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Empirical Investigation into the Relationship between Accounting Conservatism and Financial Performance: Evidence from Manufacturing Companies in Nigeria.

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ABSTRACT

In a nation like Nigeria, the manufacturing sector has a lot of potential to boost competitiveness and economic growth. According to studies, the manufacturing industry has been unstable throughout time due to various financial situations, which has caused a drop and fluctuation in the financial performance of Nigerian manufacturing companies. As a result, there is an urgent need for high-quality accounting. This study looked into the relationship between accounting conservatism and financial performance of manufacturing companies in Nigeria. An ex post facto research design was used in the study. As of December 31, 2022, there were twenty consumer products manufacturing companies listed on the Nigerian Exchange Group. Of these, sixteen companies were specifically chosen for the study. The study period was 12 years which spanned from 2011 to 2022. Information was taken from the publicly available audited financial accounts, which were verified by the certification of the external auditors. Descriptive and inferential statistics were used in the study's data analysis. The study's conclusions showed that Return on Asset (ROA) was significantly impacted by Accounting conservatism and AC together, with AdjR2 = 0.1980; F= 14.09, p = 0.000. According to the study's findings, manufacturing companies listed in Nigeria can improve their financial performance by applying accounting conservatism. It was suggested that managers of manufacturing companies address knowledge asymmetry by implementing conservative financial management techniques. This is because conservatism improves the performance of the manufacturing company.

Keywords: Accounting Conservatism, Asymmetric Timeliness Measure, Financial Performance, Market-to-Book Ratio, Negative Accruals, Return on Assets

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Introduction

Not only does the government care about an organization's financial success, but stakeholders do too. It promotes the long-term expansion and advancement of an economy. Besides serving as a catalyst, it offers various dynamic advantages essential for economic transformation in the global market (Ogbodo, 2018). To meet these objectives, managers need to consistently prioritize improving the company's financial outcomes. Al Shahrani and Zhengge (2016) argued that a company's long-term competitive edge depends on its capacity to align resources both human and financial with strategic challenges in an ethical and lawful manner to achieve corporate success.

Manufacturing sector has repeatedly been found as a driver for global development and growth for the economy, and industrial growth, as part of the industrial field, is generally regarded as a vital mechanism for stimulating economic growth and development. India, according to Mithe (2020), has been one of the world's fastest developing economies. While the International Monetary Funds lowered its Gross Domestic Product growth estimate for 2020 to 6.1%, it has increased its medium-term GDP forecast to 7.4%, which places India high amongst nations with booming economies, which is growing at 5.9%.

Benson (2019) opined that manufacturing sector is the 3rd leading sector contributing to the GDP of Nigeria. Nigeria's GDP was 152.32 trillion Naira, or more than 400 billion US dollars. The industrial sector made up approximately 13% of the total GDP, with the food, drinks, and tobacco industry being the largest contributor, representing 4.75% of the country's GDP in 2020 (Varrella, 2021). Manufacturing companies in Nigeria is beset with challenges, amongst them are power supply, regulating issues, multiplicity of taxes, trade facilitation issues, macro-economic instability, crime and poor security, politically weak financial system, poor infrastructure.

Since the concepts and implementation of accounting have been connected for a long time, accounting conservatism has become a key element of financial reporting (Ugwunta & Ugwuanyi, 2019). It is one of the essential characteristics of accounting practices that form the basis of modern financial reporting. Accounting conventions are the established practices or norms that guide the preparation of financial statements, ensuring they are complete and

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transparent. The conservative adage "anticipate no profits, but anticipate all losses" is included in the conservatism principle. Income anticipation requires identifying profits before verifiable legal claims are made (Ame et al., 2019).

