ZIBELINE INTERNATIONAL™ PUBLISHING
E-ISSN: 2990-9449(Online)
CODEN: BEDCAS

Business and Economics in Developing Countries (BEDC)

DOI: http://doi.org/10.26480/bedc.01.2023.11.14

REVIEW ARTICLE

INTERNAL CORPORATE GOVERNANCE MECHANISMS AND EARNINGS QUALITY OF LISTED INDUSTRIAL FIRMS IN NIGERIA

Onokebhagbe Ekata Andrew*

Department of Accounting and Management, Faculty of Arts and Social Sciences, Nigerian Defense Academy, Kaduna.
****Corresponding Author Email: epekandy@gmail.com***

ARTICLE DETAILS

Article History:

Received 23 February 2023
Revised 08 March 2023
Accepted 18 April 2023
Available Online 20 April 2023

ABSTRACT

This study examined the effects of corporate governance mechanism on earnings quality in Nigeria. To achieve the aims of this study, a total of 23 listed industrial firms in the Nigerian stock exchange market were selected and analyzed for this study using the census sampling technique. Also, the corporate annual reports for the period 2006-2016 were used for the study. The regression analysis method was used as a statistical technique for analyzing the data collected from the annual report and accounts of the selected firms. Findings from the study revealed that board independence, board gender, board size and CEO duality have a significant negative effect on earnings quality (proxied by discretionary accruals) for the sampled industrial firms in Nigeria. The study recommends that corporate governance mechanisms in Nigeria industrial firms should enable the individual companies to organise its governance optimally in accordance with the principles.

KEYWORDS

Corporate Governance, Earnings Quality, Board Independence, Board Gender, Board Size.

1. INTRODUCTION

Corporate accounting information is relevant to the extent that it is capable of influencing a decision maker by helping the decision maker predict the outcomes of past, present, and future events or to confirm or correct prior expectations. For information to be relevant, it must be timely, and it must have predictive value or feedback value or both. Financial statements should always provide reliable information to assist users in decision making. The statements should disclose relevant, reliable, comparable and understandable information (Kamaruzaman, 2009). Reliability has to do with the quality of information which assures that information is reasonably free from error, bias and faithfully represents what it intend to represent. Financial statement of companies can never be completely free from bias, since economic phenomena presented in annual reports are frequently measured under conditions of uncertainty because many estimates are included in the report (Shehu, 2011).

The need for a good corporate governance structure arose due to the separation of ownership between a firm and its owners, which turns the firm into a relationship between it and all its stakeholders such as managers, employees, shareholders, creditors, government and all its stakeholders. The separation of ownership and control by the sophistication of the modern day business redefines the relationship between the owners and the managers to that of an agent and a principal. Being the agent, the manager is expected not to pursue goals that are geared towards the achievement (personal) of his own interest at the expense of shareholders' wealth maximization. The existence of conflict of interest between managers and owners naturally compromises the value of the firm and only transparency can eliminate the conflict

Several studies investigate whether deficiencies in governance structures facilitate greater exercise of discretion to manage earnings, i.e., they hypothesize that earnings quality responds to governance, specifically that poor earnings quality is associated with weaker corporate governance structures (Marjan and Rashidah, 2013; Muhammed, 2014). Few studies set out to investigate how earnings quality shapes corporate governance structures. An exception is (Bushman, 2004), who argues that firms with information quality issues have higher monitoring needs and therefore build governance structures to enforce internal and external monitoring. Studies such as (Mark, 1996; Bello, 2002; Klien, 2002; Adams and Mehran, 2003; Park and Shinn, 2004; Borgia, 2005; Sanda et al., 2005; Fodio, 2006; Vasililli, 2010; Allam, 2013); concentrated on either the banking sector or the manufacturing sector of the economy. This study will focus on the industrial sector of the Nigerian economy and will cover a study period of eleven (11) years (2006-2016).

2. OBJECTIVES

This paper examines the effect of internal corporate governance mechanisms on earnings quality of listed industrial goods firm in Nigeria. In this study change in working capital management will be used to measure earnings quality.

The hypotheses to be tested in this study are stated below in their null forms:

Ho_1: Board Independence has no significant effect on earnings quality of listed industrial firms in Nigeria.

