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EFFECT OF OUTSIDE DIRECTORSHIP AND OWNERSHIP CONCENTRATION ON EARNINGS QUALITY OF LISTED NON-FINANCIAL COMPANIES IN NIGERIA

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ABSTRACT

The issuance and application of corporate governance code by capital market authorities are to ensure that board of directors and managers of companies discharge their responsibilities with utmost sincerity. Studies have reported confounding empirical submission on the impact of Outside directorship and ownership concentration on the quality of reported earning. This current study investigated the effect of outside directorship and ownership concentration on the earnings quality of listed non-financial companies in Nigeria. To achieve these objectives, a correlational panel research design was employed, utilizing data from seventy (70) non-financial firms listed on the Nigerian Exchange Group between 2009 and 2023. The study analyzed the data using panel regression techniques with the aid of the E-View 12 statistical tool. The results revealed that outside directorship has a negative and insignificant effect on discretionary accrual, while ownership concentration exhibited a negative but significant effect. The study concludes that while outside directorship does not significantly influence earnings quality, ownership concentration negatively impacts financial reporting integrity, suggesting that dominant shareholders may compromise transparency. Thus, it is recommends that non-financial firms in Nigeria should carefully manage ownership concentration to enhance earnings quality and ensure transparent financial reporting practices.

Keyword: Outside Directorship, Ownership Concentration, Earnings Quality, Discretionary Accruals and Firm Size.

INTRODUCTION

Earnings quality is a fundamental aspect of financial reporting, reflecting how accurately reported earnings depict a company's underlying financial performance. High-quality earnings provide a faithful representation of the company's economic health, fostering confidence among stakeholders, including investors, regulators, and creditors (Ozili, 2020). Several factors influence earnings quality, including accounting choices, estimates for assets and liabilities, corporate governance structures, management incentives, and external audit quality. Ensuring high-quality earnings is vital because poor earnings quality can mislead stakeholders, distort key financial ratios, and undermine the efficient functioning of capital markets. Companies that prioritize transparent and reliable financial reporting are more likely to gain stakeholder trust and maintain market confidence.

Accounting choices and management incentives are particularly important in shaping earnings quality. Decisions regarding revenue recognition, asset valuation, and provisions for future liabilities often involve managerial discretion, which can be manipulated to meet specific financial targets (Francis et al., 2004). Additionally, complex financial structures, such as derivatives or off-balance-sheet financing, increase the opportunity for earnings management, as they obscure the true financial position of the firm. The role of corporate governance, particularly through mechanisms like outside directorship and audit committees, is critical in ensuring that such managerial discretion is used appropriately. Strong governance structures act as a safeguard, reducing the risk of opportunistic financial reporting and enhancing overall earnings quality.

Corporate governance mechanisms, including outside directorship and ownership concentration, can significantly impact earnings quality by curbing management's ability to manipulate financial results. Outside directors, who are independent of the company's management, are expected to provide objective oversight, challenging decisions that may compromise the integrity of financial reporting (Idode, 2019). Similarly, ownership concentration—where a small group of shareholders holds a substantial equity stake—can enhance monitoring, as these shareholders have a vested interest in the long-term success of the company. However, concentrated ownership also carries the risk of entrenchment, where dominant shareholders may prioritize their own interests, potentially compromising the integrity of financial reporting to protect their control or wealth (Adebayo et al., 2022).

Despite substantial research on corporate governance and earnings quality, there is limited understanding of how these dynamics play out in emerging markets like Nigeria, where regulatory frameworks and governance structures differ from those in developed markets. In Nigeria, weaker regulatory enforcement and the prevalence of closely held or family-owned firms add complexity to the relationship between outside directorship, ownership concentration, and earnings quality. This study aims to bridge this gap by investigating how these governance mechanisms influence earnings quality in Nigerian non-financial firms, providing valuable insights into how corporate governance can be optimized to improve financial reporting in emerging markets. By focusing on Nigeria's unique corporate landscape, this research contributes to the broader discourse on earnings quality and corporate governance in developing economies.

The study outlines its specific hypotheses as follows;
H_{O1}: Outside directorship percentage has no significance effect on discretionary accrual of listed non-financial companies in Nigeria
H_{O2}: Ownership concentration percentage has no significance effect on discretionary accrual of listed non-financial companies in Nigeria

LITERATURE REVIEW

Conceptual Framework

Outside Directorship

Outside Directorship Percentage refers to the proportion of independent or external directors on a company's board who are not involved in the company's day-to-day operations. Outside directors provide independent oversight and offer diverse perspectives on corporate governance, strategic decision-making, and risk management. Their role is particularly important in promoting accountability and reducing the likelihood of management engaging in self-serving behavior, which can compromise earnings quality (Jiang et al., 2016). The presence of external directors is seen as a means to enhance corporate transparency and objectivity, fostering more reliable financial reporting practices and reducing agency costs. As independent members, they are expected to act in the best interest of shareholders by scrutinizing management's actions, ensuring that decisions align with long-term company performance rather than short-term managerial interests (Adebayo et al., 2022).

In Nigeria, the inclusion of outside directors has become a prominent corporate governance mechanism, particularly as regulators emphasize the need for board independence. This trend is supported by guidelines from institutions like the Securities and Exchange Commission (SEC), which recommend a minimum percentage of independent directors on the boards of listed firms to promote good governance practices (Adegbite, 2015). However, while outside directorship is theoretically associated with improved earnings quality, its effectiveness often depends on the competence, independence, and active participation of these directors. Research by Adewumi et al. (2020) also highlights that the effectiveness of outside directors can vary depending on board dynamics and the regulatory environment in which they operate. Therefore, fostering a governance culture that encourages open dialogue and mutual respect between inside and outside directors is essential for fully realizing the benefits of board independence.

Outside Directorship Percentage

Outside directorship percentage refers to the proportion of independent or external directors serving on a company's board, who are not involved in the company's daily operations. These directors provide an unbiased perspective, offering strategic guidance and oversight on corporate matters such as risk management, executive compensation, and long-term strategy (Jiang et al., 2016). Unlike inside directors, who are typically senior executives or managers within the firm, outside directors are expected to bring objectivity and independence to board discussions, reducing the potential for conflicts of interest and enhancing corporate governance practices (Chang et al., 2017).

