Artículo original de investigación

Empirical Discourse on Accounting Conservatism and Financial Performance of Multinational Companies in Nigeria

Discurso empírico sobre el conservadurismo contable y los resultados financieros de las empresas multinacionales en Nigeria

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Abstract

This study aims at finding out how accounting conservatism influences the financial performance of multinational companies (MNCs) in Nigeria. In particular, it investigates the impact of unconditional and conditional conservatism on the return on equity (ROE) of MNCs in Nigeria. It also considers how financial leverage and size of the firm moderate this relationship. The study takes a positive research approach and collects data from eight cross-sectional entities represented by 120 observations over 15 years (2006 – 2022). During the investigation, information was sought from the sample of eight MNCs that were used. The panel-corrected standard error regression (PCSE) was employed to deal with potential parameterization problems. In conjunction with the regression analysis, several diagnostic tests were conducted including multicollinearity testing, correlation analysis, and descriptive statistics. The statistical software Gretl was used to evaluate the regression results. The results indicate that conditional conservatism enhances the financial performance in terms of the ROE of the sampled MNCs which is significantly higher. On the other hand, unrestricted conservatism has an adverse effect on ROE reducing it. While higher levels of conditional conservatism positively affect the financial performance of MNCs, larger degrees of unconditional conservatism lower their return on equity (ROE). Given these findings, suggestions are given to the management that multinational company managers should opt for conditional conservatism so as to lower information asymmetry in financial reporting since it enhances financial performance as well as operational effectiveness.

Keywords: Accounting Conservatism, Financial Performance, Multinationals, Nigeria Return on Equity (ROE)

Resumen

Este estudio pretende averiguar cómo influye el conservadurismo contable en los resultados financieros de las empresas multinacionales (EMN) en Nigeria. En concreto, investiga el impacto del conservadurismo incondicional y condicional sobre la rentabilidad de los fondos propios (ROE) de las EMN en Nigeria. También examina cómo el apalancamiento financiero y el tamaño de la empresa moderan esta relación. El estudio adopta un enfoque de investigación positiva y recoge datos de ocho entidades transversales representadas por 120 observaciones a lo largo de 15 años (2006 - 2022). Durante la investigación, se recabó información de la muestra de ocho EMN que se utilizó. Se empleó la regresión de error estándar corregida por panel (PCSE) para tratar los posibles problemas de parametrización. Junto con el análisis de regresión, se realizaron varias pruebas de diagnóstico, como pruebas de multicolinealidad, análisis de correlación y estadísticas descriptivas. Para evaluar los resultados de la regresión se utilizó el programa estadístico Gretl. Los resultados indican que el conservadurismo condicional mejora el rendimiento financiero en términos de ROE de las EMN de la muestra, que es significativamente mayor. Por otra parte, el conservadurismo sin restricciones tiene un efecto adverso sobre el ROE, reduciéndolo. Mientras que los mayores niveles de conservadurismo condicional afectan positivamente a los resultados financieros de las EMN, los mayores grados de conservadurismo incondicional reducen su rentabilidad sobre recursos propios (ROE). A la vista de estos resultados, se sugiere a los directivos de las multinacionales que opten por el conservadurismo condicional para reducir la asimetría de la información en los informes financieros, ya que mejora el rendimiento financiero y la eficacia operativa.

Palabras clave: Conservadurismo contable, resultados financieros, multinacionales, Nigeria Rentabilidad de los fondos propios (ROE)

Introduction

Accounting standards require financial statements to be used by different stakeholders so they can know the financial situation of an enterprise. One of the most fundamental principles under these regulations is accounting conservatism. According to this principle, the accountants should follow some specific rules which were created to deal with uncertainties and risky situations (Dang, Nguyen & Tran, 2020). Zhong and Li (2017) describe conservatism as recognizing expected profits until the real or cash basis of profits is less certain thereby implying revenue should not be anticipated earlier than its receipt; matching expenses against revenues (Kian, Faghih, Sh & Amiri, 2021) . Its importance lies in the fact that it gives the information about things which although very significant yet they are not shown in the books of accounts.

El-Habashy (2019) points out that accounting conservatism arises from the careful interpretation of financial data to ensure that profit claims are not made without thorough scrutiny of the evidence. This method assumes that the worst thing about a company's economic outlook will actually happen; hence, uncertain liabilities should be recognized and recorded immediately while revenues are only acknowledged after they have been received. Thus, instead of concentrating on maximizing earnings, investors should use prudence which makes accounting conservatism necessary for those who want high returns on their investments.

