



Earnings management and shareholders' wealth in listed manufacturing firms in Nigeria

Wale Henry AGBAJE (Ph.D) & ^{*2} Olugbenga AKINFOLARIN

^{1,2} Department of Accounting, Adekunle Ajasin University, Akungba-Akoko, Ondo State, Nigeria.

*Corresponding author: olugbengaakinfolarin@gmail.com

Abstract

The study examined earnings management and shareholders' wealth in listed manufacturing firms in Nigeria. This was done with a view to explore the pressures on management to manage earnings by manipulating the company's accounting practices to meet financial expectations of shareholders and keep the company's stock price up. Ex-post Facto research design was adopted for this study. A sample of twenty-one (21) listed manufacturing firms were selected out of sixty-seven (67) manufacturing firms listed on the Nigerian Stock Exchange as at 31st December, 2018 using purposive sampling technique. Data were collected from secondary sources through the annual reports of sampled firms and Fact book of the Nigeria Stock Exchange for a period of 2008 to 2018. Data were analyzed using descriptive statistics and inferential statistics. The result revealed a positive significant relationship effect of sales growth index (SGI) on shareholders' wealth. However, further result also revealed a negative effect of leverage index (LEVI) on shareholders' wealth. The study concluded that if the Nigerian manufacturing industry is to be made more effective and developed, earnings management have to be managed in such a way that it will cover all loopholes noted in this study to ensure effective management of the indexes of earnings. The study recommended that earnings management (SGI and LEVI) should be paramount in the effective running of the manufacturing industry in Nigeria since effects of the explanatory variables have substantial effects in increasing market value added, either in short run or long run.

Keywords: Earnings management, leverage, shareholders' wealth, sales growth index.

1. Introduction

For decision-making, investors and financial analysts rely primarily on the information included in a company's financial statement. This is because it is a critical means for shareholders to learn about the status of their investment (Zayol, Agaregh & Eneji, 2017). They can tell if a company is profitable or not by looking at the financial statement. Meanwhile, financial statements are intended to be trustworthy by disclosing accounting data that reflects the firm's true status and performance. However, management may make use of accounting standards' flexibility to change reported earnings to suit their needs. (Ezeani, Ogbonna, Ezemoyih, & Okonye, 2012).

Meanwhile, earnings information which is a part of the financial statements is regularly targeted to be managed by management. Such actions can be done by choosing specific accounting policies that enhance the company's profit goal following the wish of management. Earnings management is the process by which management might possibly manipulate financial statements to reflect what they want to have happened during the period rather than what really transpired; this is usually done in reaction to internal and external pressures. In addition, a number of studies described earnings management as a feasible method of legal management decision-making and reporting with the goal of achieving consistent and predictable financial results. (Watts & Zimmerman, 1990; Holthausen, Larcker, & Sloan, 1995; Subramanyam, 1996; Dechow & Skinner, 2000; Davis-Friday & Frecka, 2002; Johnson & Fleischman, 2012; Tang, Elson, Callaghan., Walker, & Higgins 2015). There are already definitions to suggest that the management of earnings can be fraudulent or non-fraudulent; yet, financial reports have been drawn out on whatever basis.



Earnings management information is valuable and interesting to investors, as this is an important foundation to decide whether the wealth of shareholders is maximized. Sometimes companies are able to manage income to gain steady income (mostly regular dividend-paying companies). Daniel, Denis and Naveen (2007) observed that companies are more likely to adjust earnings upward when their earnings would otherwise fall short of expected returns to shareholders investment; and that firms whose discretionary accruals cause reported earnings to exceed expected dividend levels are significantly less likely to cut dividends than are firms whose reported earnings fall short of expected levels of returns on shareholder investment. But on the other hand, since earnings management manifested in the accrual component of firms' profit, it will reduce the level of net operating cash flow. Thus, it can be difficult for companies to make maximum benefit out of shareholder investment. This study consequently focuses upon the sales growth index, leverage index asset quality index, and the depreciation index to evaluate the effects of earnings management on shareholders' wealth.

2. Literature Review and Hypothesis Development

2.1 Conceptual Review

2.1.1 Earnings management

Trotman (1993) defines earnings management as a technique of communication that aims to improve the information supplied to the investors. The economic entity, therefore, submits financial statements to its investors or prospective investors through the filter of certain strategies capable of creating a more beneficial appearance in the market but also the illusion of more attractive results. A company may purposefully alter, in the desired amount and/or direction, the financial result disclosed (i.e. income statement and cash-flow statement) or report on its financial status.

