

# Institutional Ownership and cost of Capital of quoted Selected firms in Nigeria

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## ABSTRACT

This study examines the impact of Institutional Ownership on Cost of Capital of selected quoted firms in Nigeria. The study has been conducted in different parts of the globe and in Nigeria with different findings which are mixed and inconclusive. The population of the study consists of ten (10) firms quoted on the Nigerian stock exchange as at 31st December 2020 out of which ten (10) firms were selected as samples for a period of ten (10) years from 2011 to 2020 based on purposeful sampling technique. The study uses regression as a tool for analysis. The study shows that Institutional ownership has a positive significant impact on Cost of capital of quoted selected firms in Nigeria.

**Keywords:** Institutional ownership, Cost of Capital, Firm size and Leverage.

## I. INTRODUCTION

The domination of Institutional shareholding in the capital market has been continuous. Empirical evidence on the effect of institutional shareholding on accounting issues are very limited (Yakubu, Dangana, Adejoh, 2019). Institutional ownership is the amount of a company's available stock owned by mutual or pension funds, insurance companies' investment firms, private foundations, endowments or other large entities that manage funds on behalf of others. Inventories that have large amount of Institutional ownership are often looked upon favorably. Team of analysts are normally engaged by large entities frequently to perform detailed and expensive financial research before they purchase a large block of company's inventory. This makes the decisions influential in the eyes of the other potential investors. Cost of capital is a firm's calculation of the minimum return that would be

necessary in order to justify undertaking a capital budgeting project. It is used to evaluate an investment's potential return in relation to its cost and its risks. Many firms use the combination of debt and equity to finance business expansion. For such firms, the overall cost of capital is derived from weighted average cost of all capital sources. Cost of capital is seen critical to the performance of a firm. If the cost of borrowing funds is high, firm performance is affected. This concept is also related to other country characteristics. A country with a strong and effective legal system will have rules and regulations in place to protect the rights of investors. For example, a legal system that requires companies to provide their shareholders with timely information and that has rules for enforcing contracts would be considered good for investors. Companies in countries with this type of legal system would not have to engage in as much monitoring as companies in countries where this information is missing. Therefore, the cost of capital in countries with good legal systems would be relatively low. When investors decide to invest in a company, they consider their required return and systematic risk of the company (AlHares, Dominic & Abu-Asi (2020). AlHares, Dominic & Abu-Asi (2020) discovered that companies with weak corporate governance performed poorly during economic downturns, and this was usually associated with a greater cost of capital. The reason is because investors, realizing the additional risk involved in investing in companies with poor performance, required a premium on their investment. It was also the case that with poor governance, shareholders would also have to engage in more monitoring in order to protect their interests. The rationale for this poor performance and greater cost of capital can be attributed to the fact that with poor governance, there was usually

too little monitoring of management. Consequently, management was more likely to borrow more funds to support new projects. The Cost of capital is negatively correlated with shareholding period of institutional investors. Therefore, the higher the shareholding ratio, the longer the shareholding period of institutional investors, the more favorable the condition for the reduction of the level of cost of capital of the listed firms. Empirical studies have been conducted on the Institutional ownership and Cost of capital include studies of Alshwer (2007), Lev & Nissim (2003), Merino (2020) and AlHares, Dominic & Abu-Asi (2020) are largely foreign base, therefore they are not conclusive and could not provide adequate evidence on the impact of institutional ownership on cost of capital in Nigeria and have provided mixed and inconclusive findings due to the data collected, methodology used and the industry used and to the best of our knowledge, among studies conducted in Nigeria, we have not seen a study that took into consideration the selected quoted firms from food and beverage and agricultural industries. To this end, this study attempts to fill the gap by examining the impact of institutional ownership on cost of capital of selected quoted firms in Nigeria. The main objective of the study is to examine the impact of Institutional ownership on cost of capital of quoted selected firms in Nigeria. The Specific objective of the study is to determine the extent to which institutional ownership impact on Cost of capital of quoted selected firms in Nigeria. In line with the specific objective, a hypothesis was formulated which is: H01 Institutional ownership has no significant impact on Cost of capital of quoted selected firms in Nigeria.