Ho_2: Board gender has no significant effect on earnings quality of listed industrial firm in Nigeria.

Ho_3: Board size has no significant effect on earnings quality of listed industrial firms in Nigeria.

Ho_4: CEO Duality has no significant effect on earnings quality of listed industrial firms in Nigeria.

The remaining part of this work is organised as follows: section two reviews literatures related to the study. While section three focused on the research methodology adopted for the study, section four presents test of hypotheses and discussion and section five discuss the finding and conclusion of the study.

Quick Response Code	Access this article online	
	Website: www.bedc.com.my	**DOI:** 10.26480/bedc.01.2023.11.14

Cite The Article: Onokebhagbe Ekata Andrew (2023). Internal Corporate Governance Mechanisms and Earnings Quality of Listed Industrial Firms in Nigeria. *Business and Economics in Developing Countries, 1(1): 11-14.*

2.1 Literature Review

The concept of corporate governance is very wide considering the way it has penetrated the minds of numerous researchers. Thus, the concept has various definitions from the accounting, economic, political and legal points of view. Despite these, corporate governance can be broadly divided into at least two; the narrow and the broad view. The narrow view which is referred to as Anglo- Saxon is concerned with the structures within which corporate enterprise receive its direction. The proponents of the narrow view place the interest of the shareholders, issues relating to shareholders protection, management control and the popular principal-agency problem of economic theory are given proper attention. They affirmed that corporate governance deals with the relationship between corporate managers and shareholders. They also posited that providers of finance have a unique relationship to the firm as they allow their investment to be placed at risk, (Alchain and Demsetz, 1972; Jensen and Mackling, 1976; Hart and More, 1990) while the productive asset they finance remains the property of the corporation (Shliefer and Vishny, 1997).

The second category consists of the broader view referred to as Franco-German which is also said to be the heart of both market economy and a democratic society (Sullivan, 2000). The Franco-German considers first, the interest of the stake holders, that is, the shareholders, managers, directors, creditors, customers, society, government and legal authorities/agents. In addition to this, Sullivan (2000) concluded that the resultant problems of the privatization crusade, transition economy, issues of institutional, legal and capacity building as well as the rule of law are at the very heart of corporate governance.

2.2 Earnings Quality

Investors' concerns with earnings quality has increased after many international companies announced non-authentic and temporary earnings as part of their quarterly reports. Thus, investors became more cautious in considering net earnings. A studies define earnings quality as the investor's ability to predict future abnormal earnings depending on recent data (Qaraqish, 2009; Ohlson and Feltham, 1995). But their research sees that the real earnings quality is the one honestly and justly announced by the companies as their actual earnings. In other words, the announced earnings of companies have a substantial financial existence which is void of exaggeration or probability figures. Many of the definitions of earnings quality revolve around the two previous ones. Earnings quality is the ability of the present earnings to predict a company's future earnings and its ability to survive in the future. The importance of earnings quality stems from the earnings on which many parties depend when they take their decision (Dechow, 1884). Others believes that earnings quality is considered an important factor in the financial statement and is used as guidance to decision making (Bagava, 2006).

There are different views regarding the concept of earnings quality: while some use earnings continuity as a standard of its quality as explained by (Altamuro and Beatty, 2006), the continuity of earnings refers to the relationship between the present earnings with the future ones. As earnings are divided into cash flows and accruals, quality earnings means that cash flows are more than accruals (Sloan, 1996). Others indicate that earnings quality is better once free from earnings management: the less the discretionary accruals are, the better the quality is (Dechow and Dichev, 2002; Francis, 2004; Al-Sharif, 2008). Different method for measuring earnings quality led to different evaluations, where the same company might be given a higher or lower quality level according to the earnings quality form adopted (Abdelghany, 2005).

