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CAPITAL STRUCTURE AND REAL EARNINGS MANAGEMENT OF NIGERIAN LISTED DEPOSIT MONEY BANKS

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Abstract

This study examined how a firm's capital structure (CS) affects real earnings management (REM) procedures by examining a sample of twelve (12) Nigerian listed Deposit Money Banks. The abnormal discretionary expenses model was used to measure REM, and the total debt ratio (TDR), short-term debt ratio (STDR), and long-term debt ratio (LTDR) were used to proxy CS, all scaled by the firm's total equity. The data were analyzed using static panel regression with fixed and random effects. Panel regression results showed that whereas STDR had an adverse effect on the dependent variable (REM), TDR and LTDR had a favorable effect on the REM practices across the investigated banks. Hence, it is recommended that authorities ought to keep an eye on Nigerian banks' debt-term arrangements in an effort to reduce the prevalence of REM techniques in these institutions. Nigerian Deposit Money Banks are also to streamline the constraints that may compel them to participate in REM practices and are also urged to reach advantageous terms for their eternal debt or to give priority to short-term debt over long-term debt.

Keywords: Capital Structure; Long-Term Debt; Real Earnings Management; Short Term Debt

1. Introduction

The organization gives the public information concerning the firm's worth via the report of financial position, so financial reporting makes it simpler for companies to publish earnings and is generally utilized to inform the public about company achievements. Earnings proceed to be the primary objective for businesses worldwide because they serve as a guide for domestic as well as foreign users of accounting information in order to assess entity operational effectiveness (Tolulope et al., 2018). Financial reporting enables the correct and timely representation of developments related to a company's accomplishments and progress (Awuye, 2022; Chowdhury & Eliwa, 2021; Wangui & Simiyu, 2018). By using professional judgment to decide on disclosing techniques and predictions that precisely reflect the firm's economics, managers can improve financial reporting (Tarighi et al., 2022). As a result, they can affect profits (Chowdhury & Eliwa, 2021).

In Nigeria and many other business entities worldwide, the prevalence of profits manipulation has persisted unchecked. According to a latest report, the National Pension Commission (PenCom) penalized Nigeria's Stanbic IBTC bank 233 million naira in 2021 for misrepresenting its financial results and concealing forex profits. In 2022, the financial

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institution received a fine of 159 million naira for similar evidence of conducting EM practices (Prime Business, 2023). The recorded corporate malfunctions and controversies worldwide have been attributed to the practice of EM by corporate enterprises. The problems with EM have persisted to be discussed in either legislation or professional debates via the aim of determining manners to regulate the adheres to of EM across incorporated enterprises in Nigeria. Some of the well-known scenarios encompass the Enron case, One of the most significant accounting firms previously acknowledged as reputable and dependable before they were connected in financial frauds that prompted their collapse, where its auditing firms, Arthur Andersen, emitted financial documentation that concealed their debt by employing special purpose entities to enhance investment and strengthen their rankings (Edelman & Nicholson, 2011).

Capital structure (CS) has been identified in empirical studies as a possible cause of opportunistic conduct by management, including EM strategies (Fung & Goodwin 2013). This falls underneath the positive accounting theory's debt covenant premise, which states that businesses manipulate earnings to maintain the trust that they have earned from lenders over their capacity to pay back debts. The amount of debt that an enterprise uses is occasionally associated with the discretionary actions of its administration, such as EM (Dickson, 2021; Holinata, 2020). The firm's CS is typically primarily conceptualized via the measure of the debt-to-equity ratio, which indicates the ratio of the corporation's capital that is composed of debt. The magnitude and certainly of the CS undermine on managerial accounting discretionary behavior, nonetheless, may vary depending on the loan maturity duration. Specifically, the result and trajectory of the short-term debt element within the company may be different from those of the long-term financing component.

There is no doubt that deposit money banks (DMBs) in Nigeria play a fundamental function within Nigerian economy, contributing greatly to its growth, stability, and development by providing funds for investments, entrepreneurship, and innovations that contribute to Nigerian economic development. They are also capable of creating both direct and indirect employment opportunities through the operations and the businesses that they finance through both direct and indirect means. As well as promoting economic growth and reducing poverty, financial stability is also important for attracting investments, promoting economic growth, and preserving confidence in the financial system. In other words, the importance of complete transparency from this sector is more important, because it is necessary to give details on their actions so that the public and investors are to make informed decisions about their activities.