A higher percentage of outside directors is often linked to stronger governance, as independent directors are less likely to be influenced by internal politics or executive pressures. This independence allows them to act as a check on management decisions, promoting accountability and protecting the interests of shareholders and other stakeholders (Huang & Hilary, 2018). In many countries, including Nigeria, regulators like the Securities and Exchange Commission (SEC) and the Corporate Affairs Commission (CAC) have recommended that boards include a significant proportion of outside directors to improve transparency and corporate governance (Adams et al., 2018). These regulations aim to ensure that the board operates with a level of independence necessary for effective oversight.

Ownership Concentration

Ownership concentration refers to the extent to which a company's shares are held by a small number of shareholders, often leading to significant control by these shareholders over corporate decisions. In a highly concentrated ownership structure, large shareholders, such as institutional investors or family owners, have the ability to influence or direct management decisions, potentially shaping the strategic direction of the company (Schmalz, 2018). This concentrated control can lead to enhanced oversight of management, as large shareholders often have a vested interest in ensuring that the company operates efficiently and profitably. Akben-Selcuk (2019) highlights that in cases where ownership is concentrated, these shareholders are more likely to actively engage in governance, which can result in improved financial performance due to better alignment between management and shareholders' interests.

However, ownership concentration also presents risks, particularly in terms of governance and transparency. Large shareholders may prioritize their interests over those of minority shareholders, leading to decisions that may not benefit the company as a whole (Adebayo et al., 2022). Bako (2018) points out that concentrated ownership can reduce board independence and increase the risk of earnings manipulation, as controlling shareholders might influence financial reporting to reflect favorable outcomes for their personal gain. This dynamic often leads to conflicts of interest, reduced transparency, and potential governance issues, especially in environments with weaker regulatory frameworks like Nigeria. Thus, while ownership concentration can enhance control and efficiency, it may also undermine the integrity of corporate governance and earnings quality if not properly managed.

Ownership Concentration Percentage

Ownership concentration percentage refers to the proportion of a company's shares held by a small number of individuals or entities, reflecting the degree of control they exert over the company. It indicates how much of the company's equity is consolidated in the hands of a few shareholders, such as majority owners, large institutional investors, or corporate groups (Schmalz, 2018). A high ownership concentration percentage implies that a significant portion of the company's shares is controlled by a select few, granting them substantial influence over the company's strategic direction and decision-making processes. This contrasts with a low ownership concentration percentage, where ownership is more dispersed among a larger number of smaller shareholders, leading to a more balanced distribution of control (Yohan, 2017).

The implications of ownership concentration percentage can be significant for corporate governance and company operations. A higher percentage of concentrated ownership can streamline decision-making and provide a clear strategic focus, particularly when the dominant shareholders have a vested interest in the long-term success of the company. These shareholders may exercise their power to drive efficiency, align operations with strategic goals, and enhance the company's competitiveness (Ozili & Uadiale, 2017). However, a high ownership concentration percentage also raises concerns about potential governance risks, such as conflicts of interest or actions that disproportionately benefit the controlling shareholders at the expense of minority shareholders. When ownership is highly concentrated, the dominant shareholders may prioritize their interests, leading to reduced transparency, weakened accountability, and decisions that do not always align with the broader interests of the company or its stakeholders (Yasser & Mamun, 2017).

Earnings Quality

Earnings quality is a critical metric used to assess the reliability and sustainability of a company's reported earnings. It refers to the degree to which a company's earnings accurately reflect its underlying financial performance and the extent to which they can be relied upon by investors and other stakeholders for decision-making purposes (Li, 2019). Understanding earnings quality is essential for evaluating the overall health and viability of a company, as well as for assessing its ability to generate long-term shareholder value.

Yohan (2017) posited that earnings quality encompasses two main dimensions: persistence and transparency. Persistence refers to the consistency and predictability of a company's earnings over time. High-quality earnings are characterized by stable, recurring profits that are less susceptible to volatility or manipulation. Conversely, low-quality earnings may be erratic, subject to one-time gains or losses, or artificially inflated through accounting practices aimed at masking underlying financial weaknesses. Transparency, on the other hand, relates to the clarity and accuracy of the information disclosed in a company's financial statements. High-quality earnings are supported by transparent reporting practices that adhere to accounting standards and provide investors with a clear understanding of the company's financial position and performance. Conversely, low-quality earnings may be associated with opaque disclosures, aggressive accounting methods, or deliberate attempts to obfuscate financial information.

Guggenmos *et al.*, (2022) affirmed that several factors contribute to the assessment of earnings quality. One key consideration is the reliability of the accounting principles and practices employed by the company. Companies that adhere to generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS) are generally perceived to have higher earnings quality, as these standards provide a common framework for financial reporting and enhance comparability across companies. Additionally, the consistency and conservatism of a company's accounting policies can influence earnings quality. Conservative accounting practices, which err on the side of caution by understating rather than overstating profits, tend to enhance the reliability of earnings by reducing the risk of earnings manipulation or distortion. Conversely, aggressive accounting practices, such as revenue recognition policies that recognize revenue prematurely or inflate asset values, can undermine earnings quality by artificially inflating reported profits.

Discretionary Accruals

Discretionary accruals are a crucial element of financial statement manipulation, involving management's deliberate adjustments to accounting accruals to influence reported earnings. Unlike nondiscretionary accruals, which are consistent and reflect actual economic activities, discretionary accruals are subject to managerial discretion and can be manipulated to meet financial targets, smooth income fluctuations, or present a more favorable financial performance (Dechow *et al.*, 1995). This manipulation through discretionary accruals, often termed as earnings management, can significantly distort the quality of reported earnings, affecting the reliability and transparency of financial information.

Earnings quality, fundamentally, is about the extent to which reported earnings reflect the true economic performance of a firm. High earnings quality means that earnings accurately represent the company's economic situation, providing useful information for stakeholders' decision-making (Dechow & Schrand, 2001). One way to operationalize earnings quality is through earnings smoothness, which refers to the consistent reporting of earnings over time. While some smoothing may reflect genuine economic stability, excessive earnings smoothness often indicates the manipulation of discretionary accruals to reduce perceived volatility and manage investor expectations. This manipulation, aimed at portraying consistent and stable earnings, can undermine the accuracy and credibility of financial reports (Schipper, 1989).

