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EARNINGS MANAGEMENT AND FINANCIAL PERFORMANCE OF QUOTED DEPOSIT MONEY BANKS IN NIGERIA

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ABSTRACT

This study empirically investigated Earnings Management (EM) and Financial Performance of the Nigerian Deposit Money Banks (DMBs). Population comprised DMBs quoted on the Nigerian Exchange Group. Data that spanned from 2012 – 2018 were gathered from the selected quoted DMBs in Nigeria. The simple linear regression method was used in analyzing data. The research findings disclosed significant effect of EM on DMBs' financial measures - Earnings Before Interest, Tax, Depreciation and Amortization; Dividend Pay Out Ratio; and Net Profit Margin. The study concluded that earnings management exists in DMBs and it has significant negative and positive effects on their financial performance.

Keywords: Earnings Management, Financial Performance, Deposit Money Banks, Nigeria.

INTRODUCTION

Financial statements play important roles in corporate businesses. Managers report information concerning their firms to the owners and other interested parties through the financial statement. Considering the crucial roles financial statements play to investors/shareholders visible in company performance, managers regularly try as much as it would take to ensure that the financial statement presents an enticing view to the investors and owners of the business. One of the means used in misleading the firm owners is through earnings management, as it is the more secured and officially authorized, and doesn't breach Accounting principle (Haryudanto & Yuyetta, 2011). It is a problem that has gained importance as Managers of companies have been reported to use various accounting methods to misinform those that use financial statements on their accurate financial performance, hence gain at the expense of the owners and users of the financial statement Chakroun & Amar (2021).

Banks are frequently not included in earnings management research since their operations are different from the other corporate entities. However, they may have prudential guidelines mandated by the central bank. Earnings management can exit in the banks due to restrictions in regulations (Healy and Wahlen, 1999; Cheng, Warfield, and Ye, 2011). Studies have shown that earnings management problem is more common in economies that have feeble rules of law in comparison to those whose rules of law are strong, especially on financial matters (Dyreng, Michelle, & Edward 2011). And so Nigeria is one country that has rules which are often not practiced, thus the probability of earnings management would be high. The frequent collapse of financial banks like Afribank Plc, Spring Bank Plc, Oceanic Bank plc, which were eventually acquired by other banks in Nigeria is another problem that has led to the interest of looking into the practice of earnings management in the banking sector as more banks keep collapsing including the very recent one; Diamond Bank. These in addition to others resulted in governance practices challenges faced by the DMBs. Based on these stated problems, the paper intended to achieve the below-stated objectives.

Research Objectives

The study's major purpose was to investigate the effect of earnings management on the financial performance of Deposit Money Banks (DMBs) quoted on the Nigeria Exchange Group. The specific objectives of the study are to:

i. Determine the effect of Loan Loss Provision (LLP) on Earnings Before Interest, Tax, Depreciation, and Amortization (EBITDA) of quoted DMBs in Nigeria

ii. Ascertain the effect of Loan Loss Provision on the Dividend Pay Out ratio (DIVPO) of quoted DMBs in Nigeria

iii. Find out the effect of Loan Loss Provision on Net Profit Margin (NPM) of quoted DMBs in Nigeria

Research Hypotheses

The researchers hypothesized the following null statements for this study

Ho_1. The effect of Loan Loss Provision on Earnings Before Interest, Tax, Depreciation, and Amortization (EBITDA) of quoted DMBs in Nigeria is not significant.

Ho_2. The effect of Loan Loss Provision on the Dividend Pay Out ratio (DIVPO) of quoted DMBs in Nigeria is not significant.

Ho_3. The effect of Loan Loss Provision on the Net Profit Margin (NPM) of quoted DMBs in Nigeria is not significant.

REVIEW OF RELATED LITERATURE

Conceptual Review

Concept of Earnings Management

Earnings management (EM) can be referred to as creative accounting or aggressive accounting. Roman (2009), states that EM happens when company managers have the chance of making accounting resolutions which alters reported earnings and utilize those chances. EM or Creative accounting is defined by Ignacio (2009) as an accounting practice which deviates from a normal accounting practice. The practice is typified by too much collection as well as the use of new customs of manipulating revenue, assets, and liabilities. This has resulted in the latest uncountable accounting scandals and numerous plans aimed at reforming accounting which focused on up-to-date scrutiny of finances and factors of production which properly reveal the means of adding values (Osisioma & Enahoro, 2006). Mulford and Comiskey (2002) define it as the lively manipulation of income in the direction of a preset goal. Similarly, Assurance Handbook (2003) defined it as the recording of accounting data, exclusive of any occurrence to rationalize the accounting or the failure to properly record transactions to change outcomes.