Although many researches on the relationship between CS and EM have been carried out over the years, the results of these studies are inconsistent. The impact of CS on EM, for example, has not been extensively studied (Hassan & Bello, 2013; Oktasari, 2020; Quang & Van, 2021; Tulcanaza-Prieto et al. 2020). Conversely, other research has similarly found that leverage or capital structure had no influence on EM practices (Thoharo et al. 2021). This implies that it is impossible to accurately extrapolate findings from one context to another. To put it another way, findings from other nations and certain industries cannot be extrapolated to Nigeria and all of its sectors. There are no studies that look at the impact of CS on Nigerian DMBs earnings management. Therefore, this study investigated the causal connection between CS (Total Debt Ratio, Short-Term Debt Ratio, and Long-Term Debt Ratio) and EM by management of Nigeria DMBs.

2.1 Literature Review

2.1.1 Earnings Management

The technique of manipulating accounting information in order to present an entity's financial state and success is known as EM. By exploiting inadequacies in regulations regarding accounting, it manipulates accounts of organizations so as to intentionally deceive investors regarding the business's actual financial achievements or modify contracts that might depend on financial data. It is also described as the intentional falsification of financial data in order to either deceive current and prospective investors about a company's true financial circumstances or to get specific legal advantages which are heavily reliant on changes in accounting figures (Adepimbe et al., 2018).

2.1.1 Real Earnings Management (REM)

REM means a scenario in which directors of organizations manipulate some business transactions and take activities that depart from standard norms in order to claim better results (Ewert & Wagenhofer, 2005). Schipper is said to have been the pioneer to grasp the concept of REM back in 1989 (Olotu et al., 2019). According to reports, he defines REM as the act of integrating financial or investment decisions to falsify declared outcomes. REM includes real company practices that have an effect on operating cash flows. According to Roychowdhury (2006), REM is a deviation from ordinary operational

processes that management employs to manipulate some investors into thinking that specific goals have been reached via regular normal activities.

2.1.2 Capital Structure (CS)

The term "capital structure" is used to convey the meaning of how a company manages its assets using a mix of debt, stock, and hybrid securities (Saad, 2010). In summary, an enterprise's CS made up of a combination of ordinary equity, preferred equity, and long- and short-term debt. By merging several forms of funding, a company's CS determines how it finances its entire business activities (Varian et al., 2015). Enterprises with elevated ratios of leverage tend to be more risky compared to firms with fewer metrics because they fund their assets with debts (Paramita & Isarofah, 2016). High-geared businesses that depend on borrowing to finance fresh investments are viewed as more vulnerable and are primarily concerned with obligations related to debt, claims (Alareeni 2020). Highly competent enterprises might find it more difficult to employ income smoothing since they are investigated by lenders (Abed et al., 2012). Contrary to that, creditors pressure managers to preserve normal revenue flow. Therefore, a higher debt ratio could lead to management manipulating earnings (Huang & Xue, 2016).

2.2 Theoretical Framework

Jensen and Meckling's 1976 propose agency theory coincided with the growth of big companies, whose very magnitude required the division of ownership from governance (authority). The disagreement of interest amongst managers and shareholders could lead to losses for owners of companies. Furthermore, since managers can maintain personal oversight and reap profits from an opaque business reporting strategy, these companies are typically linked to more extreme fraud on earnings (Gopalan & Jayaraman, 2012). Because it keeps information about cash flows confidential for corporate executives, EM could therefore motivate directors/managers to participate in substandard investment.

In light of this, it is envisaged that adopting financial leverage mechanisms to minimize agency conflicts by constraining the amounts of free cash flows accessible to managers will benefit shareholders. Given that managers must pay required interest instead of optional dividends, this mechanism appears to be especially efficient in cases when managers purposefully produce opaque accounting reports to deceive shareholders regarding the company's free cash flows (Jensen and Meckling, 1976, and Jensen, 1986).

2.3 Empirical Review

Numerous researches have been conducted with the aim of comprehending how the CS affects corporate EM techniques, with published outcomes that differ. The variations could be related to the distinct methods and scope used.

