INFLUENCE OF INSTITUTIONAL OWNERSHIP ON EARNINGS QUALITY: EVIDENCE FOR FIRMS LISTED ON THE PAKISTAN STOCK EXCHANGE
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Abstract

Prior studies have shown that ownership structure of firms affects their performance, decision making and earnings. Studies have found that institutional owners are well informed, organized and proactive as compared to other owners. In this study we empirically examined the impact of institutional ownership on earnings quality for the listed firms of the Pakistan Stock Exchange (PSX). The data of 200 non-financial listed firms from 2002 to 2014 is collected for this study. The conceptual framework of Financial Accounting Standards Board (FASB, 1980) is used to measure the earnings quality. The four dimensions of earnings quality studied are: predictive value, neutrality, timeliness and representational faithfulness. Results showed institutional ownership is positively related with earnings quality. Moreover, a greater level of institutional shareholding brings more oversight and enhances earnings quality.

Keywords: Institutional Ownership, Earnings Quality, Financial Reporting, Pakistan Stock Exchange.

JEL Classification: G 310

1- Institute of Management Sciences, Peshawar, Pakistan
2- University of Peshawar, Pakistan
3- Institute of Management Sciences, Peshawar, Pakistan
Introduction

Today’s modern world technologies have converted local businesses into global businesses. Investors are now investing their funds around the globe to avail the benefits of overseas opportunities. Foreign as well as local investors are interested in assessing the risks associated with the stock markets as well as the risks specific to a firm. Prior studies (Verdi, 2005; Krishnan and Yang, 2009; Martinez Ferrero, Garcia Sanchez and Cuadrado Ballesteros, 2015) have shown that the quality of earnings is relevant to investors’ investment decisions. These studies have found quality of earnings as one of the important risk factors. The quality of earnings is one of the important topics of financial reporting. Funds managers, investors and other stakeholders take keen interest in the financial reporting and quality of earnings. It is empirically found that many of the problems in financial reporting system are associated with deficiencies of corporate governance (Melis, 2000).

In any sort of ownership, the management is answerable to stakeholders and each stakeholder tries to alter the results for its own interest. With different ownership structures and management styles the timely reforms are inevitable in corporate governance mechanisms. Latif and Abdullah (2015) argued that good governance can curtail the managers’ opportunistic behavior and help to reduce agency cost. Shareholder activism and corporate governance not only provide good decision making environment but also make managers accountable by financial reporting (Smith and Michael, 1996).

Institutional ownership is one of the mechanisms of corporate governance. Shleifer and Vishny (1986) argued that institutional owners are large investors and they invest and manage on behalf of other small investors in equities and they can easily monitor the managers as compared to individual investor. Shleifer and Vishny (1997) discussed that large shareholding and legal protections to investors are identical schemes of the corporate governance and large investment can solve the agency problems effectively. Hartzell and Starks (2003) also suggested that institutional investors are better able and expert to curtail self-serving behavior of the managers.
This research work endeavored to contribute to the current literature by exploring the role of institutional ownership with respect to the quality of earnings in the context of Pakistan. Several studies (Butt and Shah, 2009; Kamran and Shah, 2014; Latif and Abdullah, 2015) on this topic have been conducted in Pakistan but the focus of these studies was to find association between ownership structure and earnings management. But no study until now has focused on the qualitative aspects of financial information.

To fill this gap we endeavored to examine the influence of institutional ownership on the qualitative characteristics of accounting information. Prior studies have used various proxies for the quality of earnings such as predictability, timeliness and conservatism (Francis, et al., 2004) information quality (Leuz and Verrecchia, 2005) announcement lag (Krishnan and Yang, 2009) and transparency, completeness, neutrality, accuracy, comparability (Martínez Ferrero, Garcia Sanchez and Cuadrado Ballesteros, 2015). In this study we have standardized our selection and examined the qualitative attributes of earnings highlighted in Financial Accounting Standards Board (FASB) Statement No. 02 (FASB, 1980). This study explores knowledge in this area in the context of Pakistan. The results of this study would help managers, investors, decision makers and other stakeholders in understanding that differences in ownership structures can influence earnings quality of the listed firms.