Conservatism is a term used by accountants to describe a helpful accounting principle. Regardless of the frequent detractors considering, it has maintained its place among the other accounting standards. In its effects on financial choices, conservatism has a more definite influence on investment performance (Chen et al, 2019). Evidence suggests that there are conservatives in industrialised nations like Nigeria as well as in America, England, and other European nations. Because of this, the way the data is presented, processed, and computed all matter greatly in terms of the qualitative aspect that financial managers and analysts take into account. The metric is designed to assess the degree of conservatism using quantitative models to analyse the relationship between the principle and corporate results and calculate accounting knowledge efficiency.

In a nation like Nigeria, the manufacturing sector has a lot of potential to boost competitiveness and economic growth. Benson (2019) claims that it is the third-largest sector in Nigeria in terms of GDP contribution. Nonetheless, the industry has fluctuated throughout time due to various financial situations. Ojoye (2016) opined that high interest rates, inadequate electricity supplies, uncertainty in regulation, a shortage of patronage for locally produced goods, a lack of supportive infrastructure as well as numerous other challenges are what lead to the shutdown of 272 companies in 2016 and 50 companies were manufacturing firms.

As a result of low or weak financial performance, businesses consolidate, downsize their employees, and liquidate (Heda & Meborn, 2017). Oyedokun, et al., 2019 argued that many consumable industries have ceased to function as a result of the global high cost of production crisis, and that more influential businesses have acquired or merged with other more influential manufacturing firms.

The objective of the study was to investigate the impact of accounting conservatism on the return on the financial performance of manufacturing companies in Nigeria. The hypothesis tested in this study is as follows: There is no significant relationship between accounting conservatism and financial performance of manufacturing companies in Nigeria.

Literature Review

Conceptual Review

Financial Performance

In order to ascertain whether the firm's goals have been met, a periodic and methodical review of its activities is part of the performance appraisal process. Certain internal or external principles must be applied in order to evaluate a company's performance. While external principles refer to a company's comparison with its industry competitors. To develop an effective business strategy that allows the firm to compete favorably in the market, internal principles are a company's ability to achieve its stated objectives (Olaitan, et al., 2020). Many techniques for assessing a company's financial success were employed in the studies that have already been conducted on the connection between capital structure and financial performance.

An organization's ability to generate profits not only helps to increase the value of its stock, but it also helps the industry as a whole, which eventually helps the economy as a whole (Banafa et al., 2016). Because manufacturing companies function as intermediaries and provide a vehicle for risk transfer, evaluating the output determinants of their performance has gained increased attention in the corporate finance literature. These companies also assist in directing the allocation of capital necessary to maintain market activities in the economy.

Return on Assets

This ratio can show economic effectiveness in generating income because it is most commonly used to display financial accounts. ROA will determine how much income the company has historically produced and how much can be predicted going forward. The assets in issue are cumulative corporate assets that are used for the survival of the company and are either derived from the capital itself or from foreign capital (Rosikah et al., 2018).

Accounting Conservatism

Instances of accounting conservatism involve promptly writing off intangible assets such as goodwill and patents, creating provisions for doubtful debts, and assessing closing inventory at the lower of its cost or net realizable value. The principal driver of conservatism in financial reporting is economic. Watts (2018) identified several reasons for this, such as the correlation between reported income and income tax liabilities. Additionally, the rise in litigation costs is a factor, as managers and auditors are more frequently sued for inflating earnings and net assets than for understating them. There is also a need to carefully manage executive compensation and debt covenants.

Felix and Umanhonien (2015) ascribe conservatism to the accounting practices that management has chosen to make financial reports transparent, as well as reporting requirements that mandate conservative reporting. As a result, conservatism is occasionally seen as a benefit to offset any managerial optimism that causes financial statements to be overstated. Basu (2017) has also investigated the widespread influence of conservatism against the backdrop of asymmetric knowledge. According to the survey, managers have access to critical sensitive information about their organisations. Additionally, because their income is based on reported earnings in situations when future profit is unknown, they may suppress information that would be seen as harmful to their interests.

