

An Empirical Examination of the Relationship between Ownership Structure and the Performance of Firms in Nigeria

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Received: August 16, 2011

Accepted: November 2, 2011

Published: January 1, 2012

doi:10.5539/ibr.v5n1p208

URL: <http://dx.doi.org/10.5539/ibr.v5n1p208>

Abstract

This study examines the relationship between ownership structure and the financial performance of listed firms in the financial sector of the Nigerian economy. To achieve the objective of this study, a total of 31 selected listed firms in the Nigerian stock exchange market were used. Also, the corporate annual reports for the period 2006-2010 were analyzed. This paper basically modeled the corporate ownership structure and firm performance relationship of the selected listed firms using the multivariate multiple regression analysis method to test the research propositions in this study. The study as part of its findings observed that institutional ownership has a significant positive impact on the performance of the selected listed firms in Nigeria. In addition, the study also revealed that there is a significant positive relationship between foreign ownership and the firm performance in Nigeria.

Keywords: Board ownership, Financial performance, Foreign Ownership, Institutional ownership, Financial sector

1. Introduction

Nigeria as a country has experienced turbulent times with regard to its corporate governance practices in the last two decades especially in the financial sector of the economy; this has invariably have resulted in a generally low corporate profits across the industry. Accidentally, this picture is fairly well replicated globally in the same period. From a global perspective, corporate governance as a concept is an issue of growing importance, both theoretically and practically. The past one decade according to Baek, Kang and Park (2004) has witnessed significant transformations in corporate governance structures, leading to increased scholarly interest in the role of board of directors in driving corporate performance. Arising from many high profile corporate failures, coupled with generally low corporate profits across the globe, the credibility of the existing corporate governance structures has been put to question. Subsequent research such as (Demsetz and Lehn, 1985, Shleifer & Vishny, 1997; Shleifer, 2001) has thus called for an intensified focus on the existing corporate governance structures, and how they ensure accountability and responsibility. The failure of Enron Corporation, together with other high profile corporate collapses such as Adelphia, Health South, Tyco, Global Crossing, Parmalat, Hollinger, Adecco, TV Azteca, Royal Dutch Shell, WorldCom, among others has resulted in calls for better corporate governance (Lavelle, 2002; Clarke, Dean & Oliver 1998). This phenomenon has invariably led to debates concerning the efficiency of corporate governance. Monks (1998) argued that the numerous cases of corporate failures are indictments on the effectiveness of the existing corporate governance structures.

Nevertheless, while there is an extensive research on relationship between ownership structure and the performance firms in developed economies, most notably the United States, Russia and France (e.g., Bianco & Casavola, 1999; Conyon & Peck, 1998a; Hossain, Prevost and Rao, 2001). On the other hand, there is a dearth of literature in this area of research from developing economies particularly in Nigeria, where there are huge institutional differences, including the mechanisms of corporate governance, between Nigeria and other developed economies. More so, it is

not known whether existing differences in institutional, regulatory and corporate governance practices also translate into differences in the relationship between ownership and firm performance. This study to this end seeks to find out whether there is a relationship between ownership structure and the performance of listed firms in Nigeria. The remaining part of this paper is structured as follows. Following the introductory section is the review of relevant literature and hypothesis development. The next section then presents our econometric model and preliminary empirical evidence. Finally, the last section summarizes the main findings of the study with discussion of the conclusion.

1.1 Scope of Study

This study basically investigates the relationship between ownership structure and the financial performance of listed firms in the financial sector of the Nigerian economy. To achieve this objective, the corporate annual reports for the period 2006-2010 were analyzed. In addition, the study considered a total of 31 listed firms in the aforementioned industry. The choice of this industry arises based on the direct and indirect contribution to the nation economy.