**Literature Review**

Managers tend to have opportunistic behavior that benefits them economically. They use judgment in structuring transactions to alter the financial report for the purpose to either misinform the stakeholders or to reap the benefits of contractual outcomes dependent on firm performance. And the likelihood of this opportunistic behavior rises where the firms have weak governance structures (Latif and Abdullah, 2015). Alteration of financial information deteriorates the quality of reported earnings and reduces the investors’ confidence on the financial reports. Broadly, corporate governance refers to the rules, laws and processes that direct the affairs of a firm. These rules, laws and processes ensure transparency, accountability and fairness in the relationship between a firm and all its stakeholders. Good corporate governance constraints the management from their self-serving
behavior and influences them to work in the interest of the shareholders.

The theories put forward with respect to corporate governance include the agency theory, stakeholder theory, and stewardship theory. Among these, the agency theory is the most influential. It states that the managers pursue self-interested strategies and will not act to maximize shareholders’ wealth unless an appropriate governance structure is implemented to safeguard the latter’s interests (Jensen and Meckling, 1976). Prior studies (Hartzell and Starks, 2003; Cornett, Marcus, Saunders and Tehranian, 2007; Kamran and Shah, 2014) have found institutional ownership to be an effective corporate governance mechanism. Shleifer and Vishny (1986) argued that institutional investors have greater stakes in the companies; hence, they have the reasons and ability to monitor and influence the decisions of the managers.

**Earnings Quality**

Earnings have always remained a very important input in the decision-making process of investors and is communicated to the investors through the financial reports. The financial reports translate the financial and operational performance of a company in business language. After the major corporate scandals of Enron, WorldCom and Tyco, the regulators placed more emphasis on the corporate governance and the quality of financial reporting. Earnings quality is an important aspect of the financial reports’ reliability. It refers to the quality of the reported earnings or the process of the financial reporting. The financial reporting does not consist of only financial information but also includes other non-financial information (SFAC, 1978).

External parties to corporations such as regulators, auditors and tax authorities play an important and constructive role in the monitoring of the earnings quality or the financial reports because they represent most of the stakeholders. A sound financial reporting system is an integral part of the corporate governance (Melis, 2000) as it makes the managers accountable and thus protects the interests of the shareholders (Watts and Zimmerman, 1978). Butt and Shah (2009) stated that financial reporting is practical and recognized system while
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the corporate governance is intellectual and theoretical. Financial reporting system still has some issues and its foundation lies in dearth of corporate governance system (Whittington, 1993). Researchers (Beasley, 1996; Dechow, Sloan and Sweeney, 1996) found that weaknesses in governance have positive relationships with poor financial reporting quality, earnings manipulation, financial statement fraud, and weaker internal controls.

Institutional Ownership and the Quality of Earnings

Ownership structure has greater influence on a firm’s governance structure and its performance (Moradi and Nezami, 2011). Ownership is more or less dominant by the following: institutional ownership, individual ownership, family ownership, block holdings and directors’ ownerships. In Pakistan the listed companies are owned by families, centralized ownership and institutional investor. Institutional investors have larger stakes in the firms therefore, it is for their own interest to keep an eye on the management and the information shared by them. There are reasons for the institutional investors to have access to the information. Financial reports are perfect sources of reliable financial information. The most important thing about the institutional investors is that they study financial reports comprehensively as compared to other stockholders and infer information (Hand, 1990). Institutional investors not only rely on financial information but also on non-financial information and evaluate financial and non-financial information for their investment decisions.

Koh (2003) studied the association between the institutional ownership and the quality of earnings. He used discretionary accruals as a proxy of earnings quality. More use of discretionary accruals deteriorates the quality of the reported information. The study found negative association between the institutional ownership and discretionary accruals that is with the increase in institutional ownership the quality of reported earnings increases. Velury and Jenkins (2006) studied the four dimensions of earnings quality, defined in FASB, which are predictive value, timeliness, neutrality and representational and evidenced that the existence of institutional ownership improves the earnings quality and argued that the earnings quality enjoys reliability. They found positive association between

Dong-Lin and Gang (2008) examined the role of institutional ownership as a corporate governance mechanism on the earnings quality. They examined three attributes of earnings: value relevance, discretionary accruals and conservatism. The results of the study showed positive association between the institutional ownership and the quality of earnings. On further examination they found that a firm with lesser or no institutional ownership had lower quality of reported information. Kamran and Shah (2014) found negative association between institutional ownership and discretionary accruals in Pakistan. They argued that institutional investors use their power to constrain managers from misrepresentation of financial information.