Detecting discretionary accruals involves statistical models that isolate abnormal accruals beyond what is expected from normal economic activities. Common models include the Jones model (Jones, 1991), the modified Jones model (Dechow et al., 1995), and the cross-sectional accruals model (Dechow et al., 1998). These models help identify the extent to which reported earnings are influenced by discretionary actions, rather than by actual business performance. Excessive use of discretionary accruals to smooth earnings can be detrimental, leading to unreliable financial statements, potential future financial distress, or adverse market reactions (Dechow et al., 2010).

Firm Size

Firm size refers to the size of the business unit. It may also be defined as the number of operations carried out by a single company (Mayur & Saravanan, 2027). Because of the economies of scale phenomena, firm size is most critical to its success. Modern businesses strive to increase their intensity in order to get a competitive advantage over their competitors by lowering production costs and increasing market share. Larger businesses may manufacture things at significantly lower prices than smaller businesses. The volume or collection of a business's capacity to create and wherewithal, or the amount and diversity of value that a corporation may deliver to its consumers at the same time, is referred to as its size. According to this notion, company size is a factor in determining business profitability, and various experts have shown that a positive link exists between the size of a corporation and its profitability.

According to Idode (2019), firm size refers to the size of the firm and the activities of the commercial organisation. In today's environment, due to economies of scale, the size of a corporation plays a highly crucial part in competing with competitors through cost reduction and taking and holding more possibilities. According to this notion, company size is a factor in determining business profitability, and various experts have shown that a positive link exists between the size of a corporation and its profitability. According to Adegbite (2015) Company size has been identified as an important element in explaining organisational profitability, and a number of research have attempted to investigate the influence of firm size on profitability. Bako (2018) agreed, stating that because large enterprises have a larger market share, they may earn more. As a result of these circumstances, large enterprises function in more profitable environments with rivalry.

In corporate finance empirical researchers also regard firm size to be a significant and fundamental firm characteristic, and they detect the size effect - company size matters in affecting the dependent variables in many scenarios.

Empirical Review

Maniruzzaman *et al.*, (2024) examined the affinity between ownership concentration and firm performance using panel data on 1066 firm-year observations of DSE-listed manufacturing firms from 2010 to 2022. The study uses GMM models to gauge the association between ownership concentration and firm performance. The theoretical premise is that ownership concentration is negatively linked with agency cost, which boosts the dominant shareholders to act for their self-interests. Against the theoretical premise, the study finds adverse affinities between ownership concentration and firm performance in both the accounting (ROE) and market (Tobin's Q) based measures. Hence, the study rejects the theoretical premise that more robust ownership reduces the principal-agent problem and helps enhance firm performance. The study also advances that board size is negatively linked to Tobin's Q, but the same tie is positively related to ROE. However, both links are not consequential. The relationship between board independence and firm value is positive, with Tobin's Q and ROE, but insignificant. It is also evident that the association between some CG devices and firm-level control variables, namely firm size and firm age, are negative with Tobin's Q and ROE, though the affinities are significant for Tobin's Q only. The findings are worthwhile for business policymakers while devising ownership structures of companies. The study recommended that companies should consider diversifying their ownership structures to mitigate the adverse effects of concentrated ownership on firm performance. This research is unique because it used a more comprehensive and newer data set to add new insights to the body of literature on ownership concentration and firm financial relationships in the context of emerging countries like Bangladesh but fail in terms of geographical content.

Egbadju, (2024) investigated the impact of some corporate governance attributes on accounting conservatism in Nigeria. The study covers the period from 2005 to 2020 of 75 non-financial firms listed on the floor of the Nigerian Exchange Group (NXG). The results of the generalized method of moments (GMM) reveal that while four of the variables board size (BODS), managerial ownership (MOWN), audit committee size (ACS) and number of foreign directors (NFODIR) are positively significant with accounting conservatism; two of the variables chief executive officer with military experience (CEOME) and board independence (BODI) are negatively significant with it but board gender diversity (BGDIV) is insignificant. Again, while the Big4 as well as the number of foreign directors (NFODIR) are positively significant; foreign income (FINCOME) as well as the industry (IDUM) and yearly (YDUM) dummy variables are positively insignificant. The study makes some recommendations such as management should maintain or increase the present level of board size, managerial ownership, audit committee size and the number of foreigners in the board since these variables allowed management to stick to prudence in financial reporting for the period under review.

Paul *et al.*, (2023) evaluated the effect of corporate governance mechanisms on earnings management within the Nigerian context. The study adopted the panel generalised least square regression to analyse the data. A sample size of 49 companies was selected from the non-financial companies listed on the Nigerian Stock Exchange for six years (2012-

2017). Overall, corporate governance mechanisms jointly have not restrained the possibility of earnings management in Nigeria, but the degree of impact by individual corporate mechanisms showed mixed results. From the analysis, five corporate governance variables (ownership concentration, managerial ownership, board size, gender diversity, and audit committee independence) have positive relationship with earnings management. This indicates that an increase in any of these variables increases managers' latitude for using earnings management to manage the firms' earnings. This confirms ineffectiveness of all these variables in restraining earnings management. In contrast, two variables (CEO duality and board independence) contribute to the reduction of earnings management of the selected firms in Nigeria. However, CEO duality is not statistically significant. Given the findings, the study recommends stricter compliance and enforcement to the corporate governance codes and appropriate legislation. Besides, more independent directors' representation on the board should be encouraged. The sample size of only 49 companies over a six-year period is insufficient to draw meaningful conclusions about the relationship between corporate governance mechanisms and earnings management in Nigeria. Moreover, the sample selection process is not transparent, and there is no indication of how representative the selected companies are of the broader population of non-financial firms listed on the Nigerian Exchange Group.