1.1.1 Ownership Structure and Firm Performance

One of the most important trademarks of the modern corporation is the separation of ownership and control. Modern corporations are typically managed by professional executives who own only a small fraction of the shares. The link between ownership structure and performance has been the subject of an important and ongoing debate in the corporate finance literature. The debate goes back to the Berle and Means (1932) thesis, which suggests that an inverse correlation should be observed between the diffuseness of shareholdings and firm performance. Their view has been challenged by Demsetz (1983), who argues that the ownership structure of a corporation should be thought of as an endogenous outcome of decisions that reflect the influence of shareholders and of trading on the market for shares. When owners of a privately held company decide to sell shares, and when shareholders of a publicly held corporation agree to a new secondary distribution, they are, in effect, deciding to alter the ownership structure of their firms and, with high probability, to make that structure more diffuse. Subsequent trading of shares will reflect the desire of potential and existing owners to change their ownership stakes in the firm. In the case of a corporate takeover, those who would be owners have a direct and dominating influence on the firm's ownership structure. In these ways, a firm's ownership structure reflects decisions made by those who own or who would own shares. The ownership structure that emerges, whether concentrated or diffuse, ought to be influenced by the profit-maximizing interests of shareholders, so that, as a result, there should be no systematic relation between variations in ownership structure and variations in firm performance.

1.1.2 Literature Review and Development of Hypothesis

Most research on the relationship between ownership and financial performance is rooted in an agency framework. Morch, Shleifer, and Vishny (1988), and McConnell and Servaes (1990), among others, empirically examined the effect of ownership structure on corporate performance. Morch, Shleifer, and Vishny (1988) estimates a piece-wise linear regression in which the dependent variable is Tobin's q ratio was a proxy for corporate performance, and the primary independent variable is the fraction of shares owned by corporate insiders. While these studies do not agree on details, they both report that the relationship between corporate performance and the degree of insider ownership is not linear: in some range of insider ownership, corporate performance is positively related to insider ownership, but in other range, a negative relationship is found. Thus, the results of these studies suggest that insider ownership does not always have a positive effect on corporate performance. Using a different methodology, McConnell and Servaes (1990) also demonstrate that corporate performance is nonlinearly related to the degree of insider ownership. Interestingly, McConnell and Servaes show that corporate performance is positively related to the degree of institutional ownership, indicating a positive effect of institutional ownership on corporate performance. They suggested that managers' entrenchment would be more difficult with the existence of institutional shareholders. In a related survey, Holderness (2003) examined the effects of management and block holder equity ownership on corporate decisions and on firm value. They observed that management and block holder equity ownership had a negative impact on corporate decisions and firm value. Also, Gordon and Schmid (2000) in their study concluded that firm performance in Germany is positively related to concentrated equity ownership. Nevertheless, Himmelberg, Hubbard and Palia (1999) using a panel data in a similar survey concluded that a large fraction of the cross-sectional variation in managerial ownership were endogenous. They suggest that managerial ownership and firm performance are determined by a common set of characteristics and, therefore, question the causal link from ownership to performance implied by previous studies.

Nevertheless, despite the extensive research in this area of finance, most research on ownership structure and firm performance has been carried out in developed economies, most notably the United States. Only a few of these

studies have considered emerging market economies, with none focusing on Nigeria. There exist huge institutional differences, including the mechanisms of corporate governance, between Nigeria and the developed economies. Moreover, it is not known whether existing differences in institutional, regulatory and corporate governance practices also translate into differences in the relationship between ownership and firm performance. This study to this end basically seeks to investigate precisely whether there is a relationship between ownership structure and the performance of firms.

1.2 Hypothesis Development

With the mixed result provided in prior researches; coupled with the dearth of literature in this area of finance in a developing country like Nigeria, the research hypothesis for this study is stated below in the null form.

H₁: there is no significant relationship between board ownership and the performance of firms in Nigeria.

H₂: there is no significant relationship between foreign ownership and the performance of firms in Nigeria

H₃: here is no significant relationship between Institutional ownership and the performance of listed firms in Nigeria.

1.2.1 Research Methodology

To achieve the objectives of this research, the study has adopted the use of corporate annual reports of listed firms in the financial sector of the Nigerian economy as our main source of data. This is due to the fact that corporate annual reports of listed companies are readily available and easily accessible. More so, the annual reports for the period 2006-2010 were used due to the fact that the period marked the introduction of bank capitalization process and the failure of some of the banks due to poor corporate governance practice. The population for this study is comprised of all listed firms in the financial sector of the Nigerian economy as at 31 December 2010. However, the selected sample size for this study includes listed firms in the financial sector of the economy which sums up to a total of 31 firms. This represents 13.5% percent of the total population and, thus, is consistent with the minimum sample size as suggested by either the conventional sample size table proposed by Krejcie & Morgan (1970) or the modern online sample size calculator by Raosoft, Inc. In addition, while the study has adopted return on assets (dependent variable) as a measure of firm performance since ROA is an accounting ratio often used to as a measure for the effective performance of management; on the other hand, board, foreign and institutional ownership (which are the independent variable) would be proxied by BODOWN, FOROWN and INSOWN respectively. Similarly, in order to assess the impact of corporate ownership structure on firm performance; we use the following regression model:

