Earnings Management and Financial Performance of Listed Industrial Goods Companies in Nigeria

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ABSTRACT

This study examined the effect of earnings management on the financial performance of listed industrial goods companies in Nigeria using Return on Assets (ROA). The study employed an ex post facto research design because of the availability of published data. The population of the study comprised all the 13 listed industrial goods companies as contained on the Nigerian Exchange Group Website and Factbook 2022 for period of the study (2011 to 2021); while census sampling technique was employed to select 11 listed industrial goods companies in Nigeria. Data were analysed using descriptive statistics and inferential statistics of panel regression method. The results revealed that accrued earnings management had a positive and significant effect on profitability The study concluded that earnings management serves as a determinant factor of financial performance of industrial good companies in Nigeria. The study recommended that firms should reassessing their governance structures and practices to prioritize ethical standards. This will help ensure that any earnings management practices are balanced and transparent, maintaining the trust of investors and the integrity of financial reporting.

Keywords: Earnings Management, Financial Performance, Accrued Earnings Management, Return On Assets

INTRODUCTION

The success of any organization in the whole world depends on sound financial management while the financial managers execute financial management practices that determine the success of an organization. Thus, the essence of a manager in the administration of companies cannot be over-emphasized especially as it relates to earnings management. Earnings to shareholders and or stakeholders of any organization serve as the faith of the firm which the stakeholders depend to make returns on capital employed (Nwaobia *et al.*, 2019). Therefore, earnings remain one of the most significant accounting items on the financial statements.

The dwindling performance of the accounting profession both locally and internationally serves as proof that accounting regulations are not fulfilling their intended aim. Proof of this failure can be seen in the various accounting scandals that have been witnessed among corporate organizations in the recent past and the global arena. Some of these companies include high-flying companies not only in Nigeria but also the world over such as Palmer & Harvey in 2017 and Carillion in 2018 in Europe which had also overstated its earnings and cost its shareholders billions of dollars as a result of its bankruptcy (Wangui, 2017).

Accruals earnings management has a tendency to reverse profits over time, which means that any predetermined profits by management strategy may be completely unsuccessful when seen over a long period (Dharan, 2003). The accrual method of earnings management is used by executives while generating financial statements. It involves managers' discretion in the choosing of accounting standards to a higher level (Kothari et al., 2012).

LITERATURE REVIEW

Earnings Management

Okolie (2014) defined earnings as the company's net income generated from its activities which has been described as the most imperative element in the financial statements as they are indicative of the level at which the management has utilized the specific resources of the organization during the accounting period. Earnings symbolize the track of allocation of resources in the stock markets as the speculative company's share value is the present value of its future earnings. Thus, an improved earning is an indication of an improvement in the value of the company and vice versa (Okolie, 2014).

Dokas (2023) defined earnings management as any action on the part of management that affects reported income and which provides no true advantage to the organization and may, in fact, in the long term, be detrimental. Thus, earnings management is the managerial activity that manipulates the reported earnings through the influence that managers have on the financial reporting process. Earnings Management has become an important area of research as it is capable of undermining the value of accounting documents that can pass relevant facts to investors in an organized financial market. According to Kaira (2023), earnings management involves the choice of accounting policies employed by managers to achieve their self-interest by misleading stakeholders via the presentation of distorted financial statements. The need for Earning Management is the basis of the agency's problem. Managers have different advantages for engaging in Earning Management practices, ranging from their remunerations to external contractual benefits. This happens because there is a divergence of interest between agents (managers) and principals (owners) and whenever managers exhibit a devious attitude, owners will be left in doubt about any financial or accounting document presented to the owners; which realistically makes it difficult for them to make an informed economic decision.

To this end, Nnko (2022) shared that earnings management are the alteration of reported firms’ activities by those within the firm either to misguide those that have an economic interest in the firm or to achieve other targets. However, it is expected that agency theory could bring both the agents and principals together by ensuring a common understanding between the two parties. If this is done, agency costs will be reduced drastically. Therefore, from the forgoing definitions, Earning Management can be seen as a deliberate action taken by the management to alter the real reported economic value of the organization to protect the interest of the management of the organization.

Abdelghany (2005) identified the various earnings management often carried out or done by companies to include:Bath, Abuse of Materiality, Cookie jar, Round Tripping, back-to-back and swap, Voluntary Accounting Changes and Conservative Accounting Changes.

Earnings Management and Firms' Performance

Managers engage in earnings management to maximize their personal wealth. Reported earnings in financial statements might not accurately reflect the companies' fundamental position, which steadily results in poor earnings quality (Ching *et al.*, 2015). This is because investors consider the earnings reported in the financial statements to be significant and beneficial in predicting future returns, alteration in the reported earnings in the financial statements may erode investors' confidence. Thus, the absence of investors' confidence in the earnings reported can negatively affect the market evaluation of the company because the investors are the leading set of people that provide needed capital support to the industrial goods companies in Nigeria.