Although it is an important idea, there is no one definition for accounting conservatism. This was noted by Ahmed et al. (2021) and Adah and Samaila (2016) who also observed that the conceptual and methodological inconsistencies surrounding this topic are rampant. Some people think companies should adopt it while others do not care much about them at all. Besides other areas such as determinants or financial reporting quality and even corporate governance having plenty more literature compared with conservative accounting's effects on financial performance; there isn't much work done in that particular field too. Additionally most previous researches fail to make a difference between conditional conservatism from unconditional conservatism as they mainly use total accruals method.

This study will fill in these gaps by investigating how multinational enterprises' financial performance in Nigeria is affected by the application of accountancy prudence i.e conservative approach in preparing their reports. The research will be done in such a way that each section has clear objectives which include:

- Examine how conditional conservatism affects the Return on Equity (ROE) of multinationals in Nigeria.
- Evaluate how unconditional conservatism influences the ROE of multinationals in Nigeria.
- Investigate the moderating influence(s) of firm size on the relationship between accounting conservatism and ROE.
- Analyze the moderating effect(s) of financial leverage on the relationship between accounting conservatism and ROE.

This study extends prior research by including unconditional conservatism along with conditional conservatism and incorporating financial leverage into the model. In addition, a focus on multinational corporations offers new perspectives regarding how accounting rules may impact financial results within diverse organizational settings. Moreover, this work contributes to the literature by considering different operational indicators instead of limiting itself to one particular country or type of industry.

Review of Literature

Accounting conservatism is all about choosing accrual methods when the situation is uncertain so as not to overstate assets and incomes which have the effect of reducing owner's equity. This involves management's approximations and assessments on future cash inflows that try to reveal the real business performance (Bill, Iftekhar, & Qiang, 2016). It means recognizing gains at the most minimal amount but not losses while at the same time assuming higher expense figures without exceeding their possibilities thus keeping them within what can be considered reasonable for such cost items like those incurred upto date with period end activities being also taken into account where necessary according Sana'a (2018).

Furthermore, apart from being used in financial statements preparation; this principal also helps in ensuring success and continuity of a going concern enterprise. Research has shown that practicing accounting conservatism can have an impact, on a companys success by protecting shareholder value (Antana & Klann 2016). Additionally it plays a role in overseeing executives and reducing concerns about risks by addressing information imbalances (Alhenaoi, 2018; Alkurdi, Al Nimer & Dabaghia 2017) thus aligning managerial decisions with the interests of shareholders and enhancing the overall value of the company. The growing emphasis on accounting conservatism is linked to its influence on information, which affects investor perceptions and supports the forecasting of cash flows.

Accounting conservatism is generally divided into two categories; unconditional conservatism. Conditional conservatism involves recognition of news than positive news leading to faster declines in net assets following adverse information (Beaver & Ryan 2005). This approach involves identifying earnings updates before ones, known as news dependent or ex post conservatism (Basu, 1997). On the hand unconditional conservatism entails recognizing book values of net assets over time due to compliance, with accounting standards and regulations (Beaver & Ryan 2005) also known as balance sheet conservatism.

Evaluating a company's performance includes assessing how effectively management uses resources to generate profits (Temile & Akan, 2024; Akan, 2024). Different measures, like return on equity (ROE) return on assets (ROA) return on capital employed (ROCE) and net income margin (NIM) are used to gauge performance. Adah and Thompson (2016) highlight that ROE is an indicator of how a company is doing as it directly reflects profitability in relation to equity. ROE helps in assessing profitability relative to equity giving insights into how effectively management deploys resources. Hence ROE was selected as the metric for performance in this research due to its relevance in evaluating a company's profitability and operational efficiency.

Theoretical framework

This study is based on agency theory, which focuses on the conflict between principals and agents due to information asymmetry and conflicting interests (Jensen & Meckling 1976). Information asymmetry, where one party has knowledge than others—is central to agency theory. Poses challenges in decision making processes.

Agents, motivated by incentives like gains and career advancement might be overly optimistic, about the firm's performance potentially deviating from the principals broader goals. The difference highlights issues, with decision making authority. Emphasizes the need for tools like accounting conservatism to address these challenges (Affes & Sardouk 2016).