Model Specification

$$ROA_t = f(BODOWN_t, FOROWN_t, INSOWN_t, U_t) \quad (1)$$

This can be written in explicit form as:

$$ROA_t = \beta_0 + \beta_1 BODOWN_t + \beta_2 FOROWN_t + \beta_3 INSOWN_t + U_t \quad (2)$$

Where:

ROA = Return on Assets as a proxy for firm performance

BODOWN = Board Ownership

FOROWN = Foreign Ownership

INSOWN = Institutional Ownership

T = Time dimension of the Variables

β_0 = Constant or Intercept.

β_{1-3} = Coefficients to be estimated or the Coefficients of slope parameters.

1.3 Discussion of Findings

A marathon review of the findings from our descriptive statistics as presented in Table 2 shows that on the average, firm's performance in the industry had an approximate mean value of about 7.3955. On the other hand, board ownership, foreign ownership and institutional ownership which constituted the variables used to capture firm ownership structure had approximate mean values of 6.9284, 6.2232 and 13.7668 respectively.

Insert Table 2 Here

Furthermore, results from the Pearson Correlation analysis on the relationship between board ownership (proxied as the proportion of board ownership to total shareholding) and the performance of firms in Nigeria as depicted in Table 3 shows that there is a positive correlation between board ownership (i.e. management ownership) and the

performance of firms in Nigeria. This is evident with a correlation coefficient of ($r = .495$) and it is significant at 1% probability level. This result suggests that managerial ownership enhances corporate performance since managers are motivated to double up efforts as part of the shareholders towards the realization of the wealth creation objective. Similarly, results from Table 3 further depicts that there is a significant positive correlation between foreign ownership and firms' performance in Nigeria. This is marked with a correlation coefficient of ($r = .397$) and it is significant at 5% level. This outcome invariably suggests that an increase in the proportion of foreign ownership would positively affect the level of firm's performance in the financial industry. This positive impact can be explained possibly by the managerial efficiency and technical skills as well as the state of technology that foreign owners bring to their work environment. More so, results from the Pearson Correlation analysis further indicate that there is a significant positive correlation between Institutional ownership and the performance of listed firms in Nigeria. This is reflected with the correlation coefficient of ($r = .429$) and it is also significant at 5% level.

Insert Table 3 Here

Meanwhile, empirical results on the goodness of fit test as shown in table 4 present an adjusted R^2 value of about .581. This in a nutshell means that the value of the dependent variable can be explained by about 58% of the independent variables. This value can be considered sufficient because the financial performance of a firm can also be influenced by other factors besides board ownership, foreign ownership and Institutional ownership. Nevertheless, findings from the Analysis of Variance (i.e. the Fishers - test) as reflected in Table 5 presents a p-value that is less than 0.01 (i.e. $p\text{-value} < 0.01$). This outcome suggests clearly that simultaneously the explanatory variables (i.e. board ownership, foreign ownership and Institutional ownership) are significantly associated with the dependent variable (i.e. firms performance). In other words, the F-statistics proves the validity of the estimated models which are statistically significant at 1% as shown by the F-probabilities. Consequently, the regression analysis results as presented in Table 6 indicates that consistent with our apriori expectation (i.e. $b_1 < 0$); there is a significant positive relationship between board ownership (i.e. management ownership) and the performance of listed firms in the finance industry. This is evident in the coefficient of beta (.414) and a t-value of 3.274. This result is also statistically significant at 1% level (i.e. $p\text{-value} < 0.01$). This basically means that a meaningful director/management stock ownership will invariably bring about a better management monitoring which will in the long-run enhance firms' performance. This outcome further implies that firms with higher managerial stake tend to perform better than firms with a low level of managerial stake. This result is consistent with the findings of Jensen and Meckling (1976), Bohren and Odegaard (2001) and Mueller and Spitz (2002) where they found a positive relationship between board ownership (i.e. management ownership) and firm's performance. However, this result contradicts the findings provided by Demsetz and Villalonga (2001) and Loderer and Martin (1997).