Similarly, Schipper (1989) Notes that earnings management resulted in poor financial quality reports that are a consequence of deliberate interference in the external financial reporting process to acquire some private profit. These definitions take the opportunity of creative accounting as a basis on which reporting quality is based, whereby management's goal is to get some private benefit through misleading stakeholders or to influence contractual results. In this perspective, the bigger the number of innovative accounting procedures, the worse the profit quality and vice versa. If earnings were managed opportunistically, the reported earnings number and the overall financial reports would be of lower quality. Filed, Sullivan, and Lin (2001), stated that earnings management is witnessed when managers exercise their discretion over accounting numbers, with or without restrictions. Such discretion can be either firm value-maximizing or opportunistic. Thus, there are two types of earning management, opportunistic and informative. Opportunistic creative accounting practices means that managers seek to mislead investor by pursuing the management's interests. The literature on this type of creative accounting mainly originated with Healy (1991) who finds that managers use accruals to strategically manipulate bonus income.

2.1.2 Sales growth index

In many industries, sales revenue is a crucial issue, as sales are the principal channel via which a firm's assets and growth potential are converted into cash (Hand, 2005). Kennon (2017) specifies that the first line of any income statement or profit and loss statement is an entry termed total revenue or total sales. According to him, the figure is the amount of money a business took in over the time period covered by the income statement, which does not represent the business's profit. The overall revenue amount is crucial since a business must bring in money in order to make a profit. If a corporation has less income, all else being equal, it will make less profit. Revenue can sometimes be used as a predictor of future profitability for start-up enterprises that have yet to earn a profit.

Total sales are computed by multiplying the total number of units sold by the price per unit, implying that market price and quantity are the most important factors of total sales revenue. Total sales will rise as quantity and market price rise, and vice versa. Total sales revenue is a critical indicator for business owners/managers and investors alike since it provides a pretty



accurate estimate of the business's performance. (Hand, 2005).

2.1.3 Leverage Index

LEVI is the total debt-to-total-asset ratio in year t relative to the similar ratio in year $t-1$. A LEVI greater than one implies that leverage has increased. The variable is provided to account for debt covenant incentives to manipulate earnings. LEVI implicitly gauges the leverage forecast error, assuming leverage follows a random walk. The change in leverage in the firms' capital structure was used given evidence in Beneish and Press (1993) that such changes are associated with the stock market effect of default.

The financial leverage index is a solvency ratio that can tell us how successfully a company uses leverage to boost its return on equity. It essentially informs us how good the firm is at leveraging its capital structure. This ratio, in general, compares a company's rate of return on equity to its rate of return on assets. The return on equity in the preceding example is much greater than the return on assets (by a multiple of 2.5). This suggests that the stock base is significantly lower than the asset base. The company has successfully used leverage to increase the returns to its stockholders (similar to the example we discussed in the introduction above). A growing index implies that the corporation has benefited from greater debt. Simultaneously, if the financial leverage index decreases over time, it suggests that the corporation has not been able to employ leverage to its advantage. You can get more clarity on the reasons behind this observation by going through the financial statements of the firm.

2.1.4 Sales Growth Index and Market-value added

Ataünal, Gürbüz, and Aybars (2016) Concluded that sales growth appears to have a major impact on value generated by shareholders. A rise in the dollar's sales revenue appears to give shareholders an average value of 0.7 dollars when their growth rate is not higher than their SGR. It is interesting to note that capital growth also gives the shareholders' value. Companies raise their capital to fund or enhance their debt ratio. Both may contribute positively to shareholder value. Within fast growth (growth rate $>$ SGR), It is noted that the coefficient of sales growth decreased from 0.71 to 0.39 and the coefficient of profitability has been minimal. When the regression estimate was performed without control variables, the sales growth coefficient dropped from 0.85 to 0.40, maintaining its high importance.

Ramezani *et. al.*, (2002) imply a growth rate at which the value of shareholders is maximized. By classifying corporations according to their growth rate, they diagnosis high-growth firms. But every company has its own potential for growth. The over-growth threshold should vary for each company. Therefore, the maximization of shareholder value should occur for each company in each observation period at a different degree of growth. We must first consider where this company-specific maximization can take place, then examine the empirical data. The "acceptable growth rate" model for a company is previously theorized.

