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COMPANY PROFITABILITY AND EARNINGS CONTROL: A LOOK AT COMPANIES LISTED ON THE NIGERIA EXCHANGE GROUP

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ABSTRACT

This research aims to analyze how company performance affects the veracity of reported earningsfor Nigerian stock-market businesses. Earnings management in the sample firms was analyzedusing the m-score model. Accounting metrics and average industry profits have been used toevaluate the company's success. The study's results clearly distinguish between the most critical factors that affect the earnings quality of businesses in Nigeria's industrial sector. This study also demonstrates the effects of financial firm size, profit before taxes, returns on assets (ROA), returnson capital employed (ROCE), depreciation business index (DEPI), and leverage index (LVGI) onthe performance of Nigerian firms listed on the Nigerian stock market. This study also confirmsprevious findings that the sales general administration index is not significantly correlated withbusiness success.

Keywords: Earnings Management; M-Score Model, Financial Performance Indicators.

INTRODUCTION

Diverse groups worldwide are interested in earnings management since it is a topical issue. Worldwide financial instability has highlighted the need for transparency in corporate accounting practices. Absurd financial reporting practices that aim to undermine the interests of the company's stakeholders have contributed to the decline of significant businesses (Huizing and Laeven, 2014 1. 111: Taylor 2016). Several Nigerian banks, including Oceanic Bank Plc, Societe Generale Bank Ltd, and All States Trust Bank, failed in the late 1990s and early 2000s, highlighting problems withthe country's corporate governance and financial reporting. The CBN and NXG have implemented increased corporate transparency and accountability initiatives to foster more informed decision- making and better protect stakeholders' interests. It has been noted that most of these studies have been conducted in industrialized countries. In contrast, only a fraction have considered the implications for developing economies like Nigeria's. Therefore, this research aims to examine the connection between RESE capital market performance indicators and firms' strategies for managing their earnings that are traded on the Nigeria Exchange Group. There are seven main parts to this research. The first part of this paper aims to close a gap in the literature by studyinghow earnings management affects the success of businesses trading on the Nigerian Stock Exchange. Section 2 discusses the research that had gone before, whereas Section 3 details the procedures used to conduct the research. The results are broken down and explained in the fourthand fifth sections. The research is summarized in the sixth chapter, while the previous chapter focused on the factors that may eventually contribute to the firm's demise.

REVIEW RELATED LITERATURE

Conceptual framework

Schipper used the term for the first time in 1989 to describe the "management of purposeful intervention in the external financial reporting process in order to get some private gains." On the other hand, Healey and Wahlen (1999) define earning management as "the practice of managers using their discretionary powers in the financial reporting process to manipulate financial reports to either mislead some stakeholders about the real economic performance of the company or to influence contractual outcomes that depend on produced financial information and accounting numbers."

Hypotheses Development

With regards to banks and their use of creative accounting, Gunther and Moore (2003) investigated the connection between LLP and realized gain and loss from the sale of securities and investments. They stood in for the technique of income smoothing with a loan loss provision. They found that banks' use of "creative accounting" was consistently related to LLP and realized gain/loss on the sale of securities and investments. In their research on Indian financial institutions, Beatty and Liao (2011) and Bushman and Williams(2012) used trend analysis in place of a model-specific model to find evidence of profit management methods through the periodic volatility in banks' provisioning. Prior studies have shown that banking provisions and securities gain and losses are valuable indicators of earnings management. The modified Jones model is the go-to for sales-based industries where revenue and net assets can be adjusted for accruals at managers' discretion. However, models that accountfor the unique aspects of the banking and financial services industries are required. Therefore, inthis study, we employ Professor Messod Beneish's model, which utilizes 8 variables linked to financial measures, to isolate the effects of earnings management on the performance of Nigerianlisted businesses. In light of this, the authors of this study evaluated the correlation between earnings management and the efficiency ratios (ROA, ROCE, PBT) of Nigerian stock market businesses. In light of this, the research proposes the following hypothesis.

The research's hypotheses, which the literature will support, are listed below in their Null versions.

H1: In Nigerian listed firms, there is no connection between the day sales receivableindex and firm performance.

H2: In Nigerian listed companies, there is no correlation between sales generaladministration index and firm performance.

H3: The depreciation index and company performance are unrelated.

MATERIAL AND METHOD

Method of Data Collection

From 2015 to 2020, time series and cross-sectional data of the sample firms listed on the Nigerian Exchange Group were gathered from the Federal Ministry of Finance, the National Bureau of Statistics, the Central Bank of Nigeria, and other CBN annual publications. However, using the purposive sample approach, 10 listed companies from the Nigerian stock exchange market were chosen and examined for the study.