Insert Table 4 Table 5 & Table 6 Here

Also, consistent with our apriori expectations (i.e. $b_2 < 0$); the study further observed that there is a significant positive relationship between foreign ownership and the firm performance in Nigeria. This is evident as presented in Table 6 with a t-value of 3.803 and it is statistically significant with a p-value of that is less than 0.01% (i.e. $p\text{-value} < 0.01$). This outcome for hypothesis (2) basically suggest that foreign ownership has positive effect on firm performance possibly due to the managerial efficiency and technical skills as well as the state of technology that foreign owners bring to their work environment. In addition, this positive impact might be adduced to the foreign owned firms are more likely to benefit from prudent management of risks as influenced by the policies of the parent company, and strict focus on profitability to maximize shareholders' wealth creation capacity. This result nevertheless corroborates the findings provided by Claessens and Demirguc-kunt (2000), Imam and Malik (2007) and Barako & Tower (2007) were they observed that foreign holding is positively and significantly related to firm performance.

Finally, findings on the relationship between institutional ownership and firm performance further indicate that consistent with our apriori expectation (i.e. $b_2 < 0$), there is also a significant positive relationship between institutional ownership and the performance of the selected listed firms in Nigeria. This is also evident in the coefficient of beta (.436) and a t-value of 3.391. Interestingly, this result is statistically significant with a p-value .002. This invariably suggests that the monitoring role of institutional investors has value in enhancing performance of firms upon acquiring a substantial proportion of firm equity. This outcome corroborates the findings of Wu (2000) and Barako & Tower (2007). However, this outcome contradicts to the findings of Claessens et al. (2000) were they observed that there was no relationship between institutional ownership and firm performance.

1.3.1 Conclusion and Recommendations

This paper basically examined the relationship between ownership structure and the performance of 31 listed firms in the financial sector of the Nigerian economy over a period of 5 years (i.e. 2006 – 2010). Findings from the study

revealed that there is a significant positive relationship between board ownership (i.e. management ownership) and the performance of listed firms in the financial industry. That is, the nature of the managerial ownership of a firm has significant impact on the performance of such firm. This basically suggests that firms with higher managerial stake tend to perform better than firms with a low level of managerial stake. Secondly, the study also revealed that foreign ownership has a significant positive impact on the firm performance. Interestingly, the paper suggests that this positive impact could be possibly due to the managerial efficiency and technical skills as well as the state of technology that foreign owners bring to their work environment. Finally, findings from the paper further revealed that there institutional ownership has a significant positive impact on the performance of the selected firms since the monitoring role of institutional investors has value in enhancing performance of firms upon acquiring a substantial proportion of firm equity.

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Table 1. Proxies and Predicted Signs for Explanatory Variables

| Variable | Predicted Sign | Type | Scale |
|----------|----------------|----------------------|--|
| BODOWN | (+) | Independent Variable | Proportion of board ownership to total shareholding |
| FOROWN | (+) | Independent Variable | Ratio of foreign ownership stake to total shareholding |
| INSOWN | (+) | Independent Variable | This was taken as the ratio of shareholding held by institutions to the total number of shares outstanding in the bank |

Table 2. Descriptive Statistics of Variables

| | ROA | BODOWN | FOROWN | INSOWN |
|--------------|---------|---------|----------|----------|
| Mean | 7.3955 | 6.9284 | 6.2232 | 13.7668 |
| Median | 4.6600 | 2.6400 | .0000 | .0000 |
| Maximum | 23.87 | 34.60 | 95.00 | 78.30 |
| Minimum | 1.10 | .00 | .00 | .00 |
| Std. Dev. | 6.79519 | 9.59805 | 22.27548 | 22.40524 |
| Observations | 31 | 31 | 31 | 31 |

Note: ROA represents Return on Asset, BODOWN represents Board Ownership, FOROWN represents Foreign Ownership, INSOWN represents Institutional Ownership

