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Earning Management Practices and Corporate Governance Mechanism in Manufacturing and Oil Sector in Nigeria: A Post Covid-19 Review

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ABSTRACT

The study broadly investigated earning management practices and corporate governance mechanism in manufacturing and oil sector in Nigeria especially after the Covid-19 era. Specifically, this study adopted board independence, audit committee effectiveness and ownership concentration as proxies for corporate governance while discretionary accruals was adopted as proxy for earning management practices. Data for the study was collected from annual reports of selected manufacturing and oil firms from 2020-2024. Panel data (fixed effect) regression technique was deployed in analyzing the data. Findings showed that board independence had negative and significant effect on earning management practices in Nigerian manufacturing and oil sectors while audit committee effectiveness dipped earning management practices insignificantly. Furthermore, the study showed that ownership concentration had positive and insignificant effect on earning management practices in Nigeria. The study recommends that manufacturing and oil firms should endeavor to sustain the level of board independence in order to significantly reduce earning management practices in Nigeria.

1. INTRODUCTION

In the emerging economies of the world including Nigeria, just as it did in the advanced economies, the COVID-19 Pandemic posed significant challenges to corporate financial stability. This resulted in increased economic uncertainty, reduced profitability and greater pressure on firms to maintain investors' confidence even after the pandemic. With such economic distortions and quagmire, managers were believed to have been incentivized to manipulate earnings in order to meet performance targets, secure financing or portray stability to its stakeholders (Kabir, 2022; Ombugu & Udeh, 2023). With the shift to remote operations and virtual oversight which was adopted during the pandemic and continued even post COVID-19 era, many have argued that traditional monitoring mechanism has been weakened thereby giving management greater latitude to engage in earning manipulation without immediate detection (Okegbe, Egbunike & Echekoba, 2019). However, many have argued that earning management manipulations would only be rife when corporate governance mechanisms are weak but not when corporate governance mechanisms are strengthened (Al-Azeez, Sukoharsono, Roekhudin & Andayani, 2019; Ombugu & Udeh, 2023).

Based on the foregoing, the role of corporate governance mechanism in influencing earning management practices has remained subject of intense scholarly debate (Aleqab & Ighnaim, 2021; Kabir, 2022). While some have found that corporate governance mechanism (components) reduced earning management practices, other scholars have argued that they failed to reduce earning management practices (Al-Azeez, Sukoharsono, Roekhudin & Andayani, 2019; Aleqab & Ighnaim, 2021). For instance, board independence audit committee, CEO duality, audit committee independence and ownership structure and a host of other corporate governance mechanisms, which are designed to promote transparency and accountability, have yielded different effects on earning management practices in firms. While Al-Azeez *et al* (2019) argued that CEO duality improved earning management practices, Aleqab and Ighnaim (2021) argued that board independence and financial experience failed to improve earning management practices in firms. Furthermore, Ombugu and Udeh (2023) found that audit committee size and independence significantly increased earning management practices in Nigerian firms.

In providing answers to the debate, this study sought to answer the following questions:

(i) To what extent does board independence affect earning management practices of manufacturing and oil sectors in Nigeria?

(ii) To what magnitude does audit committee effectiveness affect earning management practices of manufacturing and oil sectors in Nigeria?

(iii) What is the effect of ownership concentration on earning management practices of manufacturing and oil sectors in Nigeria?

Following the research questions, this study was specifically aimed at:

(i) Determining the effect of board independence on earnings management practices of manufacturing and oil sectors in Nigeria.

(ii) Evaluating the effect of audit committee effectiveness on earning management practices of manufacturing and oil sectors in Nigeria.

(iii) Investigating the effect of ownership concentration on earning management practices of manufacturing and oil sectors in Nigeria.

Three hypotheses were tested in their null forms in the study:

(i) H_0: Board independence does not have significant effect on earning management practices of manufacturing and oil firms in Nigeria.