Marinakakis (2011) studied the Beneish M-score model to offer the model of profit detection for manipulation. The result indicates that the enhanced model identifies possible manipulators. Similarly, (Dechow, Ge and Larson, 2011) added the Beneish M-score model to other models developed to deduct earning management, then came up with the Z-score model. The study concludes that the Z-score provides a supplementary and complementary measure to researchers for discretionary accruals for the identification of low-quality earning firms. The findings revealed that Japan and ASEAN had no significant difference with each other in their sales growth performance. Meanwhile, ASEAN shows better performance in profitability when comparing with Japan in the ICT industry. The analysis also supports The Global Information Technology Report publish by INSTEAD and World Economic Forum, OECD report, and previous literature studies. It also has practical implications for business leaders and owner-managers in the ICT sector.



2.1.5 Leverage Index and Market-value added.

One of a company's key choices is a financial plan, as the financial plan has an impact on the company's market value, capital cost, and shareholders' return. A company's financial leverage is the debt-to-equity proportion. As the optimum debt ratio affects the market value and return of the shareholder, the ratio is a variable to optimize market value in order to maximize the return of shareholders. Over the years, numerous investigations on these concerns were done. Most of the empirical investigations were undertaken from the perspective of industrialized countries. This study attempts to analyze the impact on shareholder returns of certain listed businesses in Bangladesh under four industries. The study determines that Bangladesh's leverage/E-listed companies regard the indebtedness ratio as an independent variable and EPS as a dependent variable. The results of the study show that leverage has a statistically important effect on returns and efficient leverage management can maximize the EPS value.

Nirujah, Niththiya, Kunalan, Visuvarajh, Adams, and Kinchchili (2014) examined the impact of leverage on shareholders' return of selected listed manufacturing companies on Colombo stock exchange (CSE) in Sri Lanka. Leverage is the shareholders' and shareholder fund proportionate ratio which affects the return of a company's shareholders. There have been no researchers on these concerns over the years. In this paper, leverage was regarded as the stand-alone variable measuring equity debt (DE), total asset debt (DTA), and shareholder return (DTA) as the dependent variable measured by shareholders' fund return (ROSF), share earnings (EPS), and dividend return (DY). In the sample, the 12 manufacturers listed on CSE were investigated for a period of five years between 2008 and 2012. The information and data required for the study have been collected from public annual reports, fact sheets, and CSE websites from 2008 to 2012. To detect the association and indicate the influence between the levy and shareholder return, Correlation and Regression Analytics were employed. Analyzed data demonstrated that all variables other than debt relate adversely to the total asset and income per share.

Akinmulegun (2012) The impact of financial leverage on selected corporate performance indicators in Nigeria was empirically examined. The economic technique of the vector autoregression (VAR) model was used to try to juxtapose the earlier findings specific to developing countries. The research showed that Leverage shocks significantly impact Nigeria's corporate performance. In addition, income per share (EPS) is more dependent on feedback and less on leverage. Earnings shocks per share indirectly influence net assets per company share, as the bulk of the net asset shocks per share is shared by the companies' profit per share. Leverage therefore significantly affects corporate performance in Nigeria. Instead of depending on the structured theories of the advanced developed world countries, theories that are suitable for indigenous macro-economic variables should therefore be produced, because these theories cannot be suitable proxies for the progress of developing countries.

Jean and Siham (2013) examine the role of cross-listed activities to alleviate domestic market restrictions and to promote mergers and procurement in the US. The results reveal that the cross-listing permits target companies' shareholders to draw up greater collection premiums in comparison to non-cross-listed partners. Moreover, stockholders of Sarbanes-Oxley seem to have a higher premium. The investigator discovered that cross-listed businesses tend to be purchase targets, in line with the idea that cross-listed businesses boost corporate control attractiveness and market visibility. Matemilola et al., (2013) A sample of the study undertaken by 94 companies listed on the Bursa Malaysia throughout the period 2000 to 2009 was carried out in empirical tests, entitled "Impact of Leverage and Management skills on shareholder return." In part, management usage of excessive leverage is a result of the recent financial crisis that saw a rise of the world risk premium and shareholder return. The research examines the impact on the return of shareholders of leverage and management competence. Our examination of regression, which controls for managerial skills, shows a good association between leverage and shareholder's return. Management skills also have a beneficial connection with the shareholders.