2.3 Previous Studies

Some investigation found the relationship between corporate governance and earnings quality of listed banks in Rivers State Nigeria (Lilian et al., 2016). It examined the relationship between board size and accrual quality, audit committee independence, value relevance, directors' independence and accrual quality of listed banks in Rivers State. Using Regression analysis and Pearson product moment correlation coefficient, the result indicated a positive relationship between corporate governance and earnings quality. It revealed positive association between board size, independent directors and accrual quality. No relationship was established between independent audit committee and accrual quality. The effect of corporate governance on earnings quality, following changes in corporate governance mechanisms in Korea (Yo, 2009). The analysis utilizes panel data of 509 non-financial Korea firms and a total of 3054 firms-year observations, listed on the Korean Stock Exchange for the period 2000-2005. The study employed three corporate governance mechanisms based on the Koreas corporate governance reforms (ownership structure, internal governance, External governance). The study provides evidence that high quality financial reporting requires well-balanced corporate governance mechanism. Moreover, high quality financial reporting is achieved by financial statement preparers.

The effect of corporate governance on earnings quality with surplus free cash flow as moderating variable (Reskino, 2015). The research aims to obtain empirical evidence about the effect of corporate governance (Independent commissioners, CEO duality of commissioners and audit committee independence) on earnings quality proxied by representational faithfulness and moderated by surplus free cash flow. The data analysis method uses multiple regression analysis. The result of the research from the multiple regressions indicate that independent commissioners and CEO duality of commissioners has a significant effect on earnings quality and the result of the research from the moderated regression analysis indicate that all variables of corporate governance are moderated by surplus free cash flow has a significant effect on earnings quality.

The relationship between corporate governance and earnings quality worldwide. The result suggested a substitute relationship between corporate governance and earnings quality. The study found that the country effect is extremely relevant in shaping this relationship. This relation is more pronounced in developed countries with strong investor's protection (Cristina and Clara, 2014).

3. Methodology

The population of the study consisted of twenty-six industrial firms listed on the Nigerian stock exchange as at 31 December 2016. The use of the industrial firms were suitable for the study since they are public entities operating under strict corporate governance code, making their financial and accounting disclosure dependable. This study focused on examination of specific factors that drives earnings quality of listed industrial firms in Nigeria. Census sampling technique was adopted for the study. The population and sample of the study was based on the industrial sector.

3.1 Variables and their Measurement

To measure the accounting quality of the industrial firms under study in the sample, change in working capital management was used to measure earnings quality.

$\beta 0 + \beta 1 CFO_{it}{-}1 + \beta 2\, CFO_{it} + \beta 3 CFO_{it}{+}1$

Where:

β0= *Constant*

β1*CFOit* −1=*Represents Previous Cash Flow from Operation*

β2*CFO= Represents Present Cash Flow from Operation*

β3*CFOit* +1= *Future Cash from Operation*

3.2 Independent Variables

Independent variables are Board Independence, Board gender, Board size and CEO duality.

Board Independence (BIND):

Number of non-executive members in board of directors (independent directors/total directors)

Board Gender (BGEN): Number of female directors in the board.

Board size (BODSIZ): Number of directors on the board

CEO Duality (CDU): CEO equals 1 if CEO is also chairman of the board and 0 if otherwise.

3.3 Model Specification

In line with recorded literatures, the regression equation can be expressed as follows:

$CWC = \beta_0 + \beta_1 BIND + \beta_2 BGEN + \beta_3 BODSIZ + \beta_4 CEODU + \varepsilon_{it}$

Where:

CWC= Earnings quality

BIND= Board Independence

BGEN = Board Gender

BODSIZ = Board Size

CDU = CEO Duality

βo = Parameters

Ɛ = Error term

4. Discussion

4.1 Descriptive statistics for listed Industrial goods firms in Nigeria.

The descriptive statistics shown in Table 1 for the sampled firms' reveals that the average changes in working capital management index was 7.0026 while the minimum index was 3.87. This implies that some companies had managed their working capital efficiently because the efficiency index was greater than 1. As presented in table 1, the non-executive directors (BINP) account for 23% of board which shows that board composition of listed industrial goods firms in Nigeria is dependent. The minimum level of non-executive directors is 0 which means some firms already disregard the terms in Nigeria corporate governance code stating that the board members should consist more of independent or non-executive directors. Similarly, board gender with a mean value of 0.1253 and a standard deviation of 0.2033 with a min and max values of 0 and 1.3 means an average of 12% of females were appointed as board members of the sampled firms. Board of directors is composed of an average number of 8 directors which literally complied with the criteria stated in the Nigerian corporate governance code requiring a board size within a range between 5 and 15 members. Also, agency theory supports smaller boards relative to lager boards to enhance corporate governance and improve the quality of financial reports.