(ii) H_0: Audit committee effectiveness does not have significant effect on earning management practices of manufacturing and oil firms in Nigeria.

(iii) H_0: Ownership concentration has no significant effect on earning management practices of manufacturing and oil firms in Nigeria.

2. REVIEW OF RELATED LITERATURE

2.1 CONCEPTUAL REVIEW

Corporate Governance:

In general term corporate governance is a system by which companies are directed and controlled, focused on enthroning accountability, fairness and transparency in a firm's relationship with stakeholders. OECD (2010) defined corporate governance as involving a set of relationships between a company's management, its board, its shareholders and other stakeholders. To Kyereboah (2016), corporate governance refers to the processes and structures by which the business and affairs of institutions are directed and managed in order to improve long-term shareholders value and protect the interest of other stakeholders. The definitions portray that corporate governance is all about the control and direction of an entity, being accountable and transparent to stakeholders and ensuring fairness from those charged with decision making with the ultimate goal of enhancing the performance of the firm (Karmadin, 2016).

Earnings Management

Healy and Wahlen (1999) states that earnings management occurs when managers use their own judgment in financial reporting and in structuring transaction to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers. The position of Healy and Wahlen (1999) reinforces the stand earlier taken by Dechow, Sloan and Sweeney (1996) which stated that earnings management involves taking deliberate steps within the confines of generally acceptable accounting principles to bring about a desired level of reported earnings. According to Kadir (2022), earnings management could be opportunistic and beneficial. Opportunistic earnings management occurs if earnings are manipulated to ensure managers' objectives or personal incentives while beneficial earnings management involves manipulating of earnings in order to incentivize investors (or stockholders). Overall, earnings management implies a deliberate manipulation of accounting results for the purpose of creating a favourable impression of organizational performance.

2.2 THEORETICAL FRAMEWORK

Agency Theory

This theory was postulated by Jensen and Mecking in 1976 and explains the conflict between principals (shareholders) and agents (managers) where managers may act in their own interest rather than in the best interest of owners. Earning management usually arises as a result of agency conflict where managers manipulate earnings to achieve personal goals which comprise bonuses, reputation and others. Corporate governance mechanism including board independent oversight, audit committee effectiveness and ownership diffusion could reduce agency problems thereby curbing earnings management practices.

Stakeholders Theory

The stakeholders theory was postulated by Freeman in 1984 and posited that firms are accountable to a broad range of stakeholders not only shareholders but employees, customers, regulators and host community. Earning manipulation may harm trust among stakeholders not only in the pandemic era but also in the post-COVID crisis environment. Good corporate governance ensures that interests of all stakeholders are protected thereby reducing earnings management practices.

Positive Accounting Theory

Positive accounting theory was postulated by Watts and Zimmerman in 1978 and advocated that managers choose accounting policies that best serve their interests including bonuses and contracts. Especially in the post-COVID era, managers may increase reported earnings to secure performance-based compensation. In addition, post-COVID losses might push the managers to use discretionary accruals to inflate profit. More so, large firms may reduce reported profits to avoid political attention or tax burdens particularly with respect to oil sector that is highly regulated in Nigeria.

2.3 EMPIRICAL REVIEW

Some empirical researches have been carried out on establishing the nexus between earnings management and corporate governance mechanism. For instance, in a study of listed industrial goods firms in Nigeria, Ombugu and Udeh (2023) investigated audit committee and earnings management for the period, 2012-2022. Discretionary accrual was adopted as proxy for earnings management. Panel least square regression analysis was carried out on the data collected from eleven (11) industrial goods firms. Audit committee size and audit committee independence had significant positive effect on earnings management in Nigerian industrial goods firms.

Firm's characteristics and earnings management in listed pharmaceutical firms in Nigeria was determined by Bello, Oyediran and Onifade (2023). The study covered the period 2012-2021 with five (5) pharmaceutical firms being the sample size for the study. Multiple regression technique was employed in analyzing the data. The study showed that board independence and audit committee quality had positive and significant effect on earnings management of listed pharmaceutical firms in Nigeria.

