% and maximum level of 71.59%. This might be due to the reason that some of the non-executive directors have a high level of indirect interest through the institutions they represent whereas some banks non-executive directors do not have any direct or indirect interest in the bank. However, the Audit committee members with financial expertise have an average of almost 4 members with a variation of about 1 among banks as well as the minimum of 1 and maximum of 7 members with financial expertise. As for the distribution of the variables that is skewness and kurtoses are within the normal range. Similarly, the VIF which is simply the reciprocal of TV ranges from 1.11 to 1.49 indicates the absence of multicollinearity.

Hierarchical regression[1] result of the moderating effect of Audit Committee Financial Expertise on the relationship between board ownership and going-concern is presented in Table 2 below:

Table 2. Regression Results of the Moderating Effect of Audit Committee Financial Expertise

GC	FIXED-EFFECT				RANDOM-EFFECT			
Variables	**Coef.**	**Std. Err.**	**T**	**P**	**Coef.**	**Std. Err.**	**Z**	**p>|z|**
CO	-29.3756	6.9643	-8.4400	0.0000	-23.4636	7.4232	-6.3200	0.0010
EO	-144.5258	44.5182	-6.5000	0.0010	-103.0190	46.3356	-4.4400	0.0130
NO	-0.9824	0.9920	-1.9800	0.1635	0.0843	0.9133	0.1800	0.4630
ACE	-0.0456	0.0658	-1.3800	0.2455	-0.0589	0.0658	-1.7800	0.1855
AEC	6.0560	2.1300	5.6800	0.0030	5.3138	1.9883	5.3400	0.0040
AEE	35.0959	12.1929	5.7600	0.0030	23.2984	12.9227	3.6000	0.0355
AEN	0.1379	0.1796	1.5400	0.2230	0.0087	0.1820	0.1000	0.4810
SZ	0.3947	0.1963	4.0200	0.0250	0.1888	0.1129	3.3400	0.0470
Tang	-25.9398	6.4030	-8.1000	0.0000	-22.4843	5.6841	-7.9200	0.0000
Cons	-2.8599	4.1566	-1.3800	0.2475	1.2922	2.4206	1.0600	0.2965
R-squared:								
Within		0.6230				0.5911		
Between		0.2608				0.2695		
Overall		0.3093				0.3394		
Prob>F		0.0000				0.0000		
Hausman (Prob>Chi)				0.8282				

Given the Hausman Specification Test result of 0.8282 which is higher than 0.05 as shown in Table 2 above, the random-effects GLS regression is accepted. Table 2 revealed the regression analysis outcome of the relationship between board ownership variables and going-concern and the moderating effect of audit committee financial expertise. The direct effect regression results, that is the relationship between GC and CO (β =-23.4636; z = -6.3200; p = 0.0010) implied that as CO increases, GC will decrease by the same percentage. Both z-value and p-value revealed a significant relationship between CO and GC, thus it can be concluded that there is a negative and significant relationship between the CO and going concern of listed banks in Nigeria. This in line with Ali, Salleh, and Hassan (2008) and Iskandar et al., (2011) but contradicts with Zureigat et al. (2014) that postulate positive relationship.

While the relationship between GC and EO (*β*=-103.0190; z = -4.4400; p = 0.0130) implied that as EO increases, GC will reduce by the same percentage as well z-value and p-value reveal a significant relationship between EO and GC. Thus, it can be concluded that relationship between the EO and going concern of listed banks in Nigeria is negative and significant. This is in line with Ali et al., (2008), Alzoubi (2016), and Hashim (2009) while opposing the findings of Elsayed (2007) and Zureigat et al. (2014) that claim positive relationship.

However, these negative relationships are overturned to positive with the existing of audit committee member with financial expertise as revealed by the Table 2 above. The result revealed the significant of moderating effect of audit committee financial expertise on the relationship between CO and EO and GC with ACE*CO (β = 5.3138; z = 5.3400; p = 0.0040) and ACE*EO (β = 23.2984; z = 3.6000; p = 0.0355) respectively. This is due to the reason that the presence of professionals in finance in the audit committee reduces the possibility of internal control weaknesses which will prevent earnings manipulations and improves the performance of CEOs and other executive directors, hence, enhances profitability and going-concern status.

5. CONCLUSION AND RECOMMENDATIONS

Based on the research findings, CEO and executive directors' ownership are significantly and negatively related to going concern of listed banks in Nigeria. However, with the present members of the audit committee with

[1] The sign of the coefficients and the significance level of direct regression are similar to those presented in the hierarchical and are available upon request.

financial expertise, this negative relationship is inverted to positive. It recommended that banks should nominate and appoint members with sound financial knowledge into audit committee, which increases the business performance and prevents their financial distress. Similarly, the presence of financial professionals in the audit committee reduces the possibility of internal control weaknesses which in turn improves profitability and going-concern status.

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