Model definition and variable definition for the operation

Regression analysis, a statistical method for identifying correlations between variables to forecast future values, is used to examine the data. by applying the formula;

$EM = a0 + a1ROA + a2ROCE + a3FIRM\ SIZE + a4PBT + \mu$

This can be written in an explicit form as

$DSRI = a0 + a1ROA + a2ROCE + a3FIRM\ SIZE + a4PBT \ldots\ldots.(1)$

$SGAI = a0 + a1ROA + a2ROCE + a3FIRM\ SIZE + a4PBT \ldots\ldots(2)$

$DEPI = a0 + a1ROA + a2ROCE + a3FIRM\ SIZE + a4PBT \ldots\ldots..(3)$

$LVGI = a0 + a1ROA + a2ROCE + a3FIRM\ SIZE + a4PBT \ldots\ldots\ldots(4)$

Where:

$EM = Earning\ management$

$ROA = Return\ on\ asset. This\ is\ computed\ by\ dividing\ profit\ before\ tax\ by\ the\ total\ firm\ assets, which\ is\ a\ proxy\ for\ firm\ performance$

$ROCE$ = *Return on capital employed. This is computed by dividing total equity by the firm's total assets.*
It is a proxy of a firm's performance.
$FIRM\ SIZE$ = *Total asset of the firm. It is a proxy of a firm's performance*
PBT = *Profit before tax. It is a proxy of firm performance*
$DSRI$ = *Daily sales receivable index. It is a proxy of earnings management.*
$SGAI$ = *SellingGeneral and Administrative expense*
$DEPI$ = *Depreciation index*
$LVGI$ = *Leverage index*
μ = *Error term*

A priori expectation of coefficient of estimates

The primary model used in this study is EM= +UIROA + ROCE+U3FIRM assessing the impact of firm performance on reported earnings stock exchange. This study expects a positive impact on ROA, ROCE, and management. For the formulated hypotheses, earnings management was decomposed into the following variables: Day sales receivable index (DSRI), Sales General Administrative index (SGAI), Depreciation index (DEPI) and leverage index (LVG1).

Data estimation Techniques

Researchers used both descriptive and inferential statistics in their analysis. In this case, the panel least squares method was employed to determine the connection between company financial performance and reported earnings. The secondary data utilized in this investigation had both cross-sectional and time-series components. Therefore it was appropriate to apply panel data estimation. Additionally, a Granger causality test was performed in E-VIEW 9.0, with the variables log-linearized to ensure they were of similar size.

RESULTS AND DISCUSSION

Earnings manipulation by publicly traded corporations is detailed in table 4.1 below. All the firms in the samples manipulate their earnings to some degree, as evidenced by the indexes. For DSRI, SGAI, DEPI, and LVGI, the average manipulated earnings are -0.26556, -0.0544, -0.6328, and -0.0290, respectively.

Table 4.1. Summary of Descriptive Statistics

	LOG(DSRI)	LOG(SGAI)	LOG(DEPI)	LOG(LVGI)	LOG(ROA)	LOG(ROCE)	LOG(FSIZE)	LOG(R
Mean	-0.265688	0.054466	-0.632814	-0.029006	-3.016725	-2.381810	17.99668	15.61705
Median	-0.146761	0.108072	-0.092297	0.006727	-2.943140	-2.246205	18.09629	15.85025
Maximum	0.571601	0.593437	0.386894	0.597187	-0.618782	-0.336732	20.66809	18.30106
Minimum	-2.643668	-0.669431	-9.210340	-0.553385	-5.744604	-8.111728	14.60408	12.11250
Std. Dev.	0.660081	0.285702	1.975902	0.267847	1.168653	1.600166	1.400525	1.278247
Skewness	-1.935792	-0.621997	-3.765812	0.249484	-0.052940	-1.536383	-0.834443	-0.692784
Kurtosis	7.762360	3.256630	16.03331	2.855637	2.676429	6.233208	3.742327	3.671900
Jarque-Bera	62.78205	2.688968	377.6542	0.449682	0.178693	30.67227	5.421378	3.655671
Probability	0.000000	0.260674	0.000000	0.798643	0.914529	0.000000	0.066491	0.160761
Sum	-10.62750	2.178623	-25.31255	-1.160246	-111.6188	-88.12698	701.8703	577.8307

Sum sq. Dev	16.99255	3.183402	152.2634	2.97946	49.16701	92.17915	74.53584	58.82099
Observation	40	40	40	40	37	37	39	37