In the review of literature, we found majority studies on the institutional ownership and the quality of earnings have their focus on accruals quality. Studies on qualitative attributes of accounting information mentioned in Statement of Financial Accounting Concept NO. 2 (FASB, 1980) are very rare. In Pakistan we did not find any study that has examined the association between institutional ownership and qualitative characteristics of information, highlighted in FASB (1980). In this study, qualitative dimensions are not selected randomly rather this selection is standardized through relating it to the conceptual framework of FASB. These dimensions are predictive value (future operating cash flows), timeliness, neutrality and representational faithfulness.

On the basis of the above discussion we draw the following hypotheses for this study:

\[ H_{01} : \text{There is no relationship between institutional ownership and future operating cash flows.} \]
\[ H_{a1} : \text{There is relationship between institutional ownership and future operating cash flows.} \]
\[ H_{02} : \text{There is no relationship between institutional ownership and neutrality of information.} \]
\[ H_{a2} : \text{There is relationship between institutional ownership and neutrality of information.} \]
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H_03: There is no relationship between institutional ownership and timeliness.
H_A3: There is a relationship between institutional ownership and timeliness.
H_04: There is no relationship between institutional ownership and representational faithfulness.
H_A4: There is a relationship between institutional ownership and representational faithfulness.

Research Methodology

From among 581 companies listed on the Pakistan Stock Exchange around 441 companies are non-financial companies. Minimum criterion for any company to be included in the final sample is the availability of at least 3 years complete data. Only 200 companies were found to meet this criterion and are included in this study. The span of the study is from the year 2002 to 2014. The data represents all the non-financial sectors of the PSX. The data for this study is extracted from the secondary source that is financial reports of the selected companies. These reports were available on the respective company’s website.

Following Velury and Jenkins (2006) four regression models, one for each dimension (predictive value, neutrality, timeliness and representational faithfulness), are used to test the hypotheses. The following are the econometric models for each dimension.

**Predictive Value or Feedback value (Future Operating Cash flows)**

Predictive value qualifies investors to study the earnings and the cash flow relationship. Predictive value enables the information users in correct forecasting i.e. predictive value and also helps users to check prior expectation i.e. feedback value (SFAC No. 2). In the equity valuation process accounting earnings are used to predict future cash flows. For this purpose, current accounting results are used to estimate future cash flows and predictive or feedback value reveals that this estimation produces accurate results. Dechow (1994) found strong evidence that earnings and future cash flows validate prior earnings. A high predictive value of earnings indicates strong
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The relationship between earnings and cash flows (Khajavi and Nazemi, 2005). In this model the association of interactive term of income before extraordinary items and institutional ownership with the future operating cash flows is examined.

\[
\text{CFO}_{it+1} = \alpha_0 + \alpha_1 \text{IBEO}_{it} + \alpha_2 \text{IBEO}_{it} \times \text{SHBI}_{it} + \alpha_3 \text{IBEO}_{it} \times \text{SHLI}_{it} + \alpha_4 \text{IBEO}_{it} \times \text{SHMN}_{it} + \alpha_5 \text{GRTH}_{it} + \alpha_6 \text{DEBT}_{it} + \alpha_7 \text{LOSS}_{it} + \alpha_8
\]

(Model 1)

Where,

- \text{CFO}_{it+1} is the dependent variable,
- \text{IBEO}_{it} SHBI (the interactive term of income before extraordinary items and institutional ownership) is independent variable and
- \text{SHLI} (block Holdings), \text{SHMN} (managerial shareholdings), \text{GRTH} (growth), \text{DEBT} (debt) and \text{LOSS} (loss) are control variables.

Neutralität

The information provided in financial statement must be unbiased. The information must reflect balanced view of the firms' activities rather than the favored ones. The financial system and its internal control must be strong enough to control and manage the deliberate or any systematic bias. Neutrality is the quality of reported financial information to be without any bias or malfunction (SFAC No 02).

Prior studies have used abnormal accruals as a measure of neutrality of financial information (Kamran and Shah, 2014; Latif and Abdullah, 2015). Smaller abnormal accruals suggest more neutrality and vice versa. Abnormal accruals are the difference between total accruals and non-discretionary accruals. Total accruals (TA) are calculated by subtracting the cash flow from operations (CFO) from Net income (NI). It can be represented as: \( TA = NI - CFO \)

For the calculation of the non-discretionary accruals we estimated Jones (1991) and Modified Jones (1996) model.