Table 3. Pearson Correlations

| | | ROA | BODOWN | FOROWN | INSOWN |
|--------|---------------------|----------|----------|---------|---------|
| ROA | Pearson Correlation | 1 | .495(**) | .397(*) | .429(*) |
| | Sig. (2-tailed) | | .005 | .027 | .016 |
| | N | 31 | 31 | 31 | 31 |
| BODOWN | Pearson Correlation | .495(**) | 1 | .018 | -.236 |
| | Sig. (2-tailed) | .005 | | .924 | .201 |
| | N | 31 | 31 | 31 | 31 |
| FOROWN | Pearson Correlation | .397(*) | -.002 | 1 | -.177 |
| | Sig. (2-tailed) | .027 | .990 | | .340 |
| | N | 31 | 31 | 31 | 31 |
| INSOWN | Pearson Correlation | .429(*) | -.190 | -.177 | 1 |
| | Sig. (2-tailed) | .016 | .306 | .340 | |
| | N | 31 | 31 | 31 | 31 |

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

Table 4. Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | | |
|-------|-------------------|----------|-------------------|----------------------------|-------------------|----------|-----|-----|--------------|
| | | | | | R Square Change | F change | df1 | df2 | Sig F Change |
| 1 | .762 ^a | .581 | .534 | 4.63840 | .581 | 12.462 | 3 | 27 | .000 |

a: Predictors: (Constant), INSOWN, FOROWN, BODOWN

Table 5. ANOVA^b

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|-------|------------|----------------|-----|-------------|--------|-------------------|
| 1 | Regression | 804.338 | 3 | 268.113 | 12.462 | .000 ^a |
| | Residual | 580.900 | 227 | 21.515 | | |
| | Total | 1385.237 | 30 | | | |

a: Predictors: (Constant), INSOWN, FOROWN, BODOWN

b: Dependent Variable: ROA

Table 6. Coefficients^a

| Model | Unstandardized Coefficients | | Standardized Coefficients | | t | Sig. |
|------------|-----------------------------|------------|---------------------------|--|-------|------|
| | B | Std. Error | Beta | | | |
| (Constant) | 2.647 | 1.157 | | | 2.288 | .030 |
| BODOWN | .293 | .090 | .414 | | 3.257 | .003 |
| FOROWN | .145 | .039 | .475 | | 3.753 | .001 |
| INSOWN | .132 | .039 | .435 | | 3.372 | .002 |

a : Dependent Variable: ROA

Table 7. List of Selected Listed Firms in the Financial Industry

| S/N | SELECTED FIRMS | S/N | SELECTED FIRMS |
|-----|---------------------------|-----|--|
| 1 | ACCESS BANK | 16 | UNITY BANK |
| 2 | DIAMOND BANK | 17 | WEMA BANK PLC |
| 3 | ECO BANK | 18 | ZENITH BANK PLC |
| 4 | FIDELITY BANK | 19 | SPRING BANK PLC |
| 5 | FIRST BANK NIG PLC | 20 | AFRI BANK |
| 6 | FIRST CITY MONUMENT BANK | 21 | ACCESS BANK |
| 7 | FIN BANK PLC | 22 | UNITED BANK FOR AFRICA PLC |
| 8 | GUARANTY TRUST BANK | 23 | INTERNATIONAL ENERGY INSURANCE COMPANY PLC |
| 9 | INTERCONTINENTAL BANK PLC | 24 | INVESTMENT AND ALLIED ASSURANCE PLC |
| 10 | OCEANIC BANK INTL PLC | 25 | CUSTODIAN & ALLIED INSURANCE PLC |
| 11 | PLATINUM HABIB BANK PLC | 26 | CUSTODIAN & ALLIED INSURANCE PLC |
| 12 | SKYE BANK PLC | 27 | EQUITY ASSURANCE PLC |
| 13 | STERLING BANK PLC | 28 | GOLDLINK INSURANCE PLC |
| 14 | STANBIC IBTC BANK PLC | 29 | GREAT NIGERIA INSURANCE PLC |
| 15 | UNION BANK PLC | 30 | GUARANTY ASSURANCE PLC |
| | | 31 | GUINEA INSURANCE PLC |

Source: Corporate Annual Report (2010)