Earnings Management (EM) and Financial Performance

A study by Farooqi, Harris and Ngo (2014) showed that significant associations exist between EM and financial performance. Similarly, Hassan and Ahmed (2012) posit that EM affects firms' financial performance. Although, Okafor, Ezeagba, and Onyali (2018) & Saidu, Ibrahim, and Muktar (2017) claimed no significant effect of EM on firms' financial performance. Harrison and Freeman (1999) insisted that the connection between EM and company performance varies in terms of the quality of the firms' managers. Fernandes and Ferreira (2007) reported that accumulation that centers on earnings management might adversely influence shareholders' accurate knowledge of the actual financial performance of the organization. Hence, this might affect the continuing performance of the companies' response to surprises. In respect of this, an accumulation that is centered on EM adversely affects firms' financial performance.

Concept of Loan Loss Provisions

Banks giving out loans to borrowers frequently results in credit risk when borrowers find it difficult to pay back the loans as a result of adverse economic situations and associated issues. In reducing credit risk, banks in principle set out a specified portion of the money as an absorber to reduce predictable losses on banks' loan portfolios. This portion of the money is known as Loan Loss Provisions (LLPs) also known as Provisions for Bad debts. Thus, LLP positively connects with the level and opening amount of non-performing loans, and entire loans, since issuing additional loans increases the risk of defaulting in loans which makes banks to increase their LLP (Kanagaretnam, Lobo & Yang, 2004; Othman and Mersni, 2014) LLP is a reduction from banks net interest income to augument likely credit losses on the loan portfolio of banks. (Ozili, 2015).

Theoretical Framework

The study is explained by different theories as follows:

Agency Theory

Agency theory propounded by Jansen and Meckling (1976), clarifies the association between the proprietors of businesses (i.e. the principals) and the managers (i.e. the agents). The proprietors hire managers to operate their businesses on their behalf, and these managers are expected to work for the proprietors' interests but sometimes satisfy their interests rather than that of the proprietors which brings about problems between them. Agency theory relates to this study as managers are motivated according to Booth & Schulz (2004) and Shapiro (2005) to administer earnings for increased bonus, compensation, and commission for them which are directly attached to the firms' income.

Signal Theory

Signal theory was developed by Micheal Spence in 1973. According to this theory, accounting figures are very important to the users, especially the investors. In the capital market, investors carry out financial analysis of the firm using the accounting figures, hence base their economic decisions on it. The theory assumes that accounting figures need to be the genuine and correct tool for signaling market trends as they enable investors to assess the firm real value. The signal theory relates to this study as earnings management results in information asymmetry between investors and firm management.

Empirical Review

Earnings management is not new to the research world and so a lot of research has been carried out on it. The review of other works done on this subject matter: earnings management includes:

Chakroun and Amar (2021) investigated the impacts which earnings management has on financial performance and also used corporate social responsibility to moderate the effects of the variables. Data were obtained from quoted French firms. Analysis of data was done using Feasible Generalized Least Square Regression method. Results showed the independent variable significantly and negatively affects the dependent variable.

Alrjoub, Almomani, Al-Hosban and Allahham (2021) assessed the relationship between financial performance of Jordanian financial firms and their earnings management practices behaviours. Finding revealed a statistically significant correlation between financial performance and earnings management practice.

Nelwin, Mambu and Tansuria (2021) studied "audit reputation, financial performance and earnings management" Nineteen quoted Indonesian manufacturing firms were sampled and analysis of data was done using structural equation modeling. The outcome showed that the mediating variable does not have any mediation on the effects of the independent variable on the dependent variable.

Tonye and Sokiri (2020) examined the influence which financial leverage has on earnings management of quoted Nigerian manufacturing companies". 29 firms were sampled. OLS was employed in analyzing data. The outcome disclosed evidence of financial leverage having insignificant influence on accruals earnings management of the sampled firms but has an influence on actual earnings management and its deferred tax aspect.

Chakroun and Amar (2019) evaluated earnings management and financial performance in France. Data were obtained from 2010 to 2014. Result indicated that the independent variable negatively impacts the dependent variable measured as ROE and ROA. However, it positively impacts the dependent variable when measured as Tobin Q and Marris ratio.

Farouk and Isa (2018) studied earnings management in Nigerian DMBs. The findings revealed that loan loss provision, total assets, loan charge off, and opening balance of loan loss significantly affects discretionary loan loss provision of the banks.