Jones model for the estimation of non-discretionary accruals is as follows:
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\[
\frac{TA_{it}}{A_{it-1}} = \left\{ \hat{\alpha}_1 \left( \frac{1}{A_{it-1}} \right) + \hat{\alpha}_2 \left( \frac{"REV_{it-1}}{A_{it-1}} \right) \right\} + \hat{\beta}_{it-1} \\
\]

Where:

- **TA** is total accruals and **"REV** is change in revenue. **A** represents previous year total assets, **PPE** is plant, property and equipment and **\( \hat{\alpha}_{it-1} \)** is error term.

Modified Jones model was proposed by De chew, Sloan and Sweeney in 1996. This model adjusts change in revenue with change in receivables for the purpose to neutralize the effect when management uses its discretion in revenues. Modified Jones model is as follows:

\[
\left( \frac{TA_{it}}{A_{it-1}} \right) = \left\{ \hat{\alpha}_1 \left( \frac{1}{A_{it-1}} \right) + \hat{\alpha}_2 \left( \frac{"REV_{it-1}}{A_{it-1}} \right) \right\} + \hat{\beta}_{it-1} \\
\]

The estimated value of \( \frac{TA_{it}}{A_{it-1}} \) shows the non-discretionary accruals. Abnormal accruals is calculated as the difference between \( TA_{it}/A_{it-1} \) and estimated \( TA_{it}/A_{it-1} \). The choice of Jones or modified Jones model for the calculation of accruals depends upon the coefficient of determination (R²).

The relationship between neutrality (abnormal accruals) and institutional ownership is examined through the following model:

\[
ABNAC_{it} = \hat{\alpha}_0 + \hat{\alpha}_1 SHBI_{it} + \hat{\alpha}_2 SHLI_{it} + \hat{\alpha}_3 SHMN_{it} \\
+ \hat{\alpha}_4 TACCR_{it} + \hat{\alpha}_5 GRTH_{it} + \hat{\alpha}_6 DEBT_{it} + \hat{\alpha}_7 LOSS_{it} + \hat{\alpha}_8 \\
\text{(Model 2)} \\
\]

Where:

- **ABNAC** (abnormal accruals) is dependent variable, **SHBI** (institutional ownership) is independent variable and **SHLI** (block holdings), **SHMN** (managerial shareholdings), **TACCR** (total accruals), **GRTH** (growth), **DEBT** (debt) and **LOSS** (loss) are control variables.

**Timeliness (the reporting lag)**

Timeliness refers to the presentation of financial reports or information in time to all users for their decision making needs. The time of financial reporting is very important and any delay in reporting
makes information irrelevant (SFAC No. 2) Timeliness is closely related to the accounting principle of relevance. Consistent with the studies of Khajavi and Nazemi (2005) and Brown, Dobbie and Jackson (2011) the timeliness is measured as reporting lag. This reporting lag is calculated as the number of days from the end of fiscal year to actual earnings announcement date. The model is:

\[
\text{Repot-Lag}_i = \alpha_0 + \alpha_1 \text{SHBI}_i + \alpha_2 \text{SHLI}_i + \alpha_3 \text{SHMN}_i + \alpha_4 \text{GRTH}_i + \alpha_5 \text{DEBT}_i + \alpha_6 \text{LOSS}_i + \alpha_7
\]

(Model 3)

Where:

- Repot-Lag is dependent variable and the SHBI is independent variable. SHLI (block holdings), SHMN (managerial shareholdings), GRTH (growth), DEBT (debt) and LOSS (loss) are control variables.

**Representational Faithfulness**

Information provided in the financial statements should faithfully represent the transaction and events that occur during a period. Representational faithfulness is the correspondence or agreement between measures or description and the phenomenon that it purports to represent (SFAC No. 2). Changes in the economic values of firms are measured or captured through earnings. Representational faithfulness is examined through the association of stock market prices and earnings. Change in earnings over a period of time causes change is prices of stocks (Beaver, 1989). The association between institutional ownership and representational faithfulness is examined through the following model.

\[
\text{RET}_i = \alpha_0 + \alpha_1 \text{ERN}_i + \alpha_2 \text{ERN}_i \times \text{SHBI}_i + \alpha_3 \text{ERN}_i \times \text{SHLI}_i + \alpha_4 \text{ERN}_i \times \text{SHMN}_i + \alpha_5 \text{GRTH}_i + \alpha_6 \text{DEBT}_i + \alpha_7 \text{LOSS}_i + \alpha_8
\]