2.2 Theoretical review

2.2.1 Agency theory

Adam Smith (1776/1937) is perhaps the first author to perceive the agency problem and was the motivating factor for the economists to propound the agency theory. According to the theory, the shareholders are the firm's owners, and the managers are the agents designated by the shareholders to run the company in order to achieve the specified goals. Agents (managers) are required to operate in the best interests of the shareholders who appointed them, however, there may be a conflict of interest between management and shareholders. To reduce this conflict, the shareholders invest agency costs so that the nominated managers can act in their best interests. When this conflict of interest arises, management has a tendency to manipulate the financial statements in a variety of ways, with earnings management being one of the most prominent. This theory is pertinent to this work since it asserts that agency crises are the primary motivator for management to engage in dishonest financial reporting (conflict of interest).

The interaction between the investor and the managers is explained by agency theory. The agent (manager) agrees to do specified tasks for the principal (investors), and the principal agrees to compensate the agent (Jensen & Meckling, 1976). Donaldson and Davis (1991) argued that in organizations with broadly distributed share ownership, managerial action does not necessarily promote shareholder return. Fiet (1995) argued that the degree of ambiguity about whether the agent would seek self-interest rather than comply with the contract terms is claimed to be an agent risk for an investor. The principal will always be interested in the output generated by the agents, according to agency theory. This highlights the significance of accounting and auditing in giving information related to stewardship. This study is grounded in Agency theory since it aims to determine the impact of managerial behavior (agent action) on performance or output that is in the principal's best interests (investor).

2.3 Empirical Review

Various studies such as Schipper (1989) and Stavroula (2019) have indicated that earnings management, which happens to be one of the forms of creative accounting practices, occurs because management has the discretion to choose from several accounting principles in preparing financial statements. Management will from time to time feel the pressure to manage earnings by manipulating the company's accounting practices to meet the financial expectations of shareholders and keep the company's stock price up. Many executives receive bonuses based on earnings performance, and others may be eligible for stock options when the stock price increases. Hence since a major part of management's emoluments are tied to the financial performances of their organizations, management will be tempted to putting their interests in receiving emoluments and bonuses ahead of the issue of ensuring that shareholders investments are maximized.

Similarly, prior studies such as Chen (2016) Ajide and Aderemi (2014), Ibrahim, Bala, Jamila and Garba (2015), Hauwa, Ocheni and Jamila (2017) noted that it may be essential to make accounting provisions and accrual (and estimations) for companies so as to maintain an entity's accounting reality. The financial scandals and corporate failures in companies throughout the world resulted from earnings management and prompted concerns about the authenticity and reliability of accounting earnings as elements that may be taken into consideration in calculating cash dividends for shareholders.

Due to this, several studies such as Marcia, Alan, and Hassan (2008), Cuong (2011), Im, Kim, and Choi (2015), Atu, Enegebe, and Atu (2016) looked into the reasons for this mistake, resulting in the collapse of enterprises. There were numerous elements in this area that, for example, are not excluded from earnings management, such as misappropriation of cash and a lack of accountabilities to mention a few. However, Monsuru and Adetunji (2014) conducted a study on the Effects of Earnings Management on dividend policy in Nigeria: An Empirical note from the perspective of quoted non-financial companies, the results reveal that earnings management has a negative relationship with the dividend policy of a firm and it is not significant in the determination of dividend payout of every firm. Consistent with the findings

of Monsuru and Adetunji (2014), the study indicated that earnings management has minimal relationships with dividend policies in Pakistan in previous studies carried out in Pakistan. The Beneish M score model has established an effective tool to detect earnings management among companies. The influence of the sales growth index, leverage index, on market value added was therefore investigated in this study. The study thus intended to link the effect of sales growth index to market value added and determine to what degree the leverage index impacts added value. Therefore, the hypothesis has been raised for achieving these goals.

3 Data and Methods

Ex-post Facto research design was adopted for this study. A sample of twenty-one (21) listed manufacturing firms were selected out of sixty-seven (67) manufacturing firms listed on the Nigerian Stock Exchange as at 31st December, 2018 using purposive sampling technique. Data were collected from secondary sources through the annual reports of sampled firms and Fact book of the Nigeria Stock Exchange for a period of 2008 to 2018. Data were analyzed using descriptive statistics and inferential statistics.