There are mainly two types of earnings management employed by management to manipulate earnings: management of earnings through accounting decisions which is known as accounting earnings management or accrual-based earnings management (AEM) and management of earnings through real business decisions or real activities identified as real earnings management (REM) or real activity-based earnings management (Olotu et al., 2019).

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Financial Performance

Financial performance is a class of financial metrics that are used to assess a business's ability to generate earnings compared to its expenses and other relevant costs incurred during a specific period. It is defined in this study as the ratio of profit after tax to total assets which implies Return on Assets (ROA) and Return on Equity (ROE).

Return on Assets (ROA)

Return on assets (ROA) measures the rate at which the companies' assets are put to use and the yield from the effective and efficient use of total assets and it can be measured as profit after tax divided by total assets. ROA is generally considered a good internal management ratio because it measures profit against all the assets an organization uses to make earnings. It shows the percentage of how profitable a company's assets are in generating revenue. Hence, it is a way to evaluate the organization's profitability, performance, and effectiveness. ROA provides good information about a firm's financial performance in terms of using assets to create income. Thus, it is considered a measure of efficiency too. A firm with a high ROA means that it is good at turning assets into profits (Zubair, 2016).

METHODOLOGY

The study employed *ex post facto* research design. The population of the study consisted of thirteen listed industrial goods companies in the Nigerian Exchange (NGX). Census sampling technique was used to select 11 listed industrial products companies for the period 2011-2021

List of Sampled Industrial Goods Companies

S/N	Company Name
1.	Austin LAZ & Company Plc
2.	Beger Paint
3.	Beta Glass Plc.
4	CAP Plc.
5	Cutix Plc.
6.	Dangote Cement
7.	Greif Nigeria Plc.
8	Lafarge Africa Plc.
9.	Meyer Plc.
10.	Premier Paint Plc.
11.	Tripple Gee & Coy Plc.

Information on all variables were analyzed using descriptive and inferential statistics. The descriptive statistics used included measures of central tendency such as mean, maximum, and minimum and measures of variability such as standard deviation, skewness, and kurtosis. The inferential statistics employed include Ordinary Least Square OLS technique-multiple Regression Analysis, fixed and random effect panel regression, and Pearson Product Correlation Analysis using the E-view 12 version to determine the relationship between a dependent

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variable and independent variables.

Model Specifications

ROA= f (AEM, FIS,)

$$ROA_{it} = \beta_0 + \beta_1 AEM_{it} + \beta_4 FSI_{it} + \varepsilon_{it}$$

Where;

ROA_{it}= Return on assets of firm i at time t

AEM_{it}= Accrued earnings management- Discretionary Accrual (DAC)

FSI_{it}= Firm size of firm I at time t

$\beta_{0,}$ intercept,

$\beta_{1-}\beta_4$ are estimated coefficients for the model

μ_{it}= Error term of firm I at time t

Measurement of Variables

Variables	Type of Variable	Variable Labels	Measurement	Source	Expected sign
Return on Asset	Dependent	ROA	profit after tax x 100 Total assets	Abdullahi *et al*. (2020)	
Accrued Earnings	Independent	AEM	Discretionary Accrual (DAC)	Olotu *et al* (2019)	
Firm size	Control	FSI	Natural log of total assets	Khuong *et al*. (2020)	±

Estimated Descriptive Statistics

	ROA	AEM	FSI
Mean	1.7921	0.0968	7.1006
Median	1.4731	0.0612	6.9083
Maximum	10.7000	0.6499	9.2609
Minimum	-8.5514	0.0001	5.0927
Std. Dev.	2.0306	0.1161	1.0219
Skewness	-0.1447	3.0369	0.3898
Kurtosis	11.7039	13.6276	2.4917
Jarque-Bera	382.3713	755.4166	4.3664

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Probability	0.0000	0.0000	0.1127
Sum	216.8368	11.7188	859.1669
Sum Sq. Dev.	494.7918	1.6168	125.3118
Observations	121	121	121

The summary statistics, as displayed, illustrate that the computed average return on assets (ROA) for the sampled listed industrial goods companies stands at 1.7921, with a range spanning from min -8.5514 to max 10.7000. The associated standard deviation of 2.0306 underscores a substantial degree of variation in the ROA among Nigerian-listed industrial goods companies. The results further indicate that the average value of accrued earnings management stands at 0.0968 with minimum and maximum values of 0.0008 and 0.6499 respectively with a standard deviation of 0.1161. This shows that the level of accrued earnings management of the sampled industrial goods firms was minimal and encouraging.

