

Earnings Management and Performance of Non-Financial Listed Firms in Nigeria

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Abstract:

The study examines the effect of Earnings Management (EM) on the performance of Non-Financial Listed Firms (NFLF) in Nigeria. EM was proxied by Discretionary Accrual (DA) and Real Earnings Management (REM) using Raman and Shahrur's (2008) and Roychowdhury's (2006) models, respectively, against firm performance measured by Return on Capital Employed (ROCE). Using purposive sampling technique, 76 NFLF with the required secondary data needed for the study from 2010 to 2020 was selected for the study out of 113 NFLF in Nigeria as at 31 December 2020. Data gathered were analysed using Generalized Method of Moment (GMM) estimator and Dumitrescu and Hurlin panel causality tests technique. The results show positive and significant influence of DA on ROCE while REM shows negative and significant effect on ROCE. Also, ROCE Granger caused both DA and REM. The study concludes that EM had significant influence on the performance of NFLF in Nigeria. Firm size and firm age are found to have positively influenced performance of NFLF. Hence, the study recommends that managers be well informed in order to stop overusing activities that result in negative effects on the firm performance in the future and to increase financial transparency.

Keywords:

Earnings management, firms' performance, non-financial listed firms, Nigeria

JEL Codes: R30, R32

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Introduction

Earnings are the most important common fact that reveals a company's financial stability and strength. "It links to the bottom line section of the comprehensive income statement. It is illustrating the level at which company is profitable and attaches amount to the wealth of the shareholders" (Kumar and Aggarwal, 2018). The attractiveness of businesses in various areas for investment prospects influences the investment decisions made by potential investors, which in turn raises stock prices (Shittu and Amao, 2022). When earnings are a crucial determinant of stock price growth, companies try to outperform predicted earnings from earlier targets. Managers use an effective and occasionally opportunistic form of Earnings Management (EM) in order to achieve certain personal interest. Over the past few decades, numerous managers, accountants, and scholars in the field of finance have discussed the issue of EM (Khanh and Phung, 2019; Tonye and Sokiri, 2020). More so, Okoye and Nwobi (2020) opined that, EM happens as a result of the expert judgments needed to apply accounting standards, which provide managers the freedom to portray the company in a way that ignores its economic reality. Managers with a background in business select the appropriate reporting methodologies, disclosures, and estimations that meet the organization's business economics because of the opportunities and loopholes provided by accounting policies. According to Kumar, Syed and Pandey (2020), scaling up operations can be aided by sustainable growth. The study further stated that managers of firms should use internet resources and technology since doing so will keep them current and also enable organizations to compete on a global scale. Furthermore, in the studies carried out by (Kumar and Pandey, 2018; Kumar and Ayedee, 2019; Shittu, Taleat, Owojori and Aminu, 2023), it was observed that enterprises face intense rivalry in the market as a result of their inability to compete with the marketing and promotion strategies used by large multinational corporations in the environment they operate.

The key players in a corporation such as regulators, lenders and investors must understand the consequences of performing EM as it is linked with financial performance so that better strategic decisions can be made. This study seeks to ascertain the influence of EM on the performance of Non-Financial Listed Firms (NFLF) in Nigeria. Pervious empirical studies from developed and developing countries in the world shows different results of the influence of EM on firms' performance. Furthermore, review also revealed the following research gaps. Most of the past studies were done in Asia especially in Malaysia and India while in Africa, the few studies were in Tunisia, Ghana and Nigeria but majority of the studies in Africa and Nigeria in particular ignore Real Earnings Management (REM). Hence this study aims to address these research gaps by including REM. Secondly, an improvement is given that a large number of NFLF are included for eleven years unlike previous studies that used short period and small observations. Lastly, the study considered COVID 19 pandemic period of 2019 and 2020 to ascertain the influence of EM on the performance of NFLF in Nigeria. Therefore, the study ascertains the effects of EM on the performance of NFLF in Nigeria. In specific terms, the study evaluates the effect of discretionary accrual as well as the effect of REM on the performance of NFLF in Nigeria.