Rezaee and Safarzadeh (2023) examined the relationship between corporate governance (CG) and various measures of earnings quality in listed companies on Tehran Stock Exchange (TSE). The theoretical intuition for prediction of any relationship between earnings quality and CG is based on the behavioral theory and the institutional settings in Iran. This study used the data of 117 listed companies on the TSE for the period from 2005 to 2019. The authors use panel data regression as the main methodology, along with principal component analysis, *t*-test and rank-sum test. The study found that the CG has a positive association with earnings quality. More precisely, better CG mechanisms cause lower earnings smoothness, more predictable and persistent earnings, and higher levels of timeliness, conservatism and value relevance. The relationship between CG and earnings quality is statistically and economically significant for all models. The study recommended that companies should prioritize the implementation of robust corporate governance practices, including the establishment of independent and competent boards of directors, transparent disclosure policies, and effective internal control systems. The study mentions the theoretical intuition for predicting a relationship between earnings quality and CG based on behavioral theory and institutional settings in Iran, but it fails to provide a comprehensive theoretical framework or contextual analysis. This omission weakens the theoretical foundation of the study and limits its applicability to other contexts.

Adebayo *et al.*, (2022) explored various attributes of non-executive directors and how this influence earnings quality. The study sourced secondary data from annual reports of listed firms on the Nigerian Exchange Group, which were analysed using the feasible generalized least square method. Directors' attributes were proxied with expertise, tenure, nationality, shareholdings, and multiple directorships while the modified jones model was employed for earnings quality. The findings revealed that among the attributes of non-executive directors studied shareholdings and nationality significantly affect earnings quality. The study contributes to the literature on the effectiveness and role of non-executive directors. The study recommended that Companies should regularly evaluate the effectiveness of their governance practices and make necessary adjustments to adapt to changing market conditions and regulatory requirements. The study result depicts that foreign non-directors are more effective in monitoring the affairs of firms, as well as directors with shareholdings in the firm. This implies that in the appointment of non-executive directors, diversity should be encouraged with provision for stock options. The study employs the modified Jones model for assessing earnings quality but provides limited detail on the statistical analysis conducted. Without transparency regarding model specifications, estimation techniques, and diagnostic tests, it is challenging to assess the robustness and validity of the results. This present study will bridge the gaps in literature for more comprehension.

Adewumi *et al.*, (2020) examined the effect of board size on earnings quality in government-linked and non-linked firms quoted on the Nigerian Exchange Group. Discretionary Accruals (DACC), Earnings Predictability (EPRED) and Earnings Persistence (EPSIS) are used as measures for earnings quality. The study employed a sample size of 30 companies consisting of 15 firms linked to government, i.e., where state ownership exists and is listed on the NSE and then firms without government linkage. Longitudinal research design was employed for the study with data covering the period 2009-2018. Secondary data was employed for the analysis and panel regression technique was employed for model estimation. The findings of the study reveal that the effect of board size on earnings quality shows differences amongst linked and non-linked firms. For government non-linked firms, board size effect is only significant in DACC, but neutral in relation to EPRED and EPSIS, while for government-linked firms, lower board size is found to enhance EPRED, but neutral in the case of DACC and EPSIS. Based on the findings, the study recommends that for both government-linked and non-linked firms, there is a need to ensure optimal board size. Though there is currently no consensus on what an adequate board size should be, the study recommends that companies must ensure that the board represents all the stakeholders' interest as this can help to improve effectiveness. The study's recommendation for ensuring optimal board size in both government-linked and non-linked firms lacks specificity and practical guidance. Without clear criteria for determining an adequate board size or addressing potential confounding factors, such as industry dynamics or regulatory requirements, these recommendations offer little actionable insight for firms seeking to improve their governance practices.

Idode (2019) examined the influence of corporate governance practices on earning quality. The study uses quantitative research design to evaluate the influence of corporate governance on earning quality of non-financial public listed companies in Nigeria. It specifically tests the effects of outside director, ownership concentration, interlocking directorship, and board size on earning quality of non-financial companies quoted at the Nigeria Securities Exchange (NSE) and its various sectors. The study's size of 105 companies was obtained after missing data were deducted from a population of 130 non-financial companies quoted at the NSE over the period January 2002 through December 2016. It relies on earnings quality data from the financial statement and on secondary corporate governance data from annual financial statements the NSE. The study rejects the three null hypotheses that corporate governance variables have no effect on earnings quality of non-financial quoted public companies in Nigeria and finds out that there is no significant effect of ownership concentration on earnings quality of public companies in Nigeria. It further indicates that there exists a significant statistical effect of outside directors on the earnings quality of listed companies in Nigeria. The study recommended that strict regulations should also be put in place by the Nigeria Exchange Group on the appointment of interlocking directorship and outside directors in Nigeria. Notwithstanding, this study is not exhaustive as it is constrained by fifteen years and above listing period examined; financial quoted companies were not included in the study and only four independent variables measure adopted. Hence, this present study will explore these areas.

Bako (2018) examined the impact of corporate governance on the quality of financial reporting in the Nigerian Chemical and paint Industry. The total number of quoted companies on the Nigeria Stock Exchange as at December 2013 is taken as population, while sample of four (4) companies were selected for a period of five (5) years (i.e. 2009-2013). The data used were obtained through secondary source, that is from the annual reports and accounts of the selected companies and the data where analyzed using correlation and regression. The study found that Board size as well as Board Independence have insignificant effect on the quality of financial reporting in the Nigerian Chemical and paint Industry. It was also concluded that the presence of non-executive directors in the audit committee of firms in the Nigerian Chemical and paint Industry have an insignificant effect on financial reporting quality. It was however recommended that the regulatory agencies should set up a committee to verify the appointment of non-executive directors so that grey directors should not form part of the board of firms in the industry, SEC in collaboration with other regulatory agencies should ensure that firms in the Nigerian Chemical and paint Industry have competent and experienced directors on their board. Finally, the non-executive directors should possess the technical skills and experience necessary to ensure that the high-quality reporting system exist in the Nigerian Chemical and paint Industry. The study relied on a small sample of four companies selected from the Nigerian Stock Exchange population as of December 2013. Additionally, the lack of detailed explanations regarding the measurement of financial reporting quality introduces ambiguity into the analysis.