(Model 4)

Where:

- \text{ERN} is change in earnings. RET (stock return) is dependent variable and the interactive term \text{ERN}_i \times \text{SHBI}_i is independent variable. SHLI (Block Holdings), SHMN (managerial shareholdings), GRTH (growth), DEBT (debt) and LOSS (loss) are control variables.
The data related to the ownership structure are taken from the pattern of shareholdings provided in the annual reports of the companies. It includes the percentage of equity owned by the managers of the firms (SHMN), by block holders (SHLI) and by institutions (SHBI). Growth (GRTH) is measured through market to book ratio. The total debt (DEBT) is obtained from the financial statement of the firms. Loss (LOSS) is used as dichotomous variable which is equal to 1 if the firm reported a loss otherwise 0.

Results and Discussion

Table 1 presents the sample distribution by industry group. The data represents companies from all the non-financial sectors of the Pakistan Stock Exchange. Table below shows the distribution of observations by industries.

Table 1: Distribution of Observations by Industry Group

<table>
<thead>
<tr>
<th>Industry Group</th>
<th>No of Observation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Textile</td>
<td>155</td>
</tr>
<tr>
<td>Cement</td>
<td>152</td>
</tr>
<tr>
<td>Chemicals</td>
<td>138</td>
</tr>
<tr>
<td>Food Producers</td>
<td>116</td>
</tr>
<tr>
<td>Automobile and Parts</td>
<td>115</td>
</tr>
<tr>
<td>General Industries</td>
<td>95</td>
</tr>
<tr>
<td>Electricity</td>
<td>89</td>
</tr>
<tr>
<td>Construction and Material</td>
<td>86</td>
</tr>
<tr>
<td>Oil and Gas</td>
<td>74</td>
</tr>
<tr>
<td>Pharma and Biotech</td>
<td>72</td>
</tr>
<tr>
<td>Engineering</td>
<td>64</td>
</tr>
<tr>
<td>Electronic and Electrical goods</td>
<td>46</td>
</tr>
<tr>
<td>Industrial Transportation</td>
<td>44</td>
</tr>
<tr>
<td>Household Goods</td>
<td>44</td>
</tr>
<tr>
<td>Fixed line</td>
<td>40</td>
</tr>
<tr>
<td>Telecommunication</td>
<td>30</td>
</tr>
<tr>
<td>Industrial Metals and Mining</td>
<td></td>
</tr>
<tr>
<td>Beverages</td>
<td>28</td>
</tr>
<tr>
<td>Forestry</td>
<td>20</td>
</tr>
<tr>
<td>Total</td>
<td>1408</td>
</tr>
</tbody>
</table>
Descriptive statistics of the sample data are shown in Table 2. The cash flow from operations has the mean of 1,027,285 with minimum value of -10,723,618 and maximum of 30,340,278. The Mean of abnormal accruals is 0. The mean of abnormal accruals are required to be zero or near to zero because in long run positive and negative accruals compensate each other. The minimum value of abnormal accruals is (0.63) and maximum is 14.36. The mean of total accruals is 369,515. The time variable (reporting lag) shows the average of 81 days with maximum 110 days and minimum of 65 days. These days' difference shows the time lag between the end of fiscal year and announcement of earnings. The mean values of institutional ownership, managers’ shareholding and concentrated ownerships are 23%, 18% and 49% respectively. The minimum values of these three variables are 0. The average of income before extraordinary items of sample data is 1,417,062.36.