Abbas (2018) also examined earnings management in the banks and it impacts firm value. The population was 33 banks, out of which 23 of them quoted in Indonesia Stock Exchange from 2007-2014 were sampled. Multiple regressions were employed in analyzing data. Findings revealed that the independent variable has no mean differences in the two IFRS eras.

Olaoye and Adewumi (2018) investigated how corporate governance affects earnings management of the Nigerian DMBs. The data were extracted from the sample banks. The Pearson method was adopted in analyzing data. Result revealed that independent directors on the board and leverage negatively and significantly affect the dependent variable.

Okafor, Ezeagba, and Onyali (2018) examined how earnings management affects performance of Nigerian firms. 17 firms were sampled. A simple regression technique was used in analyzing data. The findings showed that the independent variable negatively and insignificantly affect the dependent variable. The recommendation made was that further research should be done in all the sectors to find out the industries in which the subject matter significantly affects their performance, which will help management by exception.

Also, earnings management and performance of banks in Europe by Alhadab and Al-Own (2017) was aimed at examining if earnings management influences banks' present and future performance. The population was not specifically stated but 55 European banks in the periods of 2001 to 2015 were sampled. Data was sourced from the DataStream database. Pearson correlation matrix and descriptive statistics were used in analyzing data. The outcome shows that the adverse effect of the independent variable (which occurs in a particular year) enters into the next year.

METHODOLOGY

This paper made use of the *ex-post facto* method. Population comprised all the thirteen (13) DMBs whose shares are quoted on the Nigeria Exchange Group as at 31st Dec., 2018. The judgmental sampling was employed to select ten (10) DMBs that are individually quoted in Nigerian Exchange Group (NEG) rather than banks whose shares are only listed under its holdings and not separately listed in NEG as a quoted bank. The list of the sampled banks is as presented below:

SAMPLED DEPOSIT MONEY BANKS

1	ACCESS BANK PLC
2	ECO BANK TRANSACTIONAL INCORPORATED
3	FIDELITY BANK
4	GUARANTY TRUST BANK
5	STERLING BANK PLC
6	UNION BANK PLC
7	UNITY BANK PLC
8	UNITED BANK OF AFRICA
9	WEMA BANK PLC
10	ZENITH BANK

Source: www.NSE.ng.gov

The study involved secondary data that were collected by documentary review. The documents involved financial statements and audited annual reports of the banks collected from NEG and official websites of the banks from 2012 to 2018. Simple regression and correlation analysis were adopted in data analysis using *E-View ver. 9.* The study involved panel data analysis – a mixture of time series and cross-sectional data (that is; seven (7) time series and ten (10) listed commercial banks, which is a hundred (70) observational pooled data.

Variable Measurements

Variable	Acronym	Measurement
Dependent:		
Earnings Before Interest, Tax, Depreciation, and Amortization	EBITDA	Net profit + interest + tax + depreciation + amortization
Dividend Pay Out ratio	DPO	Dividend per share/Earnings per share
Net Profit Margin	NPM	Net profit/Revenue
Independent:		
Loan Loss Provision	LLP	$a_0(1/TA_{it}) + \beta_1 LCO_{it} + \beta_2 \Delta LOAN_{it} + \beta_3 \Delta NPL_{it} + e_{it}$.

Source: Researchers' Compilation (2019)

Model Specification

Financial Performance (FP) = f (earnings management).

EM is measured using LLP, while FP is proxy by EBITDA, DIVPO, and NPM. The equation is expressed as follows;

$Y_{it} = a_0 + \beta_1 X_{it} + e_{it}$ …………………..eqn 1

Where,

Y_{it}= dependent variable

a_0= constant

X_{it}= independent variable

β_1= coefficient of each variable

e_{it}= error term

The econometric model is expressed as follows;

$EBITDA_{it} = a_0 + \beta_1 LLP_{it} + e_{it}$ …………………..eqn 2

$DIVPO_{it} = a_0 + \beta_1 LLP_{it} + e_{it}$……………………..eqn 3

$NPM_{itP} = a_0 + \beta_1 LLP_{it} + e_{it}$ …………………..eqn 4

$LLP_{it} = a_0(1/TA_{it}) + \beta_1 LCO_{it} + \beta_2 \Delta LOAN_{it} + \beta_3 \Delta NPL_{it} + e_{it}$ …………eqn 5

Decision Rule

Accept Ho if the p value is more than or equals 5% level of significance; otherwise, reject Ho and accept H_1.