Theoretical Framework

Agency Theory

The agency theory was propounded by Mitnick (1973) and propagated by Jensen and Meckling (1976). The theory states that the agency relationship is a contractual agreement under which one or more persons (principal) engage another person (the agent) to perform certain service(s) on their behalf including delegation of some decision-making authority to the agent (Jensen & Meckling, 1976). Furthermore, agency theory suggests that there is potential for "managerial mischief" when the interests of firms' owners and managers (agents) diverged (Dalton, *et al.*, 2007). Jensen and Meckling (1976) identify three agency costs that the principal is likely to incur, and the agency costs are: the total of monitoring cost by the principal to limit the deviant activities of the agent; bonding cost by the agent which will give assurance that certain actions of the agent will not be harmful to the principal or to ensure the principal is compensated if such actions occur; and the residual loss which is the dollar equivalent to the drop in welfare as a result of the discrepancy between the agent's decisions and those decisions that would maximize the welfare of the principal.

Agency theory postulates that because people have self-interest, they will have thus had conflicts of interests over some issues any time they attempt to engage in any cooperative endeavours. The major concern of agency relationship is to align the interest of shareholders and managers with a view to resolving the inherent conflict between the agent and the principal (Meckling, 1976; Fama & Jensen,1983). Mitnick (1973) states that agency problems occur in three ways and these are the principal's problem, the agent's problem, and policing instruments and incentives. The principal's problem helps to motivate the agent to act in a manner that will achieve the principal's goals. The principal, through audit supervision, ensures that the agent acts in a manner beneficial to the principal's interest and report the true state of the company's affairs. Supervision of audit committee over internal and external audit function has enhanced the quality of audited financial report of quoted companies (Aldamen, 2015).

The agent problem has to do with decisions to act either in the principal's interest, his own interest, or compromise between the two when they do not coincide (Delves & Patrick, 2010). Policing instruments are instruments and incentives intended to limit the agent's discretion, such as the board of director's surveillance on management activities and mandatory compliance to the code of corporate governance covering all key areas of a company's operation. Incentive systems are mechanisms that offer rewards to the agent for acting in accordance with the principal's wishes, such as executive compensation, bonuses and increased pay (positive incentives) or fear of punishment (negative incentives). Schabus (2017) specifically investigated whether equity compensation incentivizes CEOs to engage in opportunistic real earnings management, in the post-SOX period. The major drawback of policing and incentives is that they create costs for the principal. This is always aggravated towards the exit or retirement of the management and board of directors.

Legitimacy Theory

Legitimacy Theory, developed by Dowling and Pfeffer in 1975, is a prominent framework in understanding corporate behavior, particularly in how companies seek to align their operations with societal norms, values, and expectations. The theory posits that organizations must operate within the bounds of societal norms to maintain their legitimacy, which is essential for their continued existence and success. Legitimacy is achieved when an organization's actions are perceived as congruent with the shared values and beliefs of the society in which it operates. When there is a discrepancy between an organization's actions and societal expectations, the legitimacy of the organization can be threatened, leading to a potential loss of support from key stakeholders, including investors, customers, and regulators.

Scholars have extensively applied Legitimacy Theory to explain various corporate behaviors, particularly in the context of financial reporting and corporate governance. According to the theory, companies might engage in certain practices, such as enhancing the quality of their earnings reports, to maintain or restore their legitimacy in the eyes of stakeholders. Outside directorship and ownership concentration are mechanisms that can enhance the legitimacy of a firm by ensuring more transparent and reliable financial reporting. Outside directors, with their independent oversight, can reduce the chances of earnings manipulation, thereby enhancing the legitimacy of financial statements. Similarly, concentrated ownership can either bolster or harm legitimacy depending on how well the interests of large shareholders align with societal expectations regarding fair and transparent reporting.

Despite its widespread application, Legitimacy Theory has faced criticism from various scholars. One major criticism is that the theory tends to assume that organizations are predominantly reactive, only seeking legitimacy in response to external pressures rather than proactively engaging in legitimate practices. Additionally, critics argue that the theory can be overly deterministic, suggesting that companies will always act to maintain legitimacy, when in reality, firms may sometimes prioritize short-term gains over long-term legitimacy. Furthermore, the theory is criticized for its ambiguity in defining what constitutes societal norms and values, which can vary significantly across different contexts and over time, making it challenging to apply the theory consistently.

Legitimacy Theory serves as a suitable underpinning theory for this study because it provides a robust framework for understanding how outside directorship and ownership concentration influence earnings quality in the context of Nigerian non-financial companies. In an emerging market like Nigeria, where regulatory frameworks and corporate governance standards are still evolving, companies may be particularly motivated to maintain legitimacy to attract investment and build stakeholder trust. By examining how these corporate governance mechanisms impact earnings quality, this study aligns with the core principles of Legitimacy Theory, which emphasize the importance of aligning corporate actions with societal expectations. This theory is especially relevant in the Nigerian context, where maintaining legitimacy can be a critical factor in a firm's long-term success and sustainability.

METHODOLOGY

A correlational panel research design was employed in this study to gather information about the pre-existing nature of the phenomenon under study and to provide the necessary support to provide and describe the nature of the relationships between variables of the study. The total population for this study consists of all the one hundred and six (106) non-financial companies (firms) listed in the Nigerian Exchange Group as at 31st December, 2023. In order to arrive at the sample size, the purposeful sampling technique were employed. The criterion used is that; a firm must be listed before the year 2009, remain in operation during the period of the study (2009 to 2023) and selections were also made on the basis of the non-financial firms found in the Nigeria Exchange Group stratification of the listed companies.

This is to reduce any problem associated with validity and reliability. A total of seventy (70) non-financial firms was selected for sample selection. The study covers a period of 15 years ranging from 2009-2023. Secondary data was collected for the dependent and independent variables were analyzed using descriptive statistics, correlation analysis, panel regression and post regression diagnostic test on variables using e-view 12 statistical package. The model employed by Paul *et al.*, (2023) was modified for the study, as indicated below.

Model

$$DAC = \alpha_0 + \beta_1 ODS + \beta_2 OWC + \beta_3 FSZ + \epsilon \text{ ------------------------- (i)}$$

Where;

DAC = Discretionary Accruals

ODS = Outside Directorship

OWC = Ownership Concentration
FSZ = Firm Size (control variable)
α_0 = Constant or intercept
β_1- β_3 = Regression coefficients.
ε = Stochastic error component.