## II LITERATURE REVIEW

Various studies have attempted to examine the impact of Institutional ownership on Cost of capital. Karasneh, Bataineh & Bshayreh (2019) identified the role of capital structure and institutional ownership to improve the financial performance at Jordanian real estate companies. Their population consisted of all (34) Jordanian real estate companies listed on the Jordan Stock Exchange from 2015-2017. The results of their study revealed that there is a positive relationship between capital structure and institutional ownership and financial performance at Jordanian real estate companies through (ROA, ROE, EPS), and also a positive relationship between the company size measured by total assets and the financial performance of Jordanian real estate companies. Hayat, Yu, Wang, & Jebran, (2018),

examined how managerial ownership and institutional ownership affect firm debt financing in the two biggest economies. They used Ordinary Least Squares (OLS) on a panel data sample of developed (USA) and developing (China) economies from 2009-2016. The result of their study showed a non-linear relationship between Managerial ownership and debt for China but not for the USA and a positive relation between Institutional ownership and debt for USA and negative for China. Alshwer (2007) examined the relationship between the institutional ownership and the cost of capital. Using firm-level data for the period from 1990 to 2006. They used different methods to check the robustness of the study. Their result showed that changes in dedicated (transient) ownership generally lower (increase) the investee's cost of capital and also found out that that highly levered investees benefit the most from an increase in dedicated ownership. Overall, the results suggest that ownership changes made by dedicated institutional investors can lower the investee's cost of financing. Lev & Nissim (2003) examined the impact of Institutional ownership cost of capital on Corporate investment. They hypothesize in their study that institutional investors alleviate some of the capital market frictions by their relatively efficient information processing and managerial monitoring activities, thereby mitigating the underinvestment problem. Their results indicated that the size of institutional ownership in public companies is positively related to the rate of investment in fixed assets, corporate acquisitions, and R&D, institutions that trade frequently attempting to exploit short-term mispricing are more effective in reducing information asymmetries and enhancing corporate investment than other institutions; and institutional investors eliminate the documented mispricing of securities associated with business investments. AlHares, Dominic & Abu-Asi (2020) studied the impact of Institutional Ownership on Cost of Capital. They used panel data of 200 companies from FORBES Global 2000 Leading Companies between 2010 and 2019. They employed ordinary least square multiple regression analysis technique to examine the relationships. Their result revealed that institutional ownership is statistically positively related to cost of capital. Lin, Meng & Woods (2020) examined effects of the heterogeneity of institutional investors on the cost of capital, and the influence of ownership structure on the relationship between them. They employed an unbalanced panel data on Ashare listed companies of Shanghai and Shenzhen in China's capital market from 2014-2019. The study reveals that institutional investors

with longer holding period and higher shareholding ratio are negatively associated with the cost of capital in China's capital market. The study showed that China's state-owned enterprises are more likely to introduce improvements at the corporate governance level and ownership concentration weakens the negative influence of institutional investors on the cost of capital. Cinko&Kasaboğlu (2017) investigated how institutional investors affect capital structures of Borsa Istanbul (BIST) firms. They gathered data from 2005 to 2013 for 150 firms. Data was obtained from Bloomberg database and Central Registry Agency. Sample consists of 150 non-financial firms which have full data set for the research period. Panel data analysis was employed to analyze 1,350 firm-year observations. The model was designed such that financial leverage is dependent variable, and institutional ownership is explanatory variable. Control variables are tangibility, size, tax, profit, liquidity and market value / book value. The result of the model showed that there is a significantly negative relationship between institutional ownership and financial leverage.

### III METHODOLOGY

This research adopted correlation research design and was considered adequate and appropriate for this study because it describes the statistical relationship between an independent variable of the study (Institutional Ownership) and the dependent variable (Cost of Capital). The population consists of selected firms namely Ellah Lakes Plc, FTN Cocoa Processing Plc, Livestock Feeds plc, Okomu Oil Palm Plc, Presco Plc, Nestle Nigeria Plc, Unilever Nigeria Plc, Cadbury Nigeria Plc, Seven Up Nigeria Plc and Nigeria Breweries Plc quoted on the Nigerian Stock Exchange as at 31st December 2020 and covered a period of Ten (10) years (2011-2020). Purposeful sampling technique was employed to select the sample. The sample selected is: Ellah Lakes Plc, FTN Cocoa Processing Plc, Livestock Feeds plc, Okomu Oil Palm Plc, Presco Plc, Nestle Nigeria Plc, Unilever Nigeria Plc, Cadbury Nigeria Plc, Seven Up Nigeria Plc, and Nigeria Breweries Plc. In line with this, the sample size is all the ten (10) selected quoted firms on the Nigerian stock exchange. The study employed panel data using statistical package for social sciences (SPSS 25) and Ordinary Least Square (OLS) method adopted in this study is a

parametric statistical test that is based on a number of assumptions, the violation of which could affect the reliability of the results. The Pearson correlation and t-test statistics were used for inferential analysis. Two of the most commonly encountered problems addressed in this study relate to normal distribution of the variables and descriptive statistics was used to test for normality of data.