First, information collected from the literature indicates that a company's debt level may exert an enormous impact on how it manages its earnings. From 2010 to 2018, the association between leverage and real earnings management (REM) in Korean non-financial firms by Tulcanaza-Prieto et al. (2020). Leverage and REM appear to be extensively positively connected. Additionally, Khanh and Thu's (2019) paper employed GMM modeling to panel data of 241 businesses registered in the Vietnamese stock markets from 2010 to 2016. Using 4 models, the findings demonstrated a favorable relationship between leverage and EM strategies. In 2023, Naz and Sheikh (2023) performed regression analysis on data gathered from Pakistan 150 non-financial businesses. The findings indicate that abnormal cash flow from operations is positively correlated with all CS metrics. In a study of Vietnamese companies, it was also shown that those with a smaller percentage of Short-term borrowing have a higher likelihood of in actual EM (Quang and Van 2021).

Conversely, Kustono et al. (2021) studied 130 Indonesian manufacturing companies to access how institutional ownership influence leverage, which acted as a control variable, on the quality of earnings. Income smoothing has been demonstrated to benefit from institutional ownership, in contrast to financial leverage as indicated by the debt-to-equity ratio. The study by Ibrahim et al. (2022) further proves the EM of DMBs within Nigeria has a high correlation with company size and leverage. Utilizing secondary data gathered from the World Bank Development Indicators, the Statistical Bulletin, and the Central Bank of Nigeria, Egiyi (2021) examines how leverage affects accrual-based EM. The results show a

strong inverse link between EM and debt ratio of Nigerian companies. The study by Muhammad et al. (2024) also confirmed that the CS had a negative impact on accrual EM.

3. Methodology

The research employed an ex post facto research design. This is due to the study's reliance on historical data. The fourteen (14) DMBs that were listed on the Nigeria Exchange Group (NGX) between 2012 and 2023 make up the study's population. Twelve (12) deposit money banks (FCMB, Fidelity, Sterlin Bank; Access Bank; UBA, GTB, Stanbic Bank, Union Bank, Wema Bank, Zenith Bank, Unity Bank and First Bank) were selected using a census sampling technique. These criteria include the bank's listing as of 2012, uninterrupted operations from 2012 to 2023, and complete data on all variables for the period studied. Secondary sources, mostly annual reports of banks, were analyzed using content analysis. Static panel regression was selected as the analysis technique due to the panel nature of the data. Using the results of the Hausman and firm effect specification tests as a reference, the best of the three possible panel regression procedures is chosen. Additionally, the study used the Wooldridge test for serial correlation, the Variance Inflation Factors (VIF) for multicollinearity, and the heteroscedasticity test for heteroscedasticity.

3.1 Measurement of Variables

Table 3.1: Measurement of Variables

Variables	Measurement	Sources	Expected sign
Dependent variable			
Real Earnings management (REM)	Absolute value discretionary component of expenses model	Roychowdhury (2006) and Gunny (2005)	
Independent Variables			
Total debt to equity ratio (TDR)	Total Debt to Equity	Naz and Sheikh (2023); Ibrahim et al. (2022)	+
Short term debt ratio (STDR)	Short Term Debt to Equity	Egiyi (2021); Tulcanaza-Prieto et al. (2020)	+
Long term debt ratio (LTDR)	Long Term Debt to Equity	Khanh and Thu's (2019); Tulcanaza-Prieto et al. (2020)	+
Control Variables			
Firm size (FS)	Log of Total Assets	Debnath & Roy; 2017	-
Firm age (AGE)	The duration since the company's listing on the NGX	Debnath & Roy; 2017	±

Source: Author's Compilation (2024)

3.2 Model Specifications

Details of the model used in this investigation are guided by the findings in the theoretical framework and related empirical literature (Alzoubi, 2018).

Model 1

$$REM = \beta_0 + \beta_1 TDR_{it} + \beta_2 FS_{it} + \beta_3 AGE_{it} + \mu_{it} \quad (1)$$

Model 2

$$ROA = \beta_0 + \beta_1 LTDR_{it} + \beta_2 STDR_{it} + \beta_3 FS_{it} + \beta_4 AGE_{it} + \mu_{it} \quad (2)$$