Table 2: Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Standard Error</th>
<th>Median</th>
<th>Range</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash FLOW</td>
<td>1,027,285</td>
<td>131,820</td>
<td>167,187</td>
<td>41,063,896</td>
<td>-10,723,618</td>
<td>30,340,278</td>
</tr>
<tr>
<td>Net Profit</td>
<td>171,452</td>
<td>9,92</td>
<td>127,750</td>
<td>0</td>
<td>-0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>EBIT</td>
<td>1,477,187</td>
<td>14,99</td>
<td>1,788,000</td>
<td>-14,935,468</td>
<td>16,188,408</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>20,16,498</td>
<td>11,003,749</td>
<td>10,624</td>
<td>0</td>
<td>-0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>Total Debt</td>
<td>39,59,125</td>
<td>9,87</td>
<td>34,188,408</td>
<td>0</td>
<td>-0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>Income Before EBIT</td>
<td>369,515</td>
<td>11,38</td>
<td>14,935,468</td>
<td>14,935,468</td>
<td>158,035</td>
<td></td>
</tr>
<tr>
<td>Income Before Extraordinary Items</td>
<td>1,417,062.36</td>
<td>181,613.83</td>
<td>162,805.00</td>
<td>70,348,703.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3 presents the correlation coefficients of all variables. Institutional ownership, growth and income before extraordinary items are positively related to the future cash flows from operation. Debts and managerial shareholding are negatively related with future cash flows from operations. Total accruals are positively related with abnormal accruals. Institutional ownership and income before extraordinary items have positive correlation with total accruals. Debts are negatively correlated with total accruals. Institutional ownership is negatively correlated with managerial shareholding and debts and shows that the existence of institutional ownership limits the role of manager and controls the total debts.
Managerial ownership is positively correlated with total debts while the institutional ownership is negatively related with total debts. Growth is positively correlated with income because higher growth results in more income, cash flows and firm performance.

Results of Fixed Effect Regression of Institutional ownership on Four Dimensions of Earning Quality

This study is based on panel data. The normality of the data is checked and the outliers are first removed. Multicollinearity is checked through VIF. Hausman test is estimated for the selection of the best suited model for our data. Table 4 represents the regression estimates. The proxies of earnings quality are predictive value, neutrality, timeliness and representational faithfulness. The estimated coefficients, p-value, t-statistic, f-test statistics and coefficient of determination are shown in the table.

The Hausman test result was insignificant with Chi-Square value of 138.61, therefore fixed effect model is estimated. Regression results of the first model (predictive value or feedback value) show significant and positive relationship between future operating cash flows and interactive term of income before extra-ordinary items and institutional ownership. This implies that with the institutional ownership the predictive and feedback value of the future operating cash flows increases or it can be explained as with the institutional ownerships, earnings can be used as an input to predict the future cash flows. This attribute of information has implications for the
investors who can make their investment decisions on the basis of correct estimation of the future cash flows. We accept our first hypothesis that there is relationship between institutional ownership and future operating cash flows. The coefficient of block holding is negatively significant that indicates the decrease in predictability of future operating cash flows with block share holdings. The coefficient of managerial shareholding is also negative but insignificant, which implies that managerial shareholding has no contribution in the prediction of future operating cash flows. Loss is also negatively associated with the future operating cash flow.

Table 04:
Estimated Coefficient from Fixed Effect Regression of Institutional Ownership on the Four Dimensions Quality (Predictive value, Neutrality, Timeliness and Representational faithfulness)

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Predictive Value</th>
<th>Neutrality of Earnings</th>
<th>Timeliness</th>
<th>Representational faithfulness</th>
</tr>
</thead>
<tbody>
<tr>
<td>INCOME BEFORE</td>
<td>Coefficient</td>
<td>P Value</td>
<td>Coefficient</td>
<td>P Value</td>
</tr>
<tr>
<td>EXTRAORDINARY ITEMS</td>
<td>0.004</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>TOTAL ACCRUALS</td>
<td>0.001</td>
<td>0.7</td>
<td>0.001</td>
<td>0.7</td>
</tr>
<tr>
<td>INSTITUTIONAL</td>
<td>1.041</td>
<td>0.006</td>
<td>-0.076</td>
<td>0.224</td>
</tr>
<tr>
<td>SHAREHOLDING</td>
<td>0.080</td>
<td>0.006</td>
<td>0.064</td>
<td>0.914</td>
</tr>
<tr>
<td>BLOCK HOLDING</td>
<td>0.092</td>
<td>0.006</td>
<td>0.203</td>
<td>0.624</td>
</tr>
<tr>
<td>MANAGERIAL</td>
<td>0.021</td>
<td>0.006</td>
<td>0.037</td>
<td>0.079</td>
</tr>
<tr>
<td>SHAREHOLDING</td>
<td>1.182</td>
<td>0.006</td>
<td>0.575</td>
<td>0.084</td>
</tr>
<tr>
<td>GROWTH</td>
<td>1.254</td>
<td>0.056</td>
<td>0.078</td>
<td>0.329</td>
</tr>
<tr>
<td>TOTAL DEBTS</td>
<td>1.364</td>
<td>0.060</td>
<td>0.076</td>
<td>0.778</td>
</tr>
<tr>
<td>LOSS</td>
<td>0.687</td>
<td>0.001</td>
<td>0.076</td>
<td>0.079</td>
</tr>
<tr>
<td>CONSTANT</td>
<td>2.318</td>
<td>0.18</td>
<td>0.047</td>
<td>0.008</td>
</tr>
<tr>
<td>PROD-F</td>
<td>0.921</td>
<td>0.006</td>
<td>0.076</td>
<td>0.079</td>
</tr>
<tr>
<td>RG</td>
<td>0.231</td>
<td>0.006</td>
<td>0.076</td>
<td>0.079</td>
</tr>
</tbody>
</table>