According to Affes and Sardouk (2016) accounting conservatism is crucial in resolving conflicts of interest by improving contracts reducing costs speeding up decision making processes and decreasing information imbalances. In economic conditions accounting conservatism is essential for ensuring the accuracy and openness of financial reporting practices (Ndubuisi & Ezechukwu 2017).

By adopting accounting conservatism companies can bring owners. Managers interests into alignment promoting trust and responsibility within governance frameworks. Additionally, using accounting principles aids in precise risk evaluation and boosts stakeholders faith in the trustworthiness of financial disclosures. In summary agency theory offers a foundation for understanding the interactions between principals and agents in environments. It stresses the significance of accounting conservatism as a tool for handling conflicts of interest and improving reporting efficiency.

Empirical analysis

Several empirical studies have explored how accounting conservatism impacts company performance across sectors and regions worldwide. These studies offer insights into the consequences of accounting practices. For his part, Ahmed (2020) investigated how accounting conservatism influences the performance of insurance companies, in Jordan. Ahmed conducted a study using data from twelve insurance companies over the period of 2007, to 2014. The research revealed that adopting accounting practices had an impact on key performance indicators such as return on assets, earnings per share and market value per share emphasizing the significance of conservative accounting policies in boosting the financial performance of insurance firms.

In a study by Ugwunta and Ugwuany (2019) the connection between accounting conservatism and the performance of consumer goods companies was investigated. Analyzing data from twelve consumer goods companies spanning from 2005 to 2016 they observed a positive influence of accounting conservatism on business performance. This suggests that Nigerian consumer goods companies tend to present reports with levels of conservatism potentially affecting the quality of financial reporting.

Ramadan (2019) delved into factors impacting earnings quality among firms listed on the Amman Stock Exchange. Using data from 58 businesses between 2000 and 2013 Ramadan discovered a correlation, between financial success and leverage accounting conservatism and business performance. This underscores the importance of adopting practices in enhancing earnings quality.

Furthermore Lyimo (2019) examined how conditional conservatism affects earnings quality and stock prices in the capital market. Lyimo analyzed data, from 500 companies listed on the Bombay Stock Exchange from 2006 to 2012 confirming the presence of conservatism in the capital market. The focus was on its influence on stock prices than the quality of reported earnings.

El Habashys research in 2019 delved into the level of accounting conservatism and its determinants within a sample of 114 companies spanning from 2002 to 2006. The study unveiled a level of accounting conservatism among companies with banking sector financial reports showing the highest level. Moreover smaller firms exhibited conservatism compared to ones.

Ramalingegowda and Yus study in 2018 examined how accounting conservatism impacts performance using a sample of over 40,000 U.S. listed businesses from 1972 to 2011. Their findings indicated that firms with financial reporting practices adjusted their capital structure more effectively especially in low leverage firms. This facilitated capital structure adjustments and ultimately boosted performance.

Khalifa, Othman and Hussainey (2018) investigated both unconditional conservatisms effects on performance in the Middle East and North Africa region spanning from 2004, to 2017.

The findings supported the idea that conditional conservatism has an impact, on performance by improving the effectiveness of debt agreements especially by hastening debt covenant breaches.

In their study, Lawal and Shehu (2017) explored how accounting conservatism influenced the performance of banks using data from ten banks in Nigeria spanning from 2012 to 2016. By breaking down accounting conservatism into unconditional components they discovered that conditional conservatism had an effect on bank performance whereas unconditional conservatism had an adverse effect.

Furthermore various research works contribute to our comprehension of the link between accounting conservatism and firm performance. For example Abbas and Abdullah (2016) analyzed how accounting conservatism impacted corporate governance mechanisms in companies while Zhou and Wang (2015) delved into the influence of accounting conservatism on investment efficiency in Chinese traded firms. These studies collectively emphasize the importance of accounting conservatism in shaping reporting practices and its effects on performance across diverse settings.

Methodology

The study employed an ex post facto research design due, to the use of data. This involved describing conditions interpreting existing data, well as uncovering and explaining past occurrences. The research followed a research philosophy. It encompassed all eight companies listed on the Nigerian Stock Exchange as of December 31st, 2021.

The primary factors, for selecting these corporations include their standing business stability and significant market presence. The research primarily relied on information extracted from the reports of the selected companies. Supplementary sources of data encompassed articles and academic publications. The study covered a period of 15 years (i.e. 2006 to 2022) over 8 cross-sectional units culminating in 120 observations (15*8=120 Observations).