4.0 DATA PRESENTATION AND ANALYSIS

Data Presentation

The combined panel data collected from the sampled deposit money banks for the period of 2012 and 2018 are presented below.

Table 4.1: The combined panel analysis data

	EBITDA	DPO	NPM	NPM	LLP
2012	105597292	0.38	0.21	0.21	19087
2013	100171449	0.3	0.14	0.14	14009
2014	125391126	0.31	0.18	0.18	66108
2015	175210186	0.17	0.22	0.22	46496
2016	182636643	0.18	0.19	0.19	81003
2017	219719724	0.23	0.13	0.13	42888
2018	273816952	0.2	0.17	0.17	21674

Source: Combined Panel Analysis Data (2019) using E-Views

Data Analysis

Descriptive Statistics

Table 4.2 is a descriptive statistics of the mean, median, minimum, maximum, standard deviation, skewness, kurtosis, and other descriptive statistics values of the data used.

Table 4.2: Descriptive Statistics

	EBITDA	DPO	NPM	LLP
Mean	1.690008	0.252857	0.177143	8.420008
Median	1.750008	0.230000	0.180000	6.610008
Maximum	2.740008	0.380000	0.220000	4.910009
Minimum	1.000008	0.170000	0.130000	2.170008
Std. Dev.	63826046	0.078680	0.033523	6.040008
Skewness	0.433237	0.455155	-0.191331	0.830997
Kurtosis	1.988792	1.828182	1.756948	2.335708
Jarque-Bera	0.517218	0.642199	0.493386	0.934356
Probability	0.072125	0.025351	0.081381	0.126768
Sum	1.180009	1.770000	1.240000	5.890009
Sum Sq. Dev.	2.440016	0.037143	0.006743	2.190018
Observations	7	7	7	7

Source: Analyzed Data Output (2019) using E-Views

In table 4.2 above, the average EBITDA of the DMBs in Nigeria is 1.70, maximum (Max) value is 2.74, minimum (Min) value is 1.00, and standard deviation (SD) is 6.38. Average DPO is 0.25, max value is 0.38, min value is 0.17, and the SD = 0.08. Average NPM is 0.18, it also has max value is 0.22, min value is 0.13, and SD = 0.03. Average LLP is 8.42, max value = 4.91, min value = 2.17, and SD is 6.04.

Test of Hypotheses

Ho_1. The effect of loan loss provision on the EBITDA of quoted DMBs in Nigeria is not significant.

$EBITDA_{it} = a_0 + \beta_1 LLP_{it} + e_{it}$ ……………….eqn 1

Table 4.3: OLS Analysis of Hypothesis 1

Dependent Variable: EBITDA

Method: Least Squares

Date: 11/09/19 Time: 15:15

Sample: 2012 2018

Included observations: 7

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.411008	27959210	8.621670	0.0003

LLP	-0.085690	0.027671	-3.096733	0.0270

R-squared	0.657294	Mean dependent var	1.690008
Adjusted R-squared	0.588752	S.D. dependent var	6382604
S.E. of regression	40930741	Akaike info criterion	38.12762
Sum squared resid	8.380015	Schwarz criterion	38.11216
Log-likelihood	-131.4467	Hannan-Quinn criteria.	37.93661
F-statistic	9.589752	Durbin-Watson stat	0.909813
Prob(F-statistic)	0.026953		

Source: E-Views 9.0

Interpretation

Table 4.3 shows that the R^2 is 0.657, which implies that 65% of the changes in the EBITDA are due to the change on LLP, while the remaining 35% are contained in the error term. The F- statistics is 9.589752, the Prob.>F = 0.026953, these show that the model is good. The beta coefficient (β_1) is -0.085690, the t-value is -3.096733, and the p-value is 0.0270, these indicates that LLP has significant negative effect on EBITDA. Hence, the alternative hypothesis is accepted and we conclude that LLP has significant negative effect on EBITDA of Nigerian quoted DMBs.