For second model, Chi-Square value of the Hausman test was 86.15, therefore we estimated the fixed effect regression model. Regression results of second model (neutrality) depict that the institutional ownership is not associated with abnormal accruals. The coefficient is negative but insignificant. We do not accept second hypothesis which states that there is a relationship between institutional ownership and accruals. The coefficient of managerial shareholding is negatively significant which implies that with managerial shareholding use of discretionary accrual minimizes. The coefficient of growth is positively significant that is the growing firms have a tendency to use more discretionary accruals. The
coefficient of loss is negatively significant that is in year of loss there is less use of discretionary accruals.

For third model, Chi-Square value of the Hausman test was 13.38, therefore we estimated the fixed effect regression model. The regression results of third model (timeliness) depict that the coefficient of institutional ownership is negatively significant. This shows that the reporting lag decreases with the institutional ownership. This is one of the important qualitative attributes of information. According to FASB (1980) the information loses its importance when it is delayed or when it cannot be used as an input in decision making process. Our results show that institutional ownership increases the usefulness of financial information by minimizing the reporting lag. We accept our third hypothesis that there is relationship between institutional ownership and timeliness. The coefficient of block holding is also negative but it is positive for managerial shareholding. It shows that the presence of institutional ownership and block holders improve the reporting lag and information is available on time to the stakeholders.

For the fourth model, Hausman test result was insignificant with chi-square value of 28.80. The regression results of the fourth model (representational faithfulness) show that institutional ownership is positively related with the representational faithfulness. This implies that with institutional ownership the agreement or correspondence between earnings and stock returns increase. Change in earnings over a period of time causes change in prices of stocks. We accept our fourth hypothesis that there is relationship between institutional ownership and representational faithfulness. The coefficient of block holding is also positively significant while that of managerial shareholding is insignificant. The coefficient of growth is positively related with the returns.

In three of our four models we found the influence of institutional ownership on the quality of reported earnings. With the presence of institutional investors, future operating cash flows can be accurately predicted through current year earnings. Also with institutional ownership the reporting lag of information announcement reduces and the correspondence between earnings and returns increases.
Robustness Checks

To check the robustness of our findings that whether institutional shareholding brings more oversight or increases the earnings quality and to make comparable the earnings quality at different levels of institutional shareholding we further analyzed the data. For this purpose we divided the data into two equal parts, using the median value of institutional shareholding. The first part of data (labeled as 1) contains observations having institutional shareholding value from minimum to median value and the second part of data (labeled as 2) contains observations having institutional shareholding value from median to maximum value. Table 5 shows the results of fixed effect regression models of institutional ownership on four dimensions of earnings quality. Column 1 shows results of first part of data set that has lower institutional ownership value and column 2 shows results of second part of data with higher institutional ownership values.

Table 05
Estimated Coefficient from Fixed Effect Regression of Institutional Ownership on the Four Dimensions Quality (On data distributed equally in two sets on the basis of institutional ownership) P-values Italized