Review of Literature

This paper reviews the earnings management and firm performance, discretionary accrual and firm performance, and real earnings management and firm performance.

Earnings management and firm performance:

Many incentives encourage managers to participate in EM. These motivations have been examined in two categories in the literature that already exists on EM: opportunistic EM and

beneficial EM (Rezaei, 2012). Opportunistic EM refers to managing earnings to accomplish personal incentives (managers' desired aims), whereas helpful EM refers to managing earnings to achieve stockholder incentives. Similarly, managers used EM opportunistically to alter earnings in various financial reporting periods or to fulfill strategic reporting incentives (Shittu, Oyediji and Onifade, 2022). To put it another way, they use their judgment when making decision on financial reporting in order to take advantage of a situation that allows them to profit for themselves (Jirapon, Miller, Yoon and Kim, 2008). According to Graham, Harvey, and Rajgopal's (2005) opinion, managers think that omissions in the report of earnings will reduce the predictability of firm's earnings. This impacts stock prices since analysts and investors detest uncertainty. According to Louis and Robinson (2005), managers should use any EM approach to generate positive anomalous accruals, especially in the period before stock split announcements, in order to achieve optimal EM. A company's financial statements can be thought of as its public face. While organizations may be able to push themselves into challenging conditions without adopting a strategy, using these beauty suggestions is not always beneficial for corporate organization (Kumar and Ayedee, 2018; Kumar, Singh and Dwivedi, 2020). More so, Tonye and Sokiri, (2020) observed that, quality of the financial information presented in the annual reports of the company, particularly the information on earnings, has a significant impact on the decision made by stakeholders, which typically influences the performance of the enterprises. It is the issue that needs to be addressed in this study. More so, the financial statement may no longer accurately reflect the nature of the firm's financial status and business performance due to actions that control earnings for the manager's benefit.

Discretionary accrual and firm performance

In Asia, the study observed that Discretionary Accrual (DA) EM was examined on the firm performance. For instance, in a study carried out by Edi and Jessica (2020) in Indonesia, DA showed a positive relationship with firm performance. Likewise, DA exert positive correlation with firm performance in a study conducted in Pakistan by Sadiq, Othman and Keong (2019). However, negative and significant influence of performance on DA was revealed by Abdelkarim and Zuriqi (2019) in a study carried out in Palestine using 33 non-financial firms. In Europe, Ugrin, Mason and Emuley, (2017) conducted a study across European countries, DA showed negative with firm performance. Similarly, positive and significant effect of DA on firm performance was discovered in a study carried out by Paolo and Laora (2017). In Africa, a study including 102 consumer products companies from three sub-Saharan African nations carried out by (Okoro and Ihenyen, 2020), a positive and significant impact of DA on the company performance was revealed. However, the research by Okafor, Ezeagba and Onyali (2018) utilizing 16 consumer goods companies in Nigeria revealed a negative but not significant influence of DA on company performance.

Real earnings management and firm performance

Previous researches on the effect of REM and firm performance can be found in the work of Ghaleb, Kamardin and Tabash, (2020) conducted using panel regression of 264 Malaysia manufacturing firms. Negative and significant influence of REM on performance of the firms was revealed in the study. Likewise, the work of Tulcanaza-Prieto, Lee and Koo (2020) carried out in Korea which shown negative and significant influence of REM on performance. However, Khuong, Ha and Thu (2019) carried out a study in Vietnamese using panel regression method for 29 energy firms, the study discovered positive and significant influence of REM on firm performance. In Africa, Shittu, Onifade, Aminu, and Ajibola (2023) evaluated how REM affected the value of the company in Nigeria. The findings demonstrate that while irregular

operating cash flow and abnormal production costs did not significantly affect company value, abnormal discretionary expenses did. Additionally, it was found that the firm's worth is not much impacted by return on equity or firm growth. Twenty-three (23) listed food and beverage firms in Nigeria were the subjects of an investigation by Onifade *et al.* 2023 into the impact of cloud accounting characteristics on performance. The study came to the conclusion that the performance of food and beverage enterprises in Nigeria is significantly impacted by the cost of software and the cost of training. More so, the work of Elkalla (2017) in MENA countries using 802 non-financial companies revealed that ROA had a positive influence on REM. From the reviewed literatures, there is no recent research evidence that examined the effect of EM both DA and REM on performance of the firms particularly in Nigeria. Hence, this constitutes research gap which this study filled.