To address over parametization issue, the paper adopted the panel-corrected standard error regression, or PCSE. Meanwhile, all relevant tests (PCSE) are run concurrently with the regression model. The relevant tests (PCSE) include multi-collinearity testing, correlation analysis, and descriptive statistics before the regression analysis was conducted. Gretl was utilized to test the regression outcomes. Meanwhile, Gretl was utilized to test the regression outcomes. The research utilized the econometric model is expressed in equation 1 below:

$$ROEit = \beta 0i + \beta 1COCSit + \beta 2UCCSit + \beta 3FSIZit + \beta 4FLEVit + eit\text{---------------------------------------}1$$

Where:

B0	=	Constant Term
ROEt	=	Return on Equity at time t
COCSt	=	Conditional Accounting Conservatism at time t
FISZt	=	Firm Size at time t
FLEVt	=	Financial Leverage at time t
$\beta 1$- $\beta 4$	=	Parameter Estimate
εit	=	Error Term (component of unobserved factor)

The model above was adapted from Lawal and Shehu's model. The adapted model included financial leverage. Also, we replaced ROE with ROA. Again, their study centered on the banking industry, the current study focused on 8 multinationals.

Table 1. Operationalization of Study Variables

Variable	Code	Measurement	Apriori Expectation
Dependent Variable-Firm Performance			
Return on Equity	ROE	Net income after tax/total equity	Nil
Independent Variable-Accounting Conservatism Parameter			
Conditional Accounting Conservatism	COCS	NIit= β0+ β1DRit+ β2Rit+ β3Rit*DRit+ εi Where: NI=Earning Yields; β0=Intercept; Β1- β3: Beta Slope/Gradient; DR=Dummy variable wherein 1 is denoted for good needs while 0 is for bad news; R-Stock return at the beginning of the fiscal year; εi = Residual error	Positive
Unconditional Accounting Conservatism	UCCS	Net income before extraordinary itemsit – operational cash flows/total assets	Negative
Moderating Variables-			
Firm Size	FSIZ	Log of total assets	Positive
Financial Leverage	FLEV	Debt to equity ratio	Negative

Source: Researcher's Compilation from Studies of Lawal and Shehu (2017)

Results and discussion

Table 2. Descriptive statistics

Variables	Mean	Median	Maximum	Minimum	Std. Dev.	Observations
COCS	6.37	4.51	24.70	1.080	3.87	120
UCCS	20.50	19.50	29.80	10.10	5.90	120
FSIZ	8.54	9.79	12.11	0.40	3.01	120
FLEV	1.45	1.52	2.92	0.12	0.73	120
ROE	2.81	2.60	15.02	-0.14	1.91	120

Source: Gretl (2023)

Table 2 reported an average ROE value of 2.81% but deviated by 1.91%. Since the mean ROE is higher than its standard deviation value suggests that the data is suitable for inferential analysis. This further inferred that the inferential statistics are not badly affected by the outliner issue. Also, the least/minimum ROE value from 2006 to 2022 was -0.14% while the highest/maximum ROE value from 2006 to 2022 was 15.02%. In like manner, conditional conservatism (COCS) has an average/mean value of 6.37 but deviated by 3.87. The fact that its standard deviation value is lower than its mean value indicates that the data is well-fitted. Lastly, the study reported an average unconditional conservatism (UCCS) of 20.50 but deviated by 5.90 with values ranging from 10.10 to 29.80.

Lastly, the study reported average FSIZ and FLEV values of 8.54 and 1.45 respectively but deviated by 3.01 and 0.73 respectively. Meanwhile, their lowest and highest values range from 0.40 to 12.11 and 0.12 to 2.92 respectively. Additionally, there is evidence that the data are not favorably biased and are suitable to yield a trustworthy conclusion.

Table 3. Correlation Analysis

	ROE	COCS	UCCS	FSIZ	FLEV
ROE	1.0000				
COCS	0.8667	1.0000			
UCCS	-0.5629	0.1438	1.0000		
FSIZ	0.3781	0.1210	0.1071	1.0000	
FLEV	-0.6118	-0.003	0.0813	-0.094	1.0000

Source: Gretl (2023)

The correlation analysis shows the direction and degree of linearity among all reported variables in the model (conditional conservatism, unconditional conservatism, firm size, financial leverage, and return on equity. The result reveals clearly that, conditional conservatism and firm size are positively related to ROE while both unconditional conservatism and financial leverage are negatively related to ROE. Overall, none of the regressors highly correlated with each other. This however calls for an investigation of the possibility of the presence of multicollinearity. This is presented in table 4:

Table 4. Multi-collinearity Test

Variables	COCS	UCCS	FSIZ	FLEV	VIF
VIF	1.58	1.39	1.52	1.30	1.45
TOV=1/VIF	0.63	0.72	0.66	0.77	0.69

TOV= Tolerance Value; VIF=Variance Inflation Factors
Source: Researcher's Computation, 2023.