Authors Computation 2022

Table 4.2 Correlation Test Analysis

	L(DRSI)	L (SGAI)	L(DEPI)	L(LVGI)	L(ROA)	L(ROCE)	L(F.SIZE)	L(PBT)
LOG (DRSI)	1.000000	0.097556	-0.256485	-0.267684	0.094005	-0.337915	-0.198431	-0.114630
LOG (SGAI)	0.097556	1.000000	0.185461	0.261965	0.291627	-0.221676	0.152956	0.394337
LOG (DEPI)	-0.256485	-0.185461	1.000000	-0.324949	-0.293513	0.230692	-0.056170	-0.314169
LOG (LVGI)	-0.267684	0.261965	-0.324949	1.000000	-0.070218	0.051645	-0.026137	0.249917
LOG (ROA)	0.094005	0.291627	-0.293513	-0.070218	1.000000	0.007912	0.164463	0.418216
LOG (ROCE)	-0.337915	-0.221676	0.230692	0.0051645	-0.007912	1.000000	-0.051376	0.003339
LOG (F.SIZE)	-0.1981	0.152956	-0.056170	-0.026137	0.164463	-0.051376	1.0000000	0.659511
LOG (PBT)	-0.114630	0.394337	-0.314169	0.249917	0.418216	0.003339	0.659511	1.000000

Authors Computation 2022

Before moving on to regression, it is necessary to do a correlation analysis. Critical variables that exhibit strong associations should be considered for regression analysis in the same model. Table 4.2 shows the association between the two variables. There is no statistically significant relationship between SGAI, DEPI, ROA, or ROCE. Nonetheless, there are a few meaningful connections that must be made. There is a very significant positive correlation between DSRI and LOGROA (0.0940), a weakly significant positive correlation between DEPI and LOGROCE (0.23069), and a highly significant positive correlation between LVGI and LOG, ROCE, LOGPBT (0.05164, 0.2499). These show that improvement in the linked variable may be expected from a rise in any of the favourable variables. The associated variable will improve performance if another crucial positive variable is introduced. The negative connection between LVGI and LOGRO is also statistically significant.

Table 4.3 Regression Analysis

Variables	**Equations**											
Dependable variable	**DSRI**			**SGAI**			**DEPI**			**LVGI**		
	Coeff.	t-statisti cs	P-value	Coeff.	t-statisti cs	P-value	Coeff.	t-statisti cs	P-value	Coeff.	t-statisti cs	P-value
Constant	0.9275	3.8253	.0009	0.9691	6.1945	0.000	1.1511	7.4800	0.000	0.7879	5.3303	0.0000
ROA	0.7615	1.2193	0.2351	0.2426	0.6020	0.53330	0.6360	1.6042	0.1223	0.5449	- 1.4311	0.1658
ROCE	0.7283	-25971	0.0161	- 0.3791	- 1.9293	0.0661	0.5127	2.8800	0.0085	0.2154	- 1.2601	0.2202

FIRMSIZE	- 1.10E 09	- 1.3684	0.184 4	1.96E 08	- 0.3791	0.708 1	1.84e09	3.6149	0.001 5	- 4.97e 10	- 1.0158	0.320 3
PBT	1.59E 09	1.0343	0.311 7	1.90E 08	1.9155 2	0.068 0	- 5.33e087.4 80	- 5.4575	0.000	2.44e 08	2.6022 3	0.015 9
ECM(-1)	- 0.0044	- 0.1319	0.896 2	0.0026	0.1208	0.904 9	-0.0469	- 2.1859	0.039 3	0.029 1	1.4152	0.170 4
R^2	0.3107			0.0362			0.576			0.2618		
R^2_{ADJ}	0.1609			0.2241			0.484			0.1014		
t-test	7.0740			5.6183			6.25			8.632		
P- VALUE	0.0075			0.00714			0.0081			0.00823		

Authors Computation 2022.

There is no goodness of fit in the model specification, as indicated by the modified R square values of 16% for DSRI, 22% for SGAI, and 10% for LVGI. According to Gujarati and Porter (2009), the closer R2 is to 1, the better the model fit is considered to be. They argued that some of the regression coefficients are statistically insignificant or have signs that run counter to a priori assumptions. Hence, the goal of regression analysis is not to attain a high R2. As a result, a low R2 is not always indicative of a poor model, and the researcher should be more concerned with the logical theoretical relevance of the regressor to the regressand and their statistical significance. The P-values of the f-statistics derived in the ECM are 0.0075 for DSRI, 0.0071 for SGAI, 0.0081 for DEPI, and 0.0082 for LVGI based on the link between the f-test and R2. Testing the overall significance of regression in terms of R2 is an alternative but equal to the F-test. At the 1% significance threshold, this is a significant and low number. The F-statistics validate the validity of the model specifications for cases 1-4.