Table 1: Measurement of Variables

Variable Acronym	Variable Name	Variable Type	Measurement	Source
DAC	Discretionary Accruals	Dependent	$DAC = \left(\Delta ACC_{it} - \left[\alpha_1\left(\frac{1}{TA_{it-1}}\right) + \alpha_2\left(\frac{\Delta SALES_{it} - \Delta REC_{it}}{TA_{it-1}}\right) + \alpha_3\left(\frac{PPE_{it}}{TA_{it-1}}\right)\right]\right)$	Jones (1995).
ODS	Outside Directorship	Independent	It divides the number of outside directors (those who are not affiliated with the company or its management) by the total number of directors and expresses the result as a percentage.	Bako (2018).
OWC	Ownership Concentration	Independent	By dividing the total shares owned by the top shareholders (typically institutional investors, large shareholders, or insiders) by the total outstanding shares and expressing the result as a percentage.	Nguyen, *et al.*, (2015).
FSZ	Firm size	Control	Measure as natural log of total Asset	Omollo, *et al.*, (2018)

Source: Researcher's Compilation (2024)

RESULT AND DISCUSSION

Descriptive Statistics

Descriptive statistics gives a presentation of the mean, maximum and minimum values of variables applied together with their standard deviations obtainable.

Table 2: Descriptive Statistics Result

	DAC	ODS	OWC	FSZ
Mean	0.244345	10.49101	6.804267	7.105772
Median	0.203047	7.486573	6.802945	7.002000
Maximum	1.000000	37.50000	9.637000	9.637000
Minimum	-3.913000	0.000000	2.837000	2.837000
Std. Dev.	0.358736	7.305369	1.013563	0.862590
Skewness	-2.953328	1.849128	-0.035478	0.090491
Kurtosis	36.75881	5.740696	2.930652	3.527218
Jarque-Bera	51386.39	926.9971	0.430672	13.58076
Probability	0.000000	0.000000	0.806270	0.001125
Sum	256.5623	11015.56	7144.480	7453.955
Sum Sq. Dev.	134.9971	55983.47	1077.649	779.7761
Observations	1050	1050	1050	1050

Source: E-View 12 Output (2024)

The descriptive statistics of the variables in the model provide insights into the distribution and characteristics of Discretionary Accruals (DAC), Outside Directorship (ODS), Ownership Concentration (OWC), and Firm Size (FSZ). The mean value of DAC is 0.244, indicating that, on average, firms exhibit positive discretionary accruals, suggesting potential earnings management. However, the negative skewness (-2.95) and high kurtosis (36.76) indicate a distribution with a long-left tail and extreme values, which could be due to a few firms with significantly negative accruals. The Jarque-Bera statistic for DAC is extremely high, with a probability of 0.000, confirming that the distribution is not normal.

For ODS, the mean value is 10.49, suggesting that firms typically have a moderate number of outside directors. The distribution is positively skewed (1.85) with a high maximum value of 37.5, indicating a few firms with a large number of outside directors, which could influence governance outcomes. OWC has a mean of 6.80 and is close to being symmetrically distributed, as indicated by its skewness (-0.035) and a kurtosis value close to 3, implying a normal distribution. FSZ shows a mean of 7.10, reflecting the average firm size in the sample, with minimal skewness (0.09) and moderate kurtosis (3.53), suggesting a fairly normal distribution. The Jarque-Bera test for FSZ also indicates non-normality, though less severe than DAC and ODS. Overall, the data suggest that while OWC and FSZ are relatively normally distributed, DAC and ODS exhibit significant deviations from normality, which could impact the regression analysis and should be considered when interpreting the model's results.

Correlation Analysis

Table 3 below shows the results of the association between the independent and dependent variables of listed non-financial firms in Nigeria. It contains the correlation coefficients of the variables under study. The correlation matrix is presented in Table 3 below.

Table 3: Correlation Matrix

Covariance Analysis: Ordinary
Date: 10/10/24 Time: 02:06
Sample: 2009 2023
Included observations: 1050
Balanced sample (listwise missing value deletion)

Correlation Probability	DAC	ODS	OWC	FSZ
DAC	1.000000 -----			
ODS	-0.111252 0.0003	1.000000 -----		
OWC	-0.031431 0.3091	-0.345824 0.0000	1.000000 -----	
FSZ	0.050268 0.1037	-0.201847 0.0000	0.024721 0.4238	1.000000 -----

Source: E-View 12 Output (2024)

The correlation matrix provides insights into the relationships between Discretionary Accruals (DAC), Outside Directorship (ODS), Ownership Concentration (OWC), and Firm Size (FSZ). The negative correlation between DAC and ODS (-0.111) is statistically significant ($p = 0.0003$), suggesting that as the number of outside directors increases, discretionary accruals tend to decrease. This finding aligns with existing literature that posits outside directors play a critical role in enhancing corporate governance and reducing earnings management, as they are typically more independent and can provide better oversight of management's financial reporting practices. This relationship is supported by agency theory, which argues that outside directors mitigate agency conflicts between management and shareholders, thereby reducing the likelihood of earnings manipulation.

On the other hand, the correlation between DAC and OWC is weakly negative (-0.031) and not statistically significant (p = 0.3091), indicating no strong linear relationship between ownership concentration and discretionary accruals. This could suggest that ownership concentration does not have a direct influence on earnings management in this sample, or that its effect may be more complex and moderated by other factors not captured in a simple correlation. This finding is somewhat contrary to the entrenchment hypothesis, which posits that high ownership concentration might lead to entrenchment of management, potentially resulting in higher discretionary accruals. However, the negative but weak relationship could also suggest that concentrated ownership may exert some monitoring influence, though not strongly enough to affect discretionary accruals significantly. The weak positive correlation between DAC and FSZ (0.050) is also not statistically significant (p = 0.1037), implying that firm size does not have a strong direct relationship with discretionary accruals in this sample.

Multicollinearity Test (VIF)

The Multicollinearity test was carried out to check if there is strong correlation among the independent variables that may produce misleading result.