As presented in Table 3, each variable's VIF and VIF reciprocal (tolerance) values are presented. Justifiably, COCS has a VIF value of 1.58 and VIF reciprocal (tolerance) value of 0.63; UCCS has a VIF value of 1.39

and TOV of 0.72; FSIZ value of 1.52 and VIF reciprocal (tolerance) value of 0.66; FLEV has a VIF value of 1.30 and VIF reciprocal (tolerance) value of 0.77. Summarily, all the variables had an average VIF value of 1.45 and an average VIF reciprocal (tolerance) value of 0.69. This indeed confirmed that all the variables reported low correlation since their VIF values are below 10 and value of 1.58 VIF reciprocal (tolerance) values above 0.10. Hence, the study confirmed that the model is free from collinearity issues.

Regression Estimate

To ensure that, the possibility of the micro panel data not causing any harm, the model corrected for the standard errors and serial correlation. The robust panel estimate is presented herein:

Table 5. Regression Result

Regressed: Return on Equity (ROE)				**No. of Obs. = 120**	
Variables	**Symbol**	**Coefficient**	**Std. Err**	**Z-value**	**P>|Z|**
COCS	6.37	4.51	24.70	1.080	3.87
UCCS	20.50	19.50	29.80	10.10	5.90
FSIZ	8.54	9.79	12.11	0.40	3.01
FLEV	1.45	1.52	2.92	0.12	0.73
ROE	2.81	2.60	15.02	-0.14	1.91

Source: Gretl (2023)

The results of the regression analysis, for the PCSE models are detailed in Table 5. The conservative predictor factors, both conditional and unconditional (with an R2 value of 0.6203) accounted for 60.48% of the variations in the regressed ROE. Moreover the Wald Statistics value of 18.90 significant at a 1% level (Wald F(4,115) Prob value 0.0000) indicates that the model fits overall. The performance of sampled companies (ROE) is positively influenced by conservatism (COCS) individually as evidenced by a z value of 6.89 with P>|Z|value 0.000. This suggests that conditional conservatism significantly enhances the performance of sampled businesses highlighting their approach from 2006 to 2022.

The benefits of conservatism include reducing inefficiencies and improving effectiveness within companies based on this research outcome, which aligns with previous studies by Ramandam (2019) Ahmed (2020) and Lawal and Shehu (2017). However it contrasts with findings from Ugwunta and Ugwuanyis study in 2019.

These results further challenge the notion that stakeholders become concerned when performance declines, suspecting mismanagement of data, by managers and advocating for conservative measures to safeguard their interests. Notably multinational corporations experience challenges when their level of conservatism is elevated.

Higher degrees of conservatism leading to performance, for the multinational corporations in the study. Therefore opting for conservatism by companies is quite unsatisfactory. Conversely making conservative decisions offers advantages such as enforcing contracts reducing tax payments or deferring them eliminating favoritism decreasing spending on politics minimizing conflicts between creditors and shareholders alleviating pressure and competitive risks and generating more reliable financial information.

Conclusions

The research has confirmed that conditional conservatism significantly benefits the return on equity (ROE) of the sampled firms while unconditional conservatism notably harms their ROE. Thus it is concluded that higher levels of conservatism enhance the ROE of corporations whereas higher levels of unconditional conservatism significantly diminish it. Consequently managers of these firms are encouraged to prioritize the implementation of conservatism to address information disparities in their reporting strategies due to its significant advantages, for business operations.

- Based on our study's findings and conclusions drawn from them we propose the following recommendations;
- Managers should prioritize using conservatism to manage information discrepancies in reporting plans as it greatly benefits business operations.
- When formulating rules and guidelines, for institutions, authorities and organizations for setting standards should take into account how absolute caution can negatively affect the success of selected companies.
- Additionally it is crucial to review the types of assets held by corporations as the growing number of assets could harm the company's performance in the long run.
- Likewise it is important to reconsider the debt profiles of corporations since specific debt arrangements could potentially result in bankruptcy, for companies over time.

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