<table>
<thead>
<tr>
<th>S No</th>
<th>Independent Variable</th>
<th>Predictive Value</th>
<th>Neutrality of Earnings</th>
<th>Timeliness</th>
<th>Representational Faithfulness</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
</tr>
<tr>
<td>1</td>
<td>INCOME BEFORE EXTRA ORDINARY ITEMS</td>
<td>5.6040</td>
<td>7.4560</td>
<td>0.0137</td>
<td>0.0021</td>
</tr>
<tr>
<td>2</td>
<td>TOTAL ACCRUALS</td>
<td>-0.0040</td>
<td>-0.0013</td>
<td>0.0120</td>
<td>0.0021</td>
</tr>
<tr>
<td>3</td>
<td>INSTITUTIONAL SHAREHOLDING</td>
<td>0.7604</td>
<td>0.8000</td>
<td>0.0237</td>
<td>0.0021</td>
</tr>
<tr>
<td>4</td>
<td>BLOCKHOLDING</td>
<td>1.5824</td>
<td>1.4897</td>
<td>0.2016</td>
<td>0.0237</td>
</tr>
<tr>
<td>5</td>
<td>MANAGER SHAREHOLDING</td>
<td>3.1489</td>
<td>-1.0241</td>
<td>-1.5438</td>
<td>-0.1935</td>
</tr>
<tr>
<td>6</td>
<td>GROWTH</td>
<td>1.4582</td>
<td>2.4581</td>
<td>0.0237</td>
<td>0.0021</td>
</tr>
<tr>
<td>7</td>
<td>TOTAL DEBTS</td>
<td>1.7970</td>
<td>0.9754</td>
<td>0.8749</td>
<td>0.0442</td>
</tr>
<tr>
<td>8</td>
<td>LOSS</td>
<td>-5.0419</td>
<td>-2.4215</td>
<td>-0.2181</td>
<td>-0.1029</td>
</tr>
<tr>
<td>9</td>
<td>CONSTANT</td>
<td>3.4598</td>
<td>4.5480</td>
<td>0.0517</td>
<td>0.0509</td>
</tr>
<tr>
<td>10</td>
<td>PROB&gt;F</td>
<td>5.6400</td>
<td>4.5700</td>
<td>2.5700</td>
<td>10.34</td>
</tr>
<tr>
<td>11</td>
<td>R2</td>
<td>0.2300</td>
<td>0.2300</td>
<td>0.2300</td>
<td>0.2300</td>
</tr>
</tbody>
</table>

***significant at 1 % level; ** significant at 5 % level; and * significant at 10 % level.
It can be seen in table 5 that in column 1 of the predictive value, the coefficient of institutional shareholding is positive but insignificant while in column 2 the coefficient is significant at 1 percent level of significance. It depicts that greater the level of institutional shareholding greater would be the predictive value or the presence of greater institutional shareholding helps investors to correctly forecast the future operating cash flows of a firm. In full data regression (table 4) it can be seen that institutional ownership was not related with neutrality of earnings. But for split data (table 5) the coefficient of institutional shareholding in column 2 is negatively significant. It shows that increase in institutional shareholding increases the oversight and reduces biasness in reported earnings. This result is in consistent with the findings of Koh (2003) and Kamran and Shah (2014). For timeliness, the coefficient of institutional shareholding is insignificant in column 1 but is significant in column 2 at 10 percent level of significance. This affirms that more the shareholding of institutions, timely would be the availability of information to the investors. It can also be seen that in column 1 the coefficient of block holding is negatively significant and in column 2 the coefficient of managers’ shareholding is positively significant. It upholds that presence of block holdings also reduces the reporting lag while presence of managers’ shareholding increases the reporting lag. For representational faithfulness the coefficients of institutional shareholding in both column 1 and 2 are significant. The magnitude of coefficient in column 2 is greater than column 1 also it is significant at 5 percent level of significance.

The results of table 5 showed that the presence of intuitional shareholding influences the managerial decisions and is an importance corporate governance mechanism. The comparison of different levels of institutional shareholding showed that greater level of institutional shareholding brings more oversight and increases quality of reported earnings.

**Conclusion**

The monitoring role of institutional ownership is related with firms’ corporate governance, performance, earnings management, and reporting quality. The earnings quality is an important area that has been examined in previous studies through the use of discretionary accruals. But the qualitative attributes of information highlighted in SFAC NO. 2 have been rarely discussed and empirically examined.
In this study the role of institutional ownership with respect to earnings quality is empirically tested. The earnings quality is a broader area and has many dimensions. For this study we have utilized the conceptual framework of Financial Accounting Standards Board (FASB, 1980) in the selection of dimensions of earnings quality. These quality dimensions are predictive value or feedback value, neutrality, timeliness and representational faithfulness.

Overall results showed that institutional ownership is positively associated with the quality of reported earnings. Moreover, the greater the level of institutional shareholding the greater would be the quality of reported earnings. It has important implications for every stakeholder. The corporate governance and ownership structure is very important for the growth of corporate sector in Pakistan. Further studies can explore the relations between other governance mechanisms and quality dimensions of earnings such as earnings smoothness, earnings variability, earnings persistence.
References


Khajavi, S. & Nazemi, A. (2005). Relationship between earnings quality and stock returns with emphasized the role of accrual figures in