Theoretical Review

Two theories considered in this study are positive accounting and agency theories. Positive accounting theory otherwise, called political-contractual theory originated by Watts and Zimmerman in (1986). It as well as explains and predicts accounting practice. The theory focuses on how EM is used when reported financial statements are being prepared. More so, this theory seeks to comprehend and forecast the selection of accounting procedures among various organizations while acknowledging that such decisions have economic consequences. It also captures how financial reports affect how creditors, the government, and businesses make decisions (Elkalla, 2017). Agency theory on the other hand was proposed by Ross in (1973). The theory is based on the association between principal and management that oversee day to day operation of the business (Melis, 2007). The relevance of agency theory can be viewed from the fact that when the interest of the capital market participants are protected, selfish interest and such missing link between managers and expected performance by their principal minimized rather than resulting into opportunistic earnings. However, the positive accounting theory, in accordance to Scott (2012), managers can behave in one of two ways: opportunist behavior, which favors their interests over those of other stakeholders, or behavior aimed to apply accounting standards effectively to maximize the company's value. This demonstrated that accounting information could influence managerial and other stakeholders' actual decisions rather than just reflecting their outcomes.

METHOD

Ex-post facto research design was employed. The study population consisting of one hundred and thirteen (113) Non-Financial Listed Firms in Nigeria (NFLF) as at December 31, 2020. A purposive sampling technique was also adopted in line with Otekunrin, *et al.* (2021) to select from ten sectors Services (17), Healthcare (6), Industrial Goods (10), Consumer Goods (16), Conglomerates (5), Oil & Gas (8), Natural Resources (4), ICT (4), Agriculture (4), Construction & Real Estate (2) totaling thirty-seven (76) for the study. The firms were chosen based on availability and accessibility of data (annual report) for the period under consideration from 2010 to 2020. Generalized Method of Moment (GMM) estimator and Dumistrescu and Hurlin Panel Causality Tests were used to analyze data.

Table 1: List of Selected Firms for the Study

Sectors	Non-Financial Listed Firms	Non-Financial Listed Firms with Data Needed for the Study	Non-Financial Listed Firms without Data Needed for the Study
Services	25	17	8
Consumer Goods	20	16	4
Industrial Goods	15	10	5
Oil and Gas	11	8	3
Healthcare	10	6	4
Construction and Real Estate	9	2	7
Information Communication Technology	9	4	5
Conglomerates	5	5	-
Agriculture	5	4	1
Natural Resources	4	4	-
Total	113	76	37

Model Specification

The model for DA is adapted based on previous work of Rahama and Shahrur, (2008) and cited by Elkalla (2017).

DA= TA-NDA

$$NDA_t = \alpha_1 \left(\frac{1}{A_{t-1}} \right) + \alpha_2 \left(\frac{\Delta REV_t - \Delta REC_t}{A_{t-1}} \right) + \alpha_3 \left(\frac{NCA_t}{A_{t-1}} \right) + \alpha_4 ROA_t + \alpha_5 MB_t \quad (3.1)$$

Where,

DA = Discretionary Accruals, TA = Total Accrual and NDA is Non-Discretionary Accrual.
 ΔREV = change in Revenue, ΔREC = Change in Receivable, NCA= Non-Current Asset, ROA, Return on Asset, MB= Market Book Value, $\epsilon_{i,t}$ = Error term. , i=ith firm, t=time period

Thus the study model is as follows:

$$ROCE = f(DA, REM, FSIZE, FAGE) \quad (3.2)$$

$$ROCE = \beta_0 + \beta_1 DA_{it} + \beta_2 REM_{it} + \beta_3 FSIZE_{it} + \beta_4 AGE_{it} + \epsilon \quad (3.3)$$