Asymmetric Timeliness Measure

"The conceptualization of accounting conservatism by Basu in (1997) rests on the conclusion that earnings will more easily represent "bad news" than "good news". Basu (1997) was the first to link asymmetric timeliness with accounting conservatism, despite the fact that Warfield and Wild (1992) had established the timeliness of accounting awareness of economic events. Basu's scale indicates that the more uneven timing a business has, the more conservative it is.

The Market-to-Book Ratio

As a measure of accounting conservatism, MTB (or BTM) is theoretically based on the idea that a cautious accounting scheme generally appears to lower a company's net book value relative to its "real" economic value. Therefore, greater accounting orthodoxy is indicated by a higher MTB (and a lower BTM), and vice versa.

Due to the presence of economic rents in businesses, Roychowdhury and Watts (2007) argued that the Market-to-Book (MTB) ratio, or Book-to-Market (BTM) ratio, may be an upwardly biased indicator of the level of conservatism. They contend that, according to current GAAP, a firm's economic rentals are usually not recognizable in its book value. As a result, the

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presence of rentals still depresses the book value compared to the retail value, regardless of the degree of conservatism.

Negative Accruals Measure

Givoly and Hayn (2000) proffer an esoteric conservatism metric that accentuates non-operating accruals as a specific partition of a corporation's book value. The underlying rationale for utilizing adverse accruals is rooted in the intricacies of accrual-based accounting, wherein conservatism inclines toward deferring the acknowledgment of pecuniary gains while expediting the recognition of fiscal detriments. The cadence of accumulated accruals within an entity progressively amplifies its disfavor through this mechanism of profit deferment and loss acceleration (Givoly & Hayn, 2000).

Theoretical Review

Stakeholders' Theory

Freeman (1984) expanded the scope of stakeholders' theory after it was first introduced in 1970 in order to include a larger variety of stakeholders. Stakeholder theory, according to Freeman (1984), implies and maintains that a company has a stewardship obligation towards a range of stakeholders, which include customers, suppliers, employees, the government, the community, the environment, and future generations. These stakeholders are separate from the shareholders. According to King (2002), integrated sustainability reporting is crucial for fostering a company's relationship with the community in which it operates. Neglecting to consider stakeholders' interests can harm a company's reputation, which can have a negative impact on both operational and financial performance.

According to the stakeholder theory, an organization's operating environment takes into account the interests of other groups in addition to those of its owners. The agency theory, which sees organizations as a system of relationships between shareholders and management, is in opposition to this viewpoint (Lawal, 2012). The theory maintained that other stakeholder' interests, including those of employees, clients, suppliers, government agencies, and local communities, should be heavily considered during the strategic decision-making process because organizations cannot function and exist in isolation from their immediate

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environments. As a result, businesses should take into account the expectations of other stakeholders in addition to maximizing shareholder profit.

Empirical Review

Hanaa (2019) assessed the effect of accounting conservatism on company performance metrics in Egypt. The study gathered data from 40 of the most active non-financial companies over the period 2009–2014 to test its hypothesis. Panel data was utilized, and Return on Assets (ROA) was one of the variables used to represent accounting performance. Accounting conservatism has a considerable positive effect on organizational performance measures, according to the findings of the study. This represents the favorable impact of business profitability on shareholders, which results in a good financial position for the company.

In Nigeria, Aminu and Hassan (2017) delved into the nexus between accounting conservatism and the operational efficacy of banks. Employing panel regression techniques, they scrutinized data from a cohort of ten banks over a quinquennial span (2012–2016). with Return on Assets (ROA) serving as the performance measure. The findings revealed a strong correlation between accounting conservatism and bank performance in Nigeria. Conditional accounting conservatism was positively associated with bank performance, while unconditional conservatism showed a negative correlation. The study recommended that Nigerian bank managers adopt conditional conservatism in financial reporting to reduce information asymmetry.