### Model Specification

The model that was used to test the hypothesis formulated for this study is presented below. The null Hypothesis is tested considering the results for the P-values at 1%, 5% and 10% level of significance.

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

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

Where

$\alpha$  = the intercept

COC = Total Debt divided by Total Assets.

INSTOWN = percentage of shares owned by Institutional investors

LEV = the total liabilities divided by total assets.

FSIZE = Firm Size measured as Natural log of total assets

$\epsilon_i$  = error term

Firm size and leverage are controls variables.

### IV. DATA PRESENTATION

This part presents the results of the descriptive statistics and regression results on the impact of Institutional ownership on Cost of capital of selected quoted firms in Nigeria. An explanatory variable and two (2) control variables are employed for the purpose of explaining and predicting the impact of Institutional ownership on Cost of capital of selected quoted firms in Nigeria.

### Test of Normality

The normality tests are supplementary to the graphical assessment of normality. For this study, Z skewness and Z Kurtosis are used to test for normality of an independent variable namely institutional Ownership. The Z skewness was computed as skewness divided by standard error of skewness and the Z kurtosis was computed as kurtosis divided by standard error of kurtosis.

Table 4.2.1 shows the skewness, kurtosis and Z skewness and Z kurtosis.

**Table 4.2.1 Descriptive Statistics Table for the Variables**

Variables	Skewness	Standard Error	Z Skewness	Kurtosis	Standard Error	Z Kurtosis
INSTOWN	1.439	0.241	5.971	1.501	0.478	3.140

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

In Smallsamples like that of this study which the number of observations is 100, values of Z skewness and Z kurtosis greater or lesser than 1.96 are sufficient to establish normality of the data. The result of Skewness for Institutional ownership is 1.439. The Z skewness of Institutional ownership is 5.971 which is more than 1.96 shows

that the data is normal which indicates that the data for Institutional ownership relates linearly to the dependent variable (Cost of Capital). The result of the Kurtosis for Institutional ownership is 1.501 and the Z kurtosis of Institutional ownership is 3.140 is more than 1.96 and therefore, is normal which indicates that the data for Institutional ownership relates linearly to the dependent variable (Cost of Capital). Ghasemi and Zahediasl (2012).

**4.2.2 Institutional ownership impact on Cost of Capital**

Variable	Coefficient	T – value	P – value
Constant	23.493	2.720	0.008
INSTOWN	0.684	2.079	0.040
LEV	0.439	5.521	0.000
FSIZE	23.616	2.795	0.006
R	0.53		
R <sup>2</sup>	0.28		
Adj R <sup>2</sup>	0.26		
F stat	12.454		
F-Sig	0.000		
DW	0.617		

Source: Author’s computation using SPSS 25

The estimated equation of the study is presented as follows:

$$COC = 23.493 + 0.684 (INSTOWN) + 0.439 (LEV) + 23.616 FSIZE.$$

Cost of capital of firms measured by the ratio of total debts to Total assets would be equal to 23.493 when all other variables are held to zero. One-unit change of Institutional ownership all other variables remain constant, would increase Institutional ownership by 0.684. The regression result of the study shows that the beta coefficient in respect of Institutional ownership is (0.684) and the t-value is (2.079) and it is significant at 5%. This means that, Institutional ownership has a positive significant impact on Cost of capital of quoted selected firms in Nigeria. The implication of this is that, the higher the Institutional ownership, the better the cost of capital of quoted selected firms in Nigeria. This provides an evidence of rejecting the hypothesis stating that Institutional ownership has no significant impact on Cost of capital of quoted selected firms in Nigeria.

The impact of the Institutional ownership is able to explain the dependent variable up to (53%). This shows a positive relationship as indicated by the R value and the remaining (47%) are controlled by other factors. Similarly, the result

of the F- statistic shows the overall fitness of the model. The F- statistic has a value of (12.454) and is significant at 1% which implies that the model is fit because it is significant at all levels of significant. Durbin Watson of (0.617) shows that there is no problem of autocorrelation in the data set (Gujarati, 2004).

**Findings of The Study**

Institutional ownership has a positive significant impact on Cost of capital of quoted selected firms in Nigeria.

**V. CONCLUSIONS**

This study has contributed to findings on Accounting Research in Nigeria. It investigated whether institutional ownership impact on Cost of capital of quoted selected firms in Nigeria. The study concludes that Institutional ownership has a positive significant impact on Cost of capital of quoted selected agricultural and food beverages firms in Nigeria.

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