Table 1: Descriptive statistics for listed Industrial goods firms in Nigeria.

Variables	Obs	Mean	Std.Dev	Min	Max
cwc	253	7.0026	1.696	3.87	9.99
bind	253	0.2389	0.2937	0	0.75
bgen	253	0.1253	0.2033	0	1.3
bodsiz	253	8.5375	2.4208	4	19
ceodu	253	0.5573	0.4978	0	1

Source: STATA 13 output

CEO is defined as a dummy variable: 1 if CEO is the chairman of the board of directors is the same person and 0 otherwise. Therefore, the minimum value and maximum value for CEO is 0 and 1 respectively, whereas the mean is 0.5573 with a standard deviation of 0.4978. in the sampled firms, 55.7% of all the firms have CEO holding the position of chairman on the board indicate that concentrated power is prevalent in listed industrial goods firms in Nigeria and 44.3% has no CEO duality which means some of the industrial firms did not appoint individuals to assume the chairman and CEO roles separately.

Table 3 shows the result of the regression equation model used to test the entire stated hypothesis (i.e. H_1-H_4) for the study. To investigate the presence of multicolinearity, variance inflation factor (vif) for each of the explanatory variable are computed as shown in Table 2. The mean vif as shown in Table 2 is 1.15, which is lower than 10, a number that is used as a rule of thumb as an indicator of multicolinearty problem (Field, 2000). The result supports lack of presence of multicolinearity in the research model. The result of the analysis can be interpreted with a greater degree of confidence. Hence, the result for the goodness of fit test as shown in table 3 presents an Adjusted R^2 value of 0.1217. This implies that the value of the dependent variable can be explained by 12% of the independent variable. This therefore shows that 12% changes in earnings quality of listed industrial firms in Nigeria could be accounted for by the independent variables. More so, the F-test statistics as presented in table 3 shows a p-value that is less than 0.05. This outcome suggests clearly that simultaneously the explanatory variables are significantly associated with the dependent variable. Empirical findings for this study show that there is a negative significant relationship between board independence and earnings quality for the sampled firm. This is evident in the p-value and t-value of 0.001 and -3.33 respectively. Therefore, the study accepts the alternate hypothesis. This result shows that there is an indirect relationship between board independence and earnings quality.

Table 2: Variance Inflation Factor

Variables	VIF	1/VIF
bind	1.21	0.8272
bodsiz	1.18	0.84451
bodgen	1.11	0.900825
ceodu	1.09	0.914199
Mean VIF	1.15	

Source: STATA 13 output

Table 3: Regression Analysis

Cwc	Coef	StdErr	t	P>/t/	[95% ConfInteral]	
BIND	-1.1904	0.3573	-3.33	0.001	-1.8943	-.4865
BGEN	-1.5621	0.5168	-3.02	0.003	-2.5801	-.5441
BODSIZ	-0.8731	0.0434	-2.01	0.045	-0.1728	-.0018
CEODU	-0.9153	0.2098	-4.36	0.000	-1.3287	-.5020
-CONS	9.1386	0.4494	20.45	0.000	8.283	10.0189
No of Obs = 253						
F (4, 248) =9.73						
Prob>F = 0.0000						
R2 = 0.135						
Adj R2= 0.1217						

Source: STATA 13 output.

The second hypothesis indicates that there is a significant negative relationship between board gender and earnings quality for the sampled industrial firms. This is shown in the p-value and t-value of 0.003 and -3.02 respectively. The study rejects the null hypothesis. This result indicate that the presence of female members in the board of directors help reduce unethical accounting practices which has a positive role in determining the quality of earnings of the sampled firms. Board size shows a significant negative relationship on earnings quality of the sampled firms. This is shown in the p-value and t-value of 0.045 and -2.01 respectively. The null hypothesis is therefore rejected, this implies that there is an inverse relationship between board size and earnings quality. This result is indicative of the fact that firms with large board size of directors are more competent in the control of manager's discretionary disposition.