Sana'a (2016) probed the impact of accounting conservatism on financial performance indices within Jordanian insurance corporations. Return on Assets (ROA), Earnings Per Share (EPS), and Market Value (MV) are utilized as proxies for performance outcomes. The analysis spans data from 12 Jordanian insurance firms over the period of 2007–2014. The findings reveal that accounting conservatism exerts a markedly positive influence on all three performance metrics. The study emphasizes the critical importance of instituting appropriate frameworks to ensure that Jordanian insurance firms adhere to conservative accounting standards.

Ade-Imam (2020) found that bondholder disputes were linked to accounting conservatism through two proxies: Return on Assets (ROA) and Leverage (LEV). The study investigated

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bondholder-shareholder disputes in relation to accounting conservatism. Using purposive sampling, data were collected from the financial statements of banks listed on the Jakarta Stock Exchange between 2016 and 2018, with the requirement that full financial statements from the banking sector were available. The total number of observations amounted to 66. Secondly, it was established that Indonesia's banking sector fosters accounting conservatism through the application of the Basu's coefficient. Thirdly, conflicts between bondholders and the banking industry, along with accounting conservatism, can only be substantiated by dividend and leverage policies. Meanwhile, Alkurdi et al., (2017) investigated the influence of ownership structure on the degree of accounting conservatism in Jordan. Analyzing a sample of 99 manufacturing and financial firms listed on the Amman Stock Exchange, they discovered a significant positive correlation between foreign and institutional ownership and accounting conservatism.

Ugwunta and Ugwuanyi (2019) evaluated accounting conservatism and performance of Nigerian consumer goods enterprises. The statistics are obtained from the yearly financial statements of companies listed on the Nigerian Stock Exchange in the Consumer Goods category. Under the premise of fixed findings, the theories were tested using panel least squares. In contrast to the predicted negative association, the study's results reveal that accounting conservatism has a favorable but non-significant impact on corporate efficiency. As a result, companies in the Nigerian Consumer Goods market do not exercise accounting conservatism, resulting in low financial reporting efficiency.

Methodology

This study employed the ex-post facto design. The population of this study comprise of all twenty (20) consumer goods manufacturing companies listed on the Nigerian Exchange Group (NGX) as at December 31st, 2022. The Sixteen (16) Food and Beverages manufacturing companies were selected by Purposive sampling procedures. Data was analyzed using descriptive and inferential statistics.

Model Specification

Y=f(X)

Y = Dependent variable (Financial performance)

X = Independent variable (Accounting Conservatism)

$Y = y_1$

$X = x_1, x_2, x_3$

Where, x_1 = Asymmetric Timeliness Measure (AT)

x_2 = The Market-to-Book ratio (MTB)

x_3 = Negative Accruals Measure (NA)

y_1 = Return on Asset (ROA)

Functional Relationship

ROA = f(AT, MTB, NA) ---eqn 1

$ROA_{it} = \alpha_0 + \beta_1 AT_{it} + \beta_2 MTB_{it} + \beta_3 NA_{it} + \varepsilon_{it}$ ………………………...…………Model 1

Table 3.1: Measurement of Variables

Variables	Abbreviation	Measurement
Return on Asset	ROA	$\frac{net\ income}{total\ asset}$
Asymmetric Timeliness Measure	AT	$\frac{EPSit}{Pit}$=α0+α1DRit+β0Rit+β1RitDRit+εit EPSit: Earnings per share for firm i year t Pit: Opening stock market price for firm i year t Rit: Stock markets return for firm i year t DRit: Dummy variable that is equal to 1 if the stock market return for firm in year t is negative, and equal to 0 if the stock market return for firm i in year t is non- negative.
Market-to-Book ratio	MTB	Market capitalization Total book Value
Negative Accruals Measure	NA	NA=T ACC−OPACC T ACC: Total Accrual, calculated as Net Income (after depreciation) – Operating Cash Flow OPACC: Operating accrual, measured as Inventory +Debtors +Other current assets -Creditors -Other current liabilities