Table 2: Measurement of Variables and Expected Signs

Variables	Acronym	Measurement and Sources	Apriori Sign
Dependent			
Y ₁ - Return on Capital Employed	ROCE	ROCE (operating profit divided by capital employed). Edi and Jessica (2020),	
Independent			
X ₁ : Discretionary Accruals	DA	Rahama and Shahrur, (2008) model, Elkalla (2017).	-
X ₂ : Real Earnings Management	REM	Rowchowdhury (2006) model. ACFO *-1+ APCO + ADEXP. Shittu, Badmus and Onifade, (2022)	-
Control			
X ₃ : Firm Size	FS	FS measured by log of total asset. Khuong <i>et al.</i> , (2019)	+/-
X ₄ : Firm Age	FA	FA measured by firm age. Onaolapo and Shittu (2022)	+/-

Source: Author's Compilation, (2023)

Where **ROCE** =Return on Capital Employed, **REM**= Real Earnings Management, **DA**= Discretionary Accrual, **FZ**=Firm Size, **FA**= Firm Age. ACFO= Abnormal Cash from Operation, APCO= Abnormal Production Cost, ADEXP = Abnormal Discretionary Expenses

RESULTS

Descriptive Statistics

Descriptive statistics of dependent as well as explanatory variables shown in Table 3. Mean of the ROCE which proxy performance of the sampled companies was 4.1388 while it's median value was 4.099 with a Standard Deviation (SD) of 16.5458. Maximum and minimum values of ROCE was 108.897 and -179.9 respectively. This therefore means that companies with scores higher or equal to 4.1388 are perform better than companies with scores below 4.1388. In the case of Discretionary Accrual (DA), the mean value of the sampled companies was -.0026 while its median value was -.000503 with standard deviation of .235. The maximum value was 2.797 while the minimum was -.95015. The implication of this is that companies with scores higher or equal to -.0026 engaged in DA. The standard deviation of .235 shows a wide dispersal of the DA away from the mean. REM, the mean value of the sampled companies was 9.771 while its median value was -.009248 with standard deviation of .377. The maximum value was 2.103 while the minimum was -2.383. Hence, firms with higher or equal to 9.77 are engaged in REM. For control variables, Firm size proxy by log of total asset shows the average value of 7.17 while its median value was 7.12 with standard deviation of .913. The maximum value was 9.31 while the minimum was 5.09. In the case of firm age, the average firm age was 30 years since the first IPO on the Nigerian stock exchange. Apart from REM and firm age, ROCE, DA and firm size were positively skewed. Study variables particularly, ROCE and DA were highly peaked as shown in the values of their kurtosis.

Table 3: Descriptive Statistics

Variables	ROCE	DA	REM	Firm Size	Firm Age
Mean	4.1388	-.002606	9.7710	7.1734	30.5626
Median	4.0994	-.000503	-.0092	7.1201	35.00
Maximum	108.897	2.7971	2.1031	9.3059	56.00
Minimum	-179.9173	-.95015	-2.3834	5.0927	1.00
Standard deviation	16.5458	.23536	.3773	.91302	13.209
Skewness	3.1186	4.1389	-.1723	.00901	-.7529
Kurtosis	44.9818	53.1932	9.8597	2.3126	2.3959
Sum	1684.499	-1.0605	3.9807	2919.58	12439
Observation	836	836	836	836	836

Source: Authors' Computation, (2023).

Where **ROCE**=Return on Capital Employed, **REM**= Real Earnings Management, **DA**= Discretionary Accrual.

Correlation Analysis

As shown in Table 4, there is a positive and high relationship between ROCE and DA (ROCE/DA=0.58). Also, negative and moderate association exist between ROCE and REM (ROCE/REM=-0.14). However, a positive and moderate association exist between ROCE and firm size (ROCE/FSIZE=0.23). More so, there exists a negative but very weak relationship between ROCE and firm age (ROCE/FAGE=-0.065). The correlation results also show that there is a moderate and positive association between DA and REM (DA/REM=0.22).