3.1 Model Specification

Model I:

$$MVA = f(SGI) \dots\dots\dots 1$$

$$MVA = \alpha + \beta_1 SGI + ? \dots\dots\dots 2$$

Where SGI = Sales Growth Index

MVA = Market Value Added

? = Error term

This model will be used in testing hypothesis I

Model II:

$$MVA = f(LEVI) \dots\dots\dots 3$$

$$MVA = \alpha + \beta_1 LEVI + ? \dots\dots\dots 4$$

Where LEVI = Leverage Index

MVA = Market Value Added

? = Error term

4. Data analysis and discussion of findings

Table 1: Descriptive statistics of variables

Variable	Obs	Mean	Std. Dev	Coef. of variation	Min	Max	Pr(Skewness)	Pr(Kurtosis)
MVA	495	160.1042	3135.7650	19.5858	-989.3800	69701	0.0000	0.0000
LEVI	495	1.3103	1.8503	1.4121	0.0000	24.0360	0.0000	0.0000
SGI	495	1.0991	0.7612	0.6926	0.0000	9.0350	0.0000	0.0000

Source: Authors' computation (2019)

The evaluated variables include market added value (MVA), Leverage index (LEVI), and Sales growth index (SGI). It is, however, observed that except for SGI with relatively low coefficients of variation, the distribution of other variables are significantly dispersed. More noticeable is the standard deviation and coefficient of variable of both MVA at 3135.77 for standard deviation and 19.59 for coefficient of variation, respectively. The significant dispersion of the variable is obviously as a result of the heterogeneity of the cross-section i.e. companies selected across unrelated industries are aggregate for the analysis. Meanwhile, highly dispersed variables do not imply non-normal distribution, but show that most values are captured within a higher confidence level. So, a significant fraction of the total distribution is within a confidence level of 99.9% while less is within 68% confidence level. Unlike a less dispersed distribution where distribution with 99.9% and 68% are somewhat close

The P-value result of the unit root test in table 2 revealed that all the variables are integrated at level as the p-values are less than 5% level of significant. Thus, efficient and consistent model



can be produced using longitudinal/ panel data methods (fixed effect, random effect and pooled regression on the data). The Hausman test was conducted to determine the appropriate model between the fixed and random effect model. The chi square value as shown in table 3 revealed, 1175.4 with its corresponding probability value of 0.0 is greater than 5 percent level of significant. Therefore, it can be concluded that the null hypothesis was rejected while the alternative hypothesis that asserts the appropriateness of fixed effect result was accepted.

Table 2: Summary of Panel unit root test

Variable	LLC- Statistics	P-value	Remark
MVA	-16.2810	0.0000	I(0)
LVGI	-7.3090	0.0000	I(0)
SGI	-16.32030	0.0000	I(0)

Source: Authors' computation (2019)

Table 3: Summarized Hausman specification test for random effect

Test Summary	Chi-sq.		
	Statistic	Chi-sq d.f	Prob.
Cross-section random	1175.4	1	0.0000
Cross Section Random effects test comparisons:			
Variable	Fixed	Random	Var(Diff.) Prob.
EM	.274179.2685202	.0056588	0.000008

Source: Authors' Computation (2019)

4.1 Relationship between sales growth index and market value added

From the pooled regression result shown in table 4, sales growth index showed a positive relationship with the firms' market value, this means that when the firms' sales growth index is declared or recognize the market value added will increase by 9.83 percent. This is consistent with the *a-priori* expectation. This variable is highly significant with the p value and t statistics equal to 0.000 and 18.91 respectively, this showed that sales growth index is a very important determinant of market value added. The study shows that there is significant effect of the sales growth index on the market value added. This is because the p value of 0.000 is less than the level of significance of 0.05 percent. That is, the null hypothesis is rejected and the alternative hypothesis was accepted that there is significant relationship between sales growth index and market value added.