Consequently, we should reject the null hypothesis and instead infer that earnings management is related to the success of businesses. The results indicate that all the predictor variables were included in the regression model at once and that the coefficients for ROA, ROCE, and FIRM SIZE are positive and statistically significant. In contrast, the coefficient for PBT is positive but not statistically significant. Existing literature implies that Return on Assets (ROA) and Return on Capital Employed (ROCE) influence earnings management, and the positive trend of ROA and ROCE is consistent with these claims. There is a negative correlation between business size and profitability, which is counterintuitive—the existing body of evidence demonstrates that business size affects reported earnings. Since the PBT is positive but not statistically significant, it may be concluded that it has no bearing on DSRI. The most eye-opening finding concerns the second equation (with SGAI as the dependent variable): only ROCE and PBT are positive but insignificant at the 1% level, while ROA and firm size are negative but insignificant. This data indicates that SGAI is unrelated to firm performancein Nigeria-listed companies. Hence we accept the be f null hypothesis that ROA, ROCE, FIRM - SIZE, and PBT do not affect SGAI. Most notably, the loop analysis of the third equation (with DEPIas the dependent variable) reveals that ROA and ROCE are positive and statistically significant at the less-than-1% threshold. PBT is negative but not statistically significant, while the firm size is positive but not statistically significant. It appears that DEPI is positively related to ROA, ROCE, and firm size. As a result, we find a correlation between the depreciation index and the performance of Nigerian businesses. So we cannot accept the alternative hypothesis, which assertsthat there is no correlation. Since the GM analysis of the equation (with LVGI as the dependent variable) reveals that ROA and ROCE are both positive and significant at the less-than-1% level, firm size is negative and significant. PBT is positive but not significant. We reject the null hypothesisthat there is no relationship between leverage index and firm performance in Nigeria's listed companies. The study shows that ROA and ROCE are both positive and statistically significant at the less-than-1% level for the equation (with LVGI as the dependent variable). In contrast, form size is negative and statistically significant, and PBT is positive but not statistically significant. Asa result, we find that the leverage index does correlate with firm performance in Nigeria-listed companies, thereby contradicting the null hypothesis.

DISCUSSION

The results of this article agree with those of Sarkar et al.(2014), who found evidence of earnings management practice in Nigerian listed businesses. This work contrasts with Sarkar et al. (2014), who utilized a modified Jones model to calculate earnings management by using a model developed by professor Messod Beneish, called the "m-score" (1999). In addition, the researchers discovered a tangible link between earnings management methods and several market indicators for business performance (ROA and ROCE ratio) for companies listed on the NXG. DSRI, DEPI, and LVGI, which are utilized as proxies for earnings management in this study, are significantly correlated with company performance (ROA, ROCE, FIRM SIZE, PBT). However, the size of SGAI was found to have a negative correlation with firm performance in publicly traded companies. This study's findings are consistent with those of comparable studies. According to research conducted by Kilie et al. (2014) on Turkish banks, the likelihood of engaging in earning management actions is proportional to the degree to which banks' profits and earnings are negatively affected. Fang's (2009) research shows that earning management's size climbs, stabilizes, and decreases as the firm's performance improve.

SUMMARY

This article provides empirical evidence that Nigerian publicly traded corporations engage in revenue-boosting earnings management practices. Because the firm characteristics impacting firms' earnings management methods Viz DSRI and DEPI, SGAI and LVGI were calculated in this study, the emphasis is on the value of the company-based; model employed by Professor M Beneish (1999). Earnings management techniques were also shown to have a strong correlation with firms' four key performance measures (ROA, ROCE, PBT, and FIRM SIZE) studied in this study. Ultimately, the report concludes that a company's operating profit affects the rate of earnings management and that managers are motivated to engage in earnings management practice by the inherent uncertainty of their companies' performance to present the desired financial statement to the stakeholders.

FUTURE IMPLICATIONS AND LIMITATIONS

This study used Beneish's m-score to examine whether or not enterprises in Nigeria engage in earnings management (1999). This research establishes a link between the financial success of Nigerian public firms and their use of established management techniques for increasing their bottom line. The study's findings may be applied to estimating the frequency with which wages are manipulated and determining the components that contribute to earnings manipulation. The study's results may be used to spot the weaknesses in Nigeria's stock market that favour earnings management and to devise control mechanisms to prevent this practice from distorting businesses' financial statements. Due to the study's limitations, such as the small sample size and the narrow focus on the financial services industry, additional research could benefit from the inclusion of additional dependent variables such as Total Accrual to TOTAL ASSET (TATA), Sales Growth Index (SGI), Asset Quality Index (AQI), and Gross Margin Index (GMI) (GMI).

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