Table 4: Correlation Matrix

Variables	ROCE	DA	REM	Firm Size	Firm Age
ROCE	1.0000				
DA	0.5762	1.0000			
REM	-0.1390	0.2150	1.0000		
Firm Size	0.2345	0.0813	0.0325	1.0000	
Firm Age	-0.0654	-0.0261	-0.0003	0.0680	1.0000

Source: Authors computation, (2022).

Where **ROCE**=Return on Capital Employed, **REM**= Real Earnings Management, **DA**= Discretionary Accrual.

Test for Stationarity using Panel Unit Root Test

Levin, Lin, and Chu test was employed to test for stationarity of data as shown in Table 4., all the variables shows stationarity at their level at 5% level of significance (Westerlund & Breitung, 2009).

Table 5: Panel Unit Root test of the Variables

Variable	Statistic	P-Value
ROCE	-2.2371	0.0126
DA	-6.9192	0.0000
REM	-4.3960	0.0000
FS	-2.8678	0.0021
FA	-2.0698	0.0135

Source: Authors' computation, (2023).

Where **ROCE** =Return on Capital Employed, **REM**= Real Earnings Management, **DA**= Discretionary Accrual, **FZ**=Firm Size, **FA**= Firm Age.

Analysis of Effect of Earnings Management on Firm Performance Using GMM

Dynamic research enables the Authors to investigate how earnings management affects the performance in Nigeria. Authors found that because the dynamic model is measured using first differences and includes a lagged variable as an explanatory variable, it results in a loss of observations. As a result, there were 760 observations instead of 836 in the study sample. All explanatory variables, with the exception of firm age, are significant, according to the assessment of the dynamic model's findings. As shown in Table 4.4, DA (one-step $\beta=23.81(P=0.000 <0.05)$; two-step $\beta=73.95 p=0.000 <0.05$) reveals significant and positive influence on firm performance. However, findings shows a negative and significant influence of REM on firm performance (one-step $\beta=-12.65$; $P=0.000<0.05$); two-step $\beta=-60.87$; $P=0.000<0.05$). In addition, firm size (one-step $\beta=5.62$; $P=0.000<0.05$; two-step $\beta=14.36$; $P=0.000<0.05$) is found to be significantly positively influence firm performance. More so, Firm age (one-step $\beta=0.35(0.723)$; two-step $\beta=1.54(0.124)$) had positive insignificant effect on firm performance.

The findings of the Wald and Sargan tests of validity of instrument, and the Arellano-Bond test AR (2), are shown in the lower section of Table 5. The model has an excellent fit, according to the Wald chi2 statistic 651.64 and 160784.24 for one-step and two-step analysis, respectively, with probability value 0.000. The one-step and two-step Sargan test statistics are 34.624 and 32.953, respectively, with probability values of 0.3736 and 0.3913. The over identifying restrictions test's null hypothesis cannot be disproved. This indicates that the tools are reliable. Also, the Z-statistic of the second order autocorrelation test (AR2) revealed -.7721 with a probability value of 0.4400 as well as -5.7592 with a probability value of 0.0003 for one-step and two-step respectively.

Table 6: Effects of Earnings Management on Firms performance

Study Variables	One Step	Two Step
ROCE _{t-1}	-3.44** (0.001)	-208.97** (0.000)
DA	23.81** (0.000)	73.95** (0.000)
REM	-12.65** (0.000)	-60.87** (0.000)
FSize	5.62** (0.000)	14.36** (0.000)
FAge	0.35 (0.723)	1.54 (0.124)
Constant	-6.00** (0.000)	-14.69** (0.000)
First order autocorrelation test	-3.2102** (0.0013)	-4.1035** (0.0011)
Second order autocorrelation test	-.7721 (0.4400)	-5.7592** (0.0003)
Sargan Test	34.624 (0.3736)	32.953 (0.3913)
Wald chi2 Statistic	651.64 (0.000)	160784.24 (0.000)
Firms	76	76
Observations	760	760

Source: Authors' Computation, (2023)