Table 4: Pooled regression result

Fixed-effects (within) regression		Number of obs	=	495
Group variable: companies		Number of groups	=	45
R-sq:		Obs per group:		
within	= 0.5051	min	=	11
between	= 0.0002	avg	=	11.0
overall	= 0.0017	max	=	11
corr(u_i, Xb) = -0.5612		F(5, 445)	=	90.84
		Prob > F	=	0.0000

MVA	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
SGI	9.829857	.5198641	18.91	0.000	8.808163	10.85155
AQI	.8571742	.3220373	2.66	0.008	.2242713	1.490077
depi	-.2701171	.1105034	-2.44	0.015	-.4872904	-.0529438
lvgi	-.2333591	.0711192	-3.28	0.001	-.3732734	-.0934448
em	.274179	.1446048	1.90	0.059	-.0100141	.5583721
_cons	-41.81723	3.776922	-11.07	0.000	-49.24005	-34.39441
sigma_u	13.739142					
sigma_e	2.3280921					
rho	.97208827	(fraction of variance due to u_i)				

F test that all u_i=0: F(44, 445) = 249.83		Prob > F = 0.0000
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Source: Authors' computation (2019)

4.2 leverage index and market value added of listed manufacturing firms in Nigeria.

The fixed effect result is presented above as chosen through the statistical process. All the explanatory variables are significant at 5% level. Furthermore, the negative intercept of the equation at -41.82 could mean that if all explanatory variables are not considered (that is zero coefficients), market value added (MVA) is mostly going to be negative. That said, from the result above, Sale growth index (SGI) seems to be the most significant explanatory variable. Its coefficient put at 9.82 revealed that if sales growth index goes up by 1 unit, market value add (MVA) will rise by 9.82 times. However, among other factors, sales growth has significant influence on shareholder wealth maximization. Also, from the table above, leverage index showed a positive relationship with the market value added, this means that when the firms leverage index is declared or recognized the market value added increases. This is consistent with the *a-priori* expectation. This variable is highly significant with its p value and t test equal to 0.001 and -3.28 respectively, this showed that leverage index is a very important determinant of market value added. The study also shows that there is significant effect of the leverage index and market value added. This is because the p value of 0.001 is less than the level of significance of 0.005 percent. That is, the null hypothesis is rejected and the alternative hypothesis is accepted that there is significance relationship between leverage index and market value added.

Table 5: Pooled regression result

Fixed-effects (within) regression		Number of obs	=	495
Group variable: companies		Number of groups	=	45
R-sq:		Obs per group:		
within	= 0.5051	min	=	11
between	= 0.0002	avg	=	11.0
overall	= 0.0017	max	=	11
corr(u_i, Xb) = -0.5612		F(5,445)	=	90.84
		Prob > F	=	0.0000

MVA	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
SGI	9.829857	.5198641	18.91	0.000	8.808163	10.85155
AQI	.8571742	.3220373	2.66	0.008	.2242713	1.490077
depi	-.2701171	.1105034	-2.44	0.015	-.4872904	-.0529438
lvgi	-.2333591	.071192	-3.28	0.001	-.3732734	-.0934448
em	.274179	.1446048	1.90	0.059	-.0100141	.5583721
_cons	-41.81723	3.776922	-11.07	0.000	-49.24005	-34.39441
sigma_u	13.739142					
sigma_e	2.3280921					
rho	.97208827	(fraction of variance due to u_i)				

F test that all u_i=0: F(44, 445) = 249.83	Prob > F = 0.0000
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Source: Authors' computation (2019)

5. Conclusions and recommendations

The specific objective which the study sought to achieve has indeed yielded the overall result which provide an evidence to show the impact of earnings management on shareholders wealth of listed manufacturing firms in Nigeria. The market value added has been linked by the findings of the study to be having an impact on the explanatory variables, Effective and adequate management of the explanatory variables will therefore have a great result on the market value added of firms. Consequently, if the Nigerian manufacturing industry is to be made more effective and developed, earnings management (proxy by SGI and LVGI) have to be managed effectively and best means of covering all loopholes and effective management of the indexes of earnings management must be developed. However, this must be done by professionals in the field of accounting so that adequate advice can be given to the top management level for decision making. the study therefore recommend that;

The earnings management (SGI and LEVI) should be paramount in the effective running of the manufacturing industry in Nigeria. Since effects of the explanatory variables have effective effects in increasing market value added either in short run or long run.

Threat or total reduction in market sales due to improper organization of earnings management proxies including other cases may bring about firms' failure.



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