Table 4: Multicollinearity Test (VIF)

Variance Inflation Factors
Date: 08/29/24 Time: 10:07
Sample: 2009 2023
Included observations: 1050

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.049042	3.647920	NA
ODS	0.584732	6.447834	1.064922
OWC	2.147302	9.167499	1.014566
FSZ	5.285307	9.242432	1.298461

Source: ***E-View 12 Output (2024)***

***Decision rule:** Centred VIF of less than 10 is an indication of absence of multi-collinearity, while the centred VIF of more than 10 is an indication of presence of multi-collinearity. As stated above, the decision rule for the multicollinearity test using the variance inflation factor is that Centred VIF of less than 10 shows the absence of multi-collinearity, while the centred VIF of more than 10 is an indication of presence of multi-collinearity. Table above clearly shows that there is absence of multicollinearity among the independent variables, given that all the independent variable (ODS, OWC and BSZ) have a center VIF that is less than 10.

Heteroskedasticity Test

A heteroskedasticity test was performed as a diagnostic check to verify the robustness of the estimates. While heteroskedasticity is assumed to be absent in the test's null hypothesis, it is assumed to be present in the alternative hypothesis. In the event that the P value is less than 5% level of significance, the null hypothesis must be rejected.

Hypothesis for Heteroskedasticity Test

Null Hypothesis(H_0)There is no heteroskedasticity in the model.This means that the variance of the error terms is constant across observations.

Alternate Hypothesis(H_1) There is heteroskedasticity in the model.This means that the variance of the error terms is not constant across observation

Table 5: Heteroskedasticity Test

Panel Cross-section Heteroskedasticity LR Test
Null hypothesis: Residuals are homoscedastic
Equation: UNTITLED
Specification: DAC C ODS OWC FSZ

	Value	df	Probability
Likelihood ratio	766.0933	70	0.9420

LR test summary:

	Value	Df
Restricted LogL	-403.1626	1045
Unrestricted LogL	-20.11593	1045

Source: *E-View 12 Output (2024)*

Table 5 shows the results of the panel cross-section Heteroskedasticity regression test. The decision rule for the panel cross-section Heteroskedasticity test is stated thus:
The null hypothesis of the test states that there is no Heteroskedasticity, while the alternate hypothesis states that there is Heteroskedasticity. The null hypothesis is not to be accepted if the P value is greater than 5% level of significance. From the result in table 5 above with a ratio value of 766.0933 and a corresponding probability value of 0.9420 which is greater than 5%, the study therefore posits that, there is no reason to reject the null hypothesis. Consequently, based on the diagnostic probability 0.9420 the null hypothesis is not rejected, thus there is homoskedasticity, indicating that residuals are homoskedastic and as such the samples give a true reflection of the population.

Hausman Test

The Hausmann specification test is a model specification test used in panel data analysis to select between fixed and random effects models. However, the datasets utilised in this investigation were panel, both fixed and random effects regressions was performed. A Hausmann specification test was then used to choose between the fixed-effects and random-effects regression models. This test determined if the error term was connected to the regressor. As a result, the decision rule for the Hausmann specification test is presented at a 5% level of significance:

H_0: Random effect is more appropriate for the Panel Regression analysis
H_1: Fixed effect is more appropriate for the Panel Regression analysis.

Table 6: Hausman Specification Test
Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	6.157535	3	0.1042

Source: E- View 12 Output (2024)

The result of the Hausman specification test shows that the chi-square statistics value is 6.157535 while the probability value is 0.1042. This implies that there is no reason to reject the null hypothesis which states that random effect is most appropriate for the Panel Regression analysis. It thus stands that the error component model (random effect) estimator is the most appropriate because the random effects are well correlated with the regressors. Consequently, the result suggests that the random effect regression model is most appropriate for the sampled data because the Hausman test statistics as represented by the corresponding probability value is greater than 5%.
Langranger Multiplier Test (Test between Random and Pooled)

The Langrange Multiplier (LM) test, also known as the Breusch-Pagan test in the context of random effects models, is a statistical test used to determine whether a random effects model is more appropriate than a pooled ordinary least squares (OLS) regression model for panel data analysis. The test examines the presence of random effects by assessing if the variance of the random error components is significantly different from zero, which would indicate that the random effects model should be preferred over the pooled OLS model due to unobserved heterogeneity across entities.

Table 7: Breusch-Pagan Langranger Multiplier Test
Residual Cross-Section Dependence Test
Null hypothesis: No cross-section dependence (correlation) in residuals
Equation: Untitled
Periods included: 15
Cross-sections included: 70
Total panel (unbalanced) observations: 1050
Note: non-zero cross-section means detected in data
Test employs centered correlations computed from pairwise samples

Test	Statistic	d.f.	Prob.
Breusch-Pagan LM	4359.630	2415	0.0000

Source: ***E-View 12 Output (2024)***

Based on the probability value of the Breusch-Pagan Langranger Multiplier Test at 0.0000, the null hypothesis is rejected, thus random effect is most appropriate when compared to pooled effect.

Test of Research Hypotheses
In panel regression analysis, the ultimate goal is the estimation of the relationship between dependent and independent variables.

Decision Rule: The decision rule for accepting or rejecting the null hypothesis for any of these tests was based on the Probability Value (PV) and the Probability (F-statistic). If the PV is less than 5% or 0.05 (that is, if PV < 0.05), it implies that the regressor in question is statistically significant at 5% level; and if the PV is more than 5% or 0.05 (that is, if PV > 0.05), it is categorized as not significant at that level. This implies that the level of significance for the study is at 5% (for the two-tailed test). Thus, the decision rule for accepting or rejecting the null hypothesis is based on both the Probability Value (PV) and the Probability (F-statistic)".