5. Conclusions

In each of the hypothesis, change in working capital was used to proxy earnings quality representing the dependent variable. Board independence, board gender, board size, and CEO duality (proxy by BIND, BGEN, BODSIZ and CEODU) were used to represent the independent variable. The result from regression analysis indicates that 12% change in earnings quality of industrial firms can be explained by corporate governance variables. The research (study) further revealed that a negative significant relationship exist between board independence, board gender, board size, CEO duality and earnings quality of listed industrial firms in Nigeria. Hence, the study concludes that independent directors, board gender, board size and ceo duality improves earnings quality of listed industrial firms in Nigeria. The study recommends that corporate governance mechanisms in Nigeria industrial firms should enable the individual companies to organise its governance optimally in accordance with the principles and practice of corporate governance in Nigeria.

References

Alsmadi, S., and Khizindar, T., 2015. Consumers' perceptions of consumer rights in Jordan. International Journal of Commerce and Management, *25*(4), Pp. 512–530. https://doi.org/10.1108/ijcoma-02-2013-0011

Bajgai, R. C., 2016, July 25. Food safety lapses can be costly. Kuensel Online. https://kuenselonline.com/food-safety-lapses-can-be-costly/

Bennett, N., Borg, W. R., and Gall, M. D., 1984. Educational Research: An Introduction. British Journal of Educational Studies, *32*(3), 274. https://doi.org/10.2307/3121583

Cortina, J. M., 1993. What is coefficient alpha? An examination of theory and applications. Journal of Applied Psychology, *78*(1), Pp. 98–104. https://doi.org/10.1037/0021-9010.78.1.98

Dema, C., 2020, September 14. OCP received more than 100 complaints during lockdown. Kuensel Online, https://kuenselonline.com/ocp-received-more-than-100-complaints-during-lockdown/.

Dema, C., 2021, January 2. OCP penalises shops for unfair trade practices. Kuensel Online. https://kuenselonline.com/ocp-penalises-shops-for-unfair-trade-practices/

Dolkar, D., 2022, May 20. *OCP* fines 46 entities in April. Kuensel Online. https://kuenselonline.com/ocp-fines-46-entities-in-april/

Fleming, A., 2019, March 15. Consumer rights are worthless without enforcement. The Conversation. https://theconversation.com/consumer-rights-are-worthless-without-enforcement-113244

Ibarra, V. C., and Revilla, C. D., 2014. Consumers' Awareness On Their Eight Basic Rights: A Comparative Study Of Filipinos In The Philippines And Guam. International Journal of Management and Marketing Research, *7*(2), Pp. 65–78.

Kuensel, B. D. N., 2021, June 10. For consumers. Kuensel Online. https://kuenselonline.com/for-consumers/

Lokganathan, E. T., and Adaikalam, G. J., 2020. A study on awareness of consumer rights in select products with special reference to urban areas of coimbatore district. Aut Aut Research Journal, 11(11), Pp. 89–101.

Namgay, T., 2021, May 14. *OCP* and BAFRA collaborate to ensure food safety. Kuensel Online. https://kuenselonline.com/ocp-and-bafra-collaborate-to-ensure-food-safety/

Ponleu, S., 2021. Consumers' Perceptions of Consumer Rights in Cambodia. In L. Chanbormey and K. Phallack (Eds.), Law in the Digital Age: Protection of Consumer Rights. Pp. 17–38. Konrad-Adenauer-Stiftung.

Powrel, I. M., 2022, June 8. Overcharging on third country imports. The Bhutanese. https://thebhutanese.bt/overcharging-on-third-country-imports/

Rawal, D., 2019. Perception of Consumer Rights among the College Students: A Case of Tikapur Municipality. Contemporary Research: An Interdisciplinary Academic Journal, 3(1), Pp. 25–32. https://doi.org/10.3126/craiaj.v3i1.27486

Tshering, D., 2020, May 4. Consumer Protection in Bhutan in the challenging times of Covid-19 Pandemic. Kuensel Online. https://kuenselonline.com/consumer-protection-in-bhutan-in-the-challenging-times-of-covid-19-pandemic/