Corporate governance and earnings management of deposit money banks in Nigeria was investigated by Elemeforo (2023) for the period 2012-2021. Panel data regression technique was employed in analyzing the data collected from thirteen (13) deposit money banks listed on the Nigerian Exchange Group (NGX). Findings revealed that audit committee independence and risk management committee independence had positive and insignificant effect on discretionary loan loss provisions of deposit money banks in Nigeria.

Kabir (2022) studied board characteristics and real earnings management among listed non-financial firms in Nigeria for the period 2008-2020. Generalized method of moment (GMM) technique was deployed in the analysis. Findings showed that CEO duality promoted real earnings management while board independence reduced real earnings management in Nigeria.

Effects of ownership structure on earnings management of quoted companies in Nigeria was analyzed by Ali-Momoh and Ahmed (2022) for the period 2001-2021. Ordinary least squares (OLS) multiple regression technique was employed to analyze the data. Findings showed that managerial ownership had positive and significant effect on earnings management. Foreign ownership had negative and significant effect on earnings management while institutional ownership had negative and insignificant effect on earnings management of quoted companies in Nigeria.

Audit quality, ownership concentration and earnings management in quoted manufacturing firms in Nigeria was assessed by Okegbe, Egbunike and Echekoba (2019). The study covered the period, 2011-2017 using a sample of twenty-one (21) firms in the consumer goods sector. Multiple regression analysis was carried out on the data collected. The study revealed that ownership concentration had negative and significant effect on earnings management while audit firm size had negative and insignificant effect on earnings management in consumer goods firms in Nigeria.

3. METHODOLOGY

The study covered the period 2020-2024 and four quoted firms comprising two manufacturing and two oil/gas firms. For the manufacturing firms, Presco Nigeria Plc and Unilever Nigeria Plc were adopted while Seplat Nigeria Plc and Oando Plc represented oil firms. Adopting eclectic approach by anchoring the study on agency, stakeholders' and positive accounting theories, the model was specified as:

EMP = f (BID, ACE, OWD) …………………………………… (1)

Specifying the model into its econometric form, it became:

$EMP = \beta_0 + \beta_1 BID_{it} + \beta_2 ACE_{it} + \beta_3 OWD_{it} + \mu$ …………………. (2)

Where:

EMP = Earning management practices (measured by discretionary accruals (DA))

BID = Board independence (measured by proportion of non-executive directors to total directors on the board)

ACE = Audit committee effectiveness (measured by proportion of non-executive directors in the audit committee board)

OWD = Ownership concentration (measured by number of shareholdings equal to 3% or more scaled by total company shares)

μ = Stochastic error term
i = firm specific effect (i = 4)
t = Time specific effect (t = 2020-2024 = 5 years)
By *a priori*, $\beta_0 > 0, \beta_1 < 0, \beta_2 < 0, \beta_3 < 0$

4. RESULTS AND DISCUSSION OF FINDINGS

Table 1: Panel (fixed effect) regression result

Dependent variable: DA

Variable	Coefficient	Std. Error	t-statistic	Prob. Value
C	-1.989673	317.1521	-0.006274	0.9951
BID	-0.968802	0.475073	-2.039268	0.0321
ACE	-0.655307	1.555399	-0.421311	0.6834
OWD	1.685212	4.734430	0.355948	0.7301
Adj. R-squared = 0.555471				
Prob. F-statistic = 0.039145				
DW-statistic = 2.160182				

Source: Researcher's computation (2025) from E-views 10 software package

The study showed that board independence had negative and significant effect on earnings management practices (proxied by discretionary accruals) in Nigerian manufacturing and oil/gas firms. From the result in table 1 above, 1 percent increase in board independence reduced earnings management practices by 0.97 percent. Probability value of board independence (0.0321) was less than the test significant level (0.05). Thus, the study concluded that board independence had significant effect on earnings management practices in Nigerian manufacturing and oil firms. This finding contrasts Bello *et al* (2023) which found that board independence had positive and significant effect on earnings management in Nigerian firms. Perhaps, this outcome might be an indication that Nigerian manufacturing and oil firms have the right proportion of non-executive directors in their board of directors leading to reduction in earnings management practices.