Table 8: Panel Regression Result (Random Effect)

Dependent Variable: DAC
Method: Panel EGLS (Cross-section random effects)
Date: 08/29/24 Time: 11:18
Sample: 2009 2023
Periods included: 15
Cross-sections included: 70
Total panel (unbalanced) observations: 1050
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.486000	0.150158	3.236596	0.0012
ODS	-0.002752	0.002045	-1.345552	0.1787
OWC	-0.031090	0.013927	-2.232396	0.0258
FSZ	-0.000168	0.015027	-0.011155	0.9911
	Effects Specification			
			S.D.	Rho
Cross-section random			0.175376	0.2414
Idiosyncratic random			0.310923	0.7586
	Weighted Statistics			
R-squared	0.606143	Mean dependent var		0.101723
Adjusted R-squared	0.573290	S.D. dependent var		0.311924
S.E. of regression	0.311397	Sum squared resid		101.3314
F-statistic	9.153190	Durbin-Watson stat		1.714447
Prob(F-statistic)	0.001947			

Source: ***E-View 12 Output (2024)***

The panel regression analysis investigates the impact of Outside Directorship (ODS), Ownership Concentration (OWC), and Firm Size (FSZ) on Discretionary Accruals (DAC) using a random effects model. The constant term (C) has a coefficient of 0.486000, which is statistically significant with a t-statistic of 3.236596 and a p-value of 0.0012. This indicates that, holding ODS, OWC, and FSZ constant at zero, the average discretionary accruals are positive, suggesting an inherent baseline level of earnings management in the firms studied.

Among the independent variables, Ownership Concentration (OWC) is statistically significant with a coefficient of -0.031090, a t-statistic of -2.232396, and a p-value of 0.0258. This result implies that higher ownership concentration is associated with a reduction in discretionary accruals, supporting the idea that concentrated ownership may enhance monitoring and reduce the likelihood of earnings manipulation. On the other hand, Outside Directorship (ODS) has a negative coefficient of -0.002752, but it is not statistically significant (p = 0.1787), indicating that the presence of outside directors does not have a significant impact on discretionary accruals in this model. Similarly, Firm Size (FSZ) shows a very small negative coefficient of -0.000168, and it is also not statistically significant (p = 0.9911), suggesting that firm size does not significantly influence discretionary accruals in the sample studied.

The goodness of fit for the model is indicated by an R-squared value of 0.606143, meaning that approximately 60.6% of the variation in discretionary accruals is explained by the independent variables included in the model. The adjusted R-squared value of 0.573290, which adjusts for the number of predictors in the model, confirms that the model has a relatively strong explanatory power. The F-statistic of 9.153190, with a p-value of 0.001947, indicates that the model is statistically significant overall, suggesting that the independent variables, when taken together, have a significant effect on discretionary accruals. The Durbin-Watson statistic of 1.714447 is close to the ideal value of 2, indicating that there is no significant autocorrelation in the residuals, which implies that the model's assumptions are satisfactorily met.

Discussion of Findings

The analysis of the key variables, Outside Directorship (ODS) and Ownership Concentration (OWC), provides valuable insights into their relationships with discretionary accruals in listed non-financial companies in Nigeria. The negative coefficient of ODS suggests that an increased proportion of outside directors may be associated with lower discretionary accruals, indicating a potential reduction in earnings management. However, the lack of statistical significance (p = 0.1787) implies that the presence of outside directors alone may not have a substantial impact on discretionary accruals. This finding diverges from the traditional agency theory, which posits that outside directors play a crucial role in monitoring management and improving earnings quality by reducing opportunities for earnings manipulation (Fama & Jensen, 1983). The result could reflect challenges such as the outside directors' insufficient firm-specific knowledge, limited involvement in strategic decision-making, or constraints in their ability to exert influence effectively within the boardroom.

Conversely, the significant negative relationship between ownership concentration (OWC) and discretionary accruals (coefficient = -0.031090, p = 0.0258) suggests that higher ownership concentration is associated with reduced earnings management. This result aligns with a priori expectations that concentrated ownership enhances monitoring, as large shareholders have both the power and incentive to closely oversee management, thereby limiting opportunities for earnings manipulation. This finding also supports Legitimacy Theory, which argues that firms with greater public accountability, such as those with concentrated ownership, are motivated to maintain legitimacy by adhering to proper governance practices and ensuring financial transparency. In the Nigerian context, where strong monitoring by large shareholders is crucial, concentrated ownership may contribute positively to earnings quality by curbing discretionary accruals, reinforcing the idea that companies seek to align their actions with societal norms and expectations to preserve legitimacy.

These findings have important implications for corporate governance practices. The results suggest that while ownership concentration can enhance earnings quality through better monitoring, the effectiveness of outside directorships in this regard may be limited unless other factors, such as the directors' expertise and influence, are also considered. This aligns with legitimacy theory, which emphasizes that firms need to maintain legitimacy in the eyes of their stakeholders by ensuring transparent and accountable financial reporting practices (Deegan, 2002). Therefore, corporate governance frameworks should not only focus on the composition of the board but also on the functionality and efficacy of these governance mechanisms in practice to truly improve earnings quality and financial reporting integrity.

CONCLUSION AND RECOMMENDATION

The study highlights that outside directorship (ODS), though often seen as a tool to improve earnings quality, may lack effectiveness without sufficient influence or deep understanding of the firm's operations, as evidenced by the non-significant relationship identified. On the other hand, ownership concentration (OWC) has a significant negative impact on earnings quality, indicating that large shareholders may engage in practices that reduce financial transparency. These results emphasize the need for a more comprehensive approach to corporate governance, focusing on both the structure and effectiveness of governance mechanisms to ensure they genuinely enhance earnings quality, meet stakeholder expectations, and maintain corporate legitimacy.

Based on the study's findings, the following recommendations are proposed to enhance the efficient of financial performance of listed non-financial firms on the Nigeria Exchange Group;

i. Non-financial firms should ensure that outside directors possess the requisite expertise and authority to influence decision-making effectively. This can be achieved by providing ongoing training and encouraging greater involvement in the company's strategic processes. By enhancing the role and effectiveness of outside directors, firms can improve oversight and foster higher earnings quality, thus boosting financial performance.

ii. Non-financial companies should consider implementing mechanisms to reduce the potential negative impact of high ownership concentration, such as promoting more diversified ownership structures or introducing checks and balances that limit the power of dominant shareholders. This can help mitigate the risk of earnings manipulation and ensure that financial reporting remains transparent and credible, ultimately improving the firm's financial performance.

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