Where **ROCE_{t-1}** =Lagged Return on Capital Employed, **DA**= Discretionary Accrual, **REM**= Real Earnings Management, **FZ**=Firm Size, **FA**= Firm Age. ** means significant at 5%. Bracket () are p-values

Dumitrescu-Hurlin Panel Causality Test for Earnings Management and Firms Performance

In order to determine the direction of causality between EM and firm performance. The study calculated W (W-bar) and Z (Z-bar) statistics which make it possible to have critical and p-values values in order to know either to accept or reject null hypotheses formulated. The result revealed that, ROCE granger caused both DA and REM since their p-values $0.000 < 0.05$. However, DA and REM did not granger cause ROCE, because their p values, 0.1897 and 0.8193 respectively were > 0.05 . This suggests that it is uni-directional causality exists between earnings management and NFLF in Nigeria.

Table 7: Dumitrescu-Hurlin Panel Causality Test for Earnings Management and Firm Performance

Null Hypotheses:	Decision on Null Hypotheses	W-Stat.	Zbar-Stat	p-value
ROCE does not homogeneously cause DA	Rejected	5.1498	8.1460	0.0000
DA does not homogeneously cause ROCE	Accepted	2.0036	1.3113	0.1897
ROCE does not homogeneously cause REM	Rejected	3.0100	3.4976	0.0005
REM does not homogeneously cause ROCE	Accepted	1.5051	0.2284	0.8193

Source: Authors' Computation, (2023).

FINDINGS AND DISCUSSION

The positive and significant influence of DA on firm performance shows that high value corporations engage in EM to avoid reporting profits declines or losses. The results agrees with the empirical findings of Okoro and Ihenyen (2020), but differ with those of Okarfor *et al.* (2018), who discovered a negative and significant relationship between DA and firm performance. Strong evidence that REM is linked to lower levels of performance of non-financial listed enterprises in Nigeria is suggested by the negative and significant influence of REM on firm performance. The results supported by the empirical findings of Elkalla (2017) and Ghaleb *et al.* (2020). The results contradict the conclusions of the study by Khuong, *et al.* (2019). Also, a positive influence of firm size on firm performance shows that performance is improved with increasing firm size. The results is agree with the empirical results of Khuong *et al.* (2019). More so, positive insignificant effect of firm age on firm performance suggests that older firms tend to perform better.

Recommendations for further studies

Nonetheless this research succeeded in answering the stated objectives of the study, there are still some ways in future researchers could improve in the study area. Future studies can assess both financial and non-financial firms together in a comparative ways to determine which collect data from tax authorities as well to have an accurate picture of respondents' actual behavior. More so, this study only based its empirical findings on the compliance of SMEs with VAT in Nigeria. However, corporate organizations could also be considered in the future study to examine how they are complying with VAT compliance. Similarly, three states were selected from each geo-geographic zone. A future study can cover all the states in Nigeria to obtain data for the study. More so, the study was carried out in Nigeria, while further study can consider two or more countries with the same tax system. Future research should consider additional factors such as culture and religion, which may also have an influence on VAT compliance, to extend the research model. Similarly, future studies can also work on compliance with other indirect taxes such as excise taxes and customs fees.

CONCLUSION

This study examines the influence of earnings management (accrual and real) on performance of NFLF in Nigeria. Rahama and Shahur (2008) model and Rowchowdhury (2006) model were employed to measure accrual and real earnings management respectively. Seventy six (76) NFLF with data needed for the study were selected across ten (10) sectors in Nigeria. GMM estimator and Dumitrescu-Hurlin Panel Causality test were used to test hypotheses formulated. The study concludes that discretionary accrual earnings management measured by Rahama and Shahrur (2008) model had positive while real earnings management proxied by Rowchowdhury (2006) model had negative and significant influence on the performance of non-financial listed firms in Nigeria. More so, firm size and firm age shows positive and significant effect on firm value. Thus, the study recommends that, managers to be well informed in order to stop overusing activities that result in negative effects on firm performance in the future and to increase financial transparency. However, the study only focuses on NFLF while further study can consider the effect of accrual and earnings management among financial listed firms.

Disclosure Statement

No potential conflict of interest was reported by the author.

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