Similarly, the study revealed that audit committee effectiveness exerted negative but insignificant effect on earnings management practices (proxied by discretionary accruals) in Nigerian manufacturing and oil firms. Probability value of audit committee effectiveness (0.6834) was greater than the test significant level (0.05). With this outcome, this study concluded that audit committee effectiveness had insignificant effect on earnings management practices in Nigerian manufacturing and oil firms. This finding contradicts Elemeforo (2023) which found that audit committee independence had positive effect on earnings management. This outcome is an indication that manufacturing and oil firms in Nigeria enjoy robust and effective audit committee leading to minimization of earnings management.

Finally, the study showed that ownership concentration had positive and insignificant effect on earning management practices (proxied by discretionary accruals) in Nigerian manufacturing and oil/gas firms. Probability value of ownership diffusion (0.7301) was greater than the test significant level (0.05). Hence, this study concluded that ownership concentration had no significant effect on earning management practices in Nigerian manufacturing and oil firms. In a study by Okegbe *et al* (2019), ownership concentration had negative and significant effect on earnings management which runs contrary to the findings of this research.

Coefficient of determination (Adjusted R-squared) of 0.555471 meant that about 56 percent of variations in earnings management practices were due to changes in board independence, audit committee effectiveness and ownership concentration in manufacturing and oil firms in Nigeria. Therefore, the remaining 44 percent changes in earnings management practices were due to other factors not included in the model of this study. Probability F-statistic (0.039145) was less than the test significant level (0.05) and indicated that the model adopted in this study was reliable, appropriate and significant in making sound policies in the manufacturing and oil sector of Nigeria. Durbin-Watson statistic (2.160182) fell within the acceptance threshold (i.e. $2 \leq 2.160182 < 4$) and with this the study accepted that there was no presence of autocorrelation.

5. CONCLUSION

Corporate governance mechanism has been identified as pivotal to the growth and enhanced performance of firms both in developing and developed nations. Beyond growth and performance, corporate governance mechanism has been acknowledged as critical to reducing misinformation, misrepresentation and manipulations which characterizes the activities of managers (agents) especially while reporting the health or stability of firms to the shareholders and stakeholders. Given the importance of manufacturing and oil sector to the Nigerian economy, this study dwelt on both sectors. Using purposive sampling approach, two manufacturing firms and two oil firms were selected. Annual reports of the selected firms were used to collect data.

Discretionary accrual was adopted as proxy for earning management practices while board independence, audit committee effectiveness and ownership concentration were used to capture corporate governance mechanism. Employing panel data (fixed effect) regression technique, findings showed that board independence significantly reduced earning management practice in Nigerian manufacturing and oil firms. On the other hand, the study showed that audit committee effectiveness reduced earning management practice but its effect was insignificant. Interestingly, ownership concentration did not reduce earning management practices rather it exacerbated it. Overall, the study concluded that corporate governance mechanism has significant effect on earning management practice in Nigerian manufacturing and oil firms.

6. RECOMMENDATIONS

The under-listed recommendations are made in this study:

(i) Manufacturing and oil firms should endeavor to sustain the level of board independence in order to continue to significantly reduce earning management practices in Nigeria.

(ii) Although audit committee effectiveness had negative effect on earnings management, but it should be further strengthened so as to significantly reduce earning management practices in manufacturing and oil firms Nigeria.

(iii) Ownership concentration in manufacturing and oil firms should be drastically reduced by ensuring that the number (proportion) of shareholders owning 3% or more is increased. In this way, earnings management practices would significantly be reduced.

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