Dependent Variable

REM is derived from the discretionary operating expenses model using the accrual model's discretionary component. Gunny (2005) and Roychowdhury (2006) examined three indicators of the level of actual earnings management: Discretionary expenses, production costs, and abnormal cash flow from operational activities are what they are. The degree of REM was assessed in this study using the discretionary expenses measure, where the formula was as follow:

$$Discexp_{it} /TA_{it-1} = \alpha_1 \left(1/_{TA_{it-1}}\right) + \alpha_2 \left(S_{it}/_{TA_{it-1}}\right) + \varepsilon_{it} \quad (3)$$

4. Results

4.1 Descriptive Analysis

Table 2: Descriptive Statistics

Variables	Obs	Mean	Std. Dev.	Min	Max
REM	144	0.015	0.013	0	.072
TDR	144	6.007	4.207	-27.865	13.307
STDR	144	5.377	4.027	-27.521	11.381
LTDR	144	0.63	.404	-.344	2.095
FS	144	28.083	.949	25.628	29.792
Age	144	27.591	14.18	6	50

Source: Author's Computation, 2024

Table 2 showed that the average REM was 0.015, with a corresponding standard deviation of 0.013, indicating that it is evenly distributed across Nigerian banks. TDR and STDR have average values of 6.007 and 5.377, respectively. The results suggest that Nigerian banks are primarily funded by short-term debt.

4.2 Correlation Analysis

Table 3: Correlation Analysis

Variables	REM	TDR	STDR	LTDR	FS	Age
REM	1.000					
TDR	-0.092	1.000				
STDR	-0.112	0.996	1.000			
LTDR	0.158	0.482	0.403	1.000		
FS	-0.417	0.303	0.315	0.022	1.000	
Age	0.292	-0.078	-0.076	-0.058	0.025	1.000

Source: Author's Computation (2024)

Outcomes from table 3 demonstrate that the STDR and TDR have a coefficient of 0.996, suggesting the existence of multicolinearity issue if both of these variables are present in a similar regression model. Therefore, the study would specify two distinct models.

4.3 Diagnostic Test Results

Table 4: Summary of Diagnostic Tests Results

Model No	Test	Results	Remarks
Model 1	Breusch-Pagan Test for Heterosceadsticity	Chi = 37.21 Pr>Chi = 0.000	Existence of Cross Sectional Dependence at 1 per cent
	Wooldridge Test for Serial Correlation	F = 6.969 Pr>F=0.0247	First-order serial correlation exists at 5%
	VIF test for multicolinearity	Highest =1.11 Mean = 1.074	No evidence of multicolinearity
	Hausman Test	Chi =9.52 Pr>Chi = 0.0231	Fixed effect better than random effect
Model 2	Breusch-Pagan Test for Heterosceadsticity	Chi = 43.67 Pr>Chi = 0.000	Heteroscedasticity exists at 1 per cent level
	Wooldridge Test for Serial Correlation	F = 6.109 Pr>F=0.0330	First-order serial correlation exists at 5%
	VIF test for multicolinearity	Highest =1.351 Mean =1.176	No evidence of multicolinearity
	Hausman Specification Test	Chi = Pr>chi = 0.3051	Random effect performs better

Source: Author's Computation, 2024

Diagnostic tests for heteroscedasticity, serial correlation, and multicollinearity were performed on the first and second versions of the models employed in the study to determine whether or not the pertinent linear regression assumptions were violated.

The results of the Wooldridge tests confirm that first-order serial correlation exists in models one and two. Heteroscedasticity is another feature of models 1 and 2, according to the Breusch-Pagan test results. Models one and two have variance inflation factors of 1.11 and 1.351, while their mean values are 1.074 and 1.176, respectively. This indicates that both models are free of multicollinearity; the maximum VIF in each scenario does not reach the threshold of 5.

4.4 Panel Regression Results

4.4.1 Regression Analysis for Model One

Following the Hausman test in Table 4, the following section was interpreted using the model's fixed effect regression results, which are more relevant than random effects.

Table 5: Regression Results for Model 1

VARIABLES	(OLS)	(Fixed Effect)	(Random Effect)
TDR	0.000208	0.000245	0.000270
	(0.444)	(0.429)	(0.333)
FS	-0.00609***	0.00380	-0.00502***
	(1.53e-06)	(0.444)	(0.000953)
Age	0.000282***	-0.000138	0.000307***
	(0.000351)	(0.834)	(0.00347)
Constant	0.177***	-0.0893	0.146***
	(5.11e-07)	(0.471)	(0.000524)
Observations	110	110	110
R-squared	0.269	0.026	
Number of fid	11	11	11

Note: **** (0.01), ** (0.05), * (0.1)*

Source: Author's Computation (2024)

The findings from fixed effect panel regression in Table 4's second column confirm that TDR had a positive but non-significant impact on the REM practices, with a calculated coefficient of 0.000245 and matching p value of 0.429. The result indicates that REM practice is insensitive to Nigerian Deposit Money Banks.