Dependent Variable: ROA				
Method: Panel EGLS (Cross-section random effects)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.4726	1.7109	-2.6141	0.0101
AEM	1.9976	1.0071	1.9836	0.0502
FS	0.8634	0.2333	3.6997	0.0003
R-squared	0.1042	Mean dependent var		1.2099
Adjusted R-squared	0.0890	S.D. dependent var		1.848
S.E. of regression	1.7647	Sum squared resid		367.48
F-statistic	6.865	Durbin-Watson stat		2.2154
Prob(F-statistic)	0.0015			
Hausman Test	1.8226			
Prob	0.4020			

Source: E-view output Version 13.0

From the results of the random effect panel regression in Table 4.4.1, accrual earnings management had a positive and significant effect on ROA (coeff. = 1.9976; p<0.05) which implies that If firms effectively use accrual earnings management, it can lead to an improved perception of their financial health. This may enhance investor confidence and positively affect stock prices, as well-managed earnings can signal better future prospects. Investors may rely on reported earnings as a key indicator of a firm's performance. Positive accrual earnings management can lead to higher reported earnings figures, encouraging investment. However, it is crucial for investors to scrutinize the sustainability of these earnings to avoid potential losses from inflated financial reporting. With regards to the control variables it was found that firm size recorded positive influence which is significant suggesting that larger firms attracted more profitability in term of return on assets

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Estimated Panel Regression Results Dep (ROA)

Variables	Restricted Pool Effect (1)	Unrestricted Fixed Effect (2)	Unrestricted Random Effect (3)
C β_0	-4.5474***	-4.9089***	-4.7868***
t-v *p-v*	(-3.5376) (0.0006)	(-4.0586) (0.0001)	(-3.9153) (0.0002)
AEM β_1	2.8048**	2.9679**	2.8029**
t-v *p-v*	(2.0167) (0.0478)	(2.1199) (0.0428)	(2.0156) (0.0479)
FSI β_4	0.9145	0.9494	0.9377
t-v *p-v*	(5.4250) (0.0000) ***	(5.9868) (0.0000) ***	(5.9422) (0.0000) ***
R^2 Dw F-stat	0.2279 2.2199 8.5586 (0.0000)	0.3928 1.7463 4.8977 (0.0000)	0.2531 1.8498 9.8277 (0.0000) 3.7674(0.4384)

t- and p values in parentheses,

P-val<0.01***, P-val<0.05**, P-val<0.10*,

Source: E-view,13.0

The table above shows the P-value of the Hausman Test of (0.4384) which implies that Random effect is most preferred. The probability value of <0.05 and F-stat. 9.8277 showed that the model is fit and significant at a 5% level of significance and the variables were properly selected and combined. This implies that earnings management with associated control variables has a favourable influence on the profitability of sampled Nigerian consumer goods firms. R^2 of 25 % of the total variation of profitability is explained by the explanatory variables and the remainder of 75% is not explained which is accounted for by the random error term. Durbin Watson value of 1.8498 indicates there is no auto correlation and that all predictor's variables were taken as a part of factors that determined the financial performance.

The results revealed that accrued earnings management (coeff. =2.8029, P<0.05) had a positive and significant effect on profitability. By implication, accrual earnings management can sometimes prioritize short-term financial performance over long-term sustainability. Firms may benefit in the short run, but this approach can lead to issues such as reduced cash flows and operational inefficiencies if not carefully managed.

DISCUSSION OF FINDINGS

This study adopted the random effect regression results based on the Hausman test carried out which showed that it is the most appropriate in testing the hypothesis. The result revealed that accrued earnings had a positive and significant effect on profitability. The results implied that return on assets is sensitive to the changes in the accrued earnings management among Nigerian listed industrial goods firms. It raises concerns about transparency and accountability. Stakeholders must be aware that aggressive earnings management practices could mislead them regarding the firm's true financial condition, leading to misguided investment decisions. The significant role of accrual earnings management could attract attention from regulators. If firms are seen to manipulate earnings to present favourable financial results, regulatory bodies may impose stricter guidelines on financial reporting practices.

Summary

The study examines the influence of earnings management on the financial performance of listed industrial goods companies in Nigeria. Earnings management was measured by accrued earnings management while financial performance was measured in terms of return on assets. Objective is to examine the relationship between accrued earnings management and return on assets of listed industrial goods companies in Nigeria. The test of hypotheses showed that accrued earnings management had a positive and significant effect on profitability of listed industrial goods companies in Nigeria

CONCLUSION

A positive and significant impact of accrual earnings management on the financial performance of listed firms in Nigeria underlines the importance of balancing effective earnings management strategies with ethical practices and regulatory compliance to ensure sustainable growth and stakeholder trust.

RECOMMENDATION

The management of firms should indeed consider reassessing their governance structures and practices to prioritize ethical standards and long-term value creation over short-term financial gains.

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