Ho_2. The effect of loan loss provision on DIVPO of quoted DMBs in Nigeria is not significant

$DIVPO_{it} = a_0 + \beta_1 LLP_{it} + e_{it}$ …………………...eqn 2

Table 4.4: OLS Analysis of Hypothesis 2

Dependent Variable: DIVPO

Method: Least Squares

Date: 11/09/19 Time: 15:16

Sample: 2012 2018

Included observations: 7

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.165266	0.035422	4.665658	0.0055
LLP	1.040110	3.510011	2.968641	0.0312

R-squared	0.638018	Mean dependent var	0.252857
Adjusted R-squared	0.565621	S.D. dependent var	0.078680
S.E. of regression	0.051856	Akaike info criterion	-2.845748
Sum squared resid	0.013445	Schwarz criterion	-2.861202
Log-likelihood	11.96012	Hannan-Quinn criteria.	-3.036760
F-statistic	8.812829	Durbin-Watson stat	1.334182
Prob(F-statistic)	0.031206		

Source: E-Views 9.0

Interpretation

Table 4.4 reveals an F-statistic of 8.812829 and Prob.>F = 0.031206 is significant, indicating a good model. The R^2 of 0.638018 reveals that 63% changes in DIVPO is as a result of the change in LLP. The outstanding 37% are captured in the error term. The table also reveals a beta coefficient (β_1) of 1.040110 and the p-value = 0.0312 which is significant. These indicate that LLP has a positive effect on the DIVPO of quoted DMBs in Nigeria. We therefore conclude that LLP has significant and positive effect on DIVPO of Nigerian quoted DMBs.

Ho_3. The effect of loan loss provision on the NPM of quoted DMBs in Nigeria is not significant.

$NPM_{it} = a_0 + \beta_1 LLP_{it} + e_{it}$ ………………….eqn 3

Table 4.5: OLS Analysis of Hypothesis 3

Dependent Variable: NPM

Method: Least Squares

Date: 11/09/19 Time: 15:17

Sample: 2012 2018
Included observations: 7

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.169010	0.024702	6.841969	0.0010
LLP	9.661112	2.44E-11	0.395271	0.0089

R-squared	0.630301	Mean dependent var	0.177143
Adjusted R-squared	-0.563639	S.D. dependent var	0.033523
S.E. of regression	0.036162	Akaike info criterion	-3.566646
Sum squared resid	0.006539	Schwarz criterion	-3.582100
Log-likelihood	14.48326	Hannan-Quinn criteria.	-3.757657
F-statistic	0.156239	Durbin-Watson stat	1.181898
Prob(F-statistic)	0.008943		

Source: E-Views 9.0

Interpretation

Table 4.5 shows that the R^2 is 0.630301, which implies that 63% changes in NPM is caused by a change in LLP. The remaining 37% are contained in the error term. The F- statistics = 0.156329, and Prob.>F is 0.0089, implying that the model is good. The beta coefficient (β_1) and t-value are respectively 9.661112 and 0.395271. The p-value of 0.0089 is significant. Hence, the alternative hypothesis is accepted that LLP has significant and positive effect on NPM of Nigerian quoted DMBs.

Discussion of findings

The result of table 4.3 reveals that earnings management significantly and negatively affects financial performance component (EBITDA). This finding concurs with the findings of Chakroun & Amar (2021); and Chakroun and Amar (2019). But does not agree with other findings of Alrjoub, Almomani, Al-Hosban and Allahham (2021); Farouk & Isa (2018) which though are significant but are positive, and Okafor, Ezeagba, & Onyali (2018) whose finding reveals negative insignificant effect on performance. Tables 4.4, and 4.5 reveal that earnings management in DMBs in Nigeria has significant positive effect on financial performance components (DIVPO, and NPM). The findings agree with the findings of Alrjoub, Almomani, Al-Hosban & Allahham (2021); Chakroun & Amar (2019) (when financial performance is measured as Tobin Q and Marris ratio); and Farouk & Isa (2018). However, findings from other studies such as Chakroun & Amar; (2021); Chakroun & Amar (2019) (when financial performance is measured as ROE and ROA); and Okafor, Ezeagba, & Onyali (2018) are not in agreement with the findings.

CONCLUSIONS AND RECOMMENDATIONS

Conclusion

This paper investigated how earnings management affects financial performance of listed Nigerian DMBs. The result provided that earnings management affects EBITDA; dividend payout; and net profit margin of Nigerian DMBs. Based on the outcome of the study, it is, therefore concluded that earnings management exist in DMBs in Nigeria and it significantly affects their financial performance.

Recommendations

The paper made these recommendations:

1. Nigerian quoted banks should minimize their loan loss provision to create optimality by an increase in their financial statement fairness.
2. Board of directors of DMBs should endeavour to appoint auditors that are credible and capable of thoroughly and accurately reviewing the financial statements and giving an opinion as to whether the financial statements truly depict the true affairs of banks.
3. Financial Reporting Council of Nigeria (FRCN) and other relevant agencies should create accounting standards for loan loss provision measurement as it would ensure uniformity in disclosures and a reliable comparison among quoted Deposit Money Banks.

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