4.4.2 Regression Analysis for Model Two

The results of the random effect regression, which are more pertinent than fixed effects, were used to interpret the next section after the Hausman test in Table 4.

Table 6: Regression Results for Model 2

VARIABLES	(OLS)	(Fixed Effect)	(Random Effect)
STDR	-0.000121	0.000273	-0.000110
	(0.673)	(0.487)	(0.736)
LTDR	0.00643**	-0.000441	0.00635***
	(0.0323)	(0.923)	(0.00660)
FS	-0.00571***	0.00415	-0.00568***
	(0.000120)	(0.418)	(1.12e-08)
Age	0.000285***	-0.000153	0.000286***
	(0.000263)	(0.801)	(0.00130)
Constant	0.164***	-0.0983	0.163***
	(5.77e-05)	(0.467)	(1.75e-09)
Observations	110	110	110
R-squared	0.300	0.026	
Number of fid	11	11	11
Firm Effect	YES		

Note: **** (0.01), ** (0.05), * (0.1)*

Source: Author's Computation (2024)

According to column 3 of Table 6's outcomes from the random effect panel regression, STDR results in an adverse but negligible effect on the REM practices, based to the computed correlation coefficient and p-value of -0.00011 and 0.736, respectively. It is implied that REM practices are not driven by STDR. Conversely, the research discovered that LTDR has a favorable impact on REM practices, with a calculated coefficient of 0.0064 that is significant at 1% and a corresponding p-value of 0.0066 (0.0066 < 0.01). It follows that LTDR encourages REM practices of Nigerian Deposit Money Banks.

4.5 Discussion of Results

According to the model, the one displayed in Table 5, TDR has a favorable but non-significant effect on REM practices. This suggests that the proportion of aggregate debt to funding does have a substantial effect on the REM of Nigerian DMBs. The result is in line with agency theory, which makes the assumption that inside resources (funds) is superior to funding from outside sources. Furthermore, outcomes from other relevant studies, including those by Oktasari (2020), Naz and Sheikh (2023), and Muhammad et al. (2024), concur at conclusions. These studies found that an increase in the proportion of total debt in an organization influences its management to engage in EM, which is in contrast to the Thoharo et al. (2021) study conducted in Indonesia.

Table 6 results indicate that STDR had a detrimental but insignificant impact on REM practices. Conversely, the findings also show that LTDR has a favorable and noteworthy impact on the REM practices of Nigerian listed DMBs. This suggests that while the amount of long-term debt taken had an impact on the banks' EM conduct, STDR had no effect on it. These results can be a consequence of lenders' management being pressured to adhere to covenants with their prospective debtors, resulting in them participating in REM. These outcomes align with the conclusions of previous empirical studies, like the one by Quang and Van (2021) and Tulcanaza-Prieto et al. (2020), who all discovered a positive

association between LTDR and EM. However, outcomes did not support the conclusions of research of Korean enterprises by Tulcanaza-Prieto et al. (2020), which found that short-term debt enhances the tendency for earnings management.

5. Conclusion and Recommendations

This research looked into the effects of listed deposit money banks' CS, which are separated into TDR, STDR, and LTDR, on REM practices in Nigeria. Panel regression results showed that whereas STDR had an adverse effect on the dependent variable (REM), TDR and LTDR had a favorable effect on the REM practices across the investigated banks. The results of this study suggest that while attempting to comprehend the relationship between organizational entities' CS and EM practices, the debt-term structure is important. The present research is one of the few that takes into account the debt-term structure when trying to correlate the CS with REM practices in developing nations, and specifically in banking sectors in Nigeria. It is therefore recommended that authorities ought to keep an eye on Nigerian banks' debt-term arrangements in an effort to reduce the prevalence of REM techniques in these institutions. Nigerian Deposit Money Banks are also to streamline the constraints that may compel them to participate in REM practices and are also urged to reach advantageous terms for their eternal debt or to give priority to short-term debt over long-term debt.

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