Source: Author's Computation (2024)

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Results and Findings

Table 1: Descriptive Analysis

Variable	ROA	AT	MTB	NA
Mean	6.553	-2.51	4.210	-0.035
Std. Dev	8.992	0.156	16.030	0.394
Min	-44.161	-0.644	-168.661	-1.284
Max	26.517	1.243	75.572	3.3145

Source: Author's Computation, 2024

The features of Return on assets (ROA) showed that the companies are highly volatile with standard deviation of 8.992 which measures the dispersion of the range of the numbers from the mean. Also, the minimum values of -44.161 demonstrated that there are occasions within the time range when the companies recorded substantial losses as evidenced in the negative sign of these ratios. The maximum value of 26.517 signifies that the maximum return of 26.517% on Return on Asset (ROA) was generated by the companies throughout the time range of this study.

The Asymmetric Timeliness Measure (AT) ranges from a minimum of -0.644 to a maximum of 1.243, indicating a notable range between these values. This is further illustrated by a mean of -2.51 and a standard deviation of 0.156. The fact that the standard deviation exceeds the mean suggests significant variability, indicating that the variable is quite volatile.

The Market-to-Book ratio (MTB) ranges from a minimum of -168.661 to a maximum of 75.572, indicating a significant range between these values. This is further supported by a mean of 4.210 and a standard deviation of 16.030. The standard deviation being larger than the mean suggests considerable variability, highlighting the volatility of the variable.

The Negative Accruals Measure (NA) ranges from a minimum of -2.814 to a maximum of 3.3145, indicating a notable range between these values. This is further illustrated by a mean of -0.035 and a standard deviation of 0.394. The standard deviation being greater than the mean suggests significant variability, reflecting the volatility of the variable.

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Test of Hypothesis

Table 4.2: Test of Hypothesis One

	MODEL ONE			
	POOLED OLS WITH CLUSTER STD. ERR.			
Variable	Coeff	Std.Err	t-test	Prob
Constant	5.958	0.662	8.99	0.000
AT	21.545	4.228	5.10	0.000
MTB	0.116	0.040	2.89	0.004
NA	-3.135	1.681	-1.87	0.064
Adj. R^2	0.1980			
F-Stat	$F_{(6, 192)} = 14.09$			
Probability of F-Stat	0.000			
Hausman Test	$chi^2_{(3)} = 10.15$ (0.0173)			
Testparm Test	$F_{(6, 192)} = 2.53$ (0.0103)			
Heteroskedasticity Test	$chi^2_{(1)} = 5.16$ (0.0231)			
Serial Auto-Correlation Test	$F_{(1, 16)} = 17.950$ (0.0007)			

Source: Authors Computation (2024)

$ROA_{it} = \alpha_0+\beta_1 AT_{it}+ \beta_2 MTB_{it}+ \beta_3 NA_{it}+\varepsilon_{it}$ ……………………………...…………Model 1

$ROA_{it} = 5.958 +21.545AT_{it}+0.116MTB_{it}-3.135NA_{it}+\varepsilon_{it}$ ……………….……………………Model 1

Interpretation

The result of the regression model shown in Table 4.1 (Model One) indicated that Asymmetric Timeliness Measure (AT) has considerable positive effect on Return on Asset (ROA) (α = 21.545, ρ=0.00); a unit increase in AT would amount to 21.545% rise in ROA. Market-to-Book ratio (MTB) has strong positive effect on Return on Asset (ROA) (α = 0.116, ρ=0.04); a unit rise in ACP would result to 11.66% increase in ROA. While Negative Accruals Measure (NA) has negatively but insignificantly effect ROA. The explanatory power of the independent variable indicates that variations in the independent variables account for 19.8% of the variation in ROA, while the remaining 80.2% of changes in ROA are attributed to other factors not captured by this model. The significance of the F-test (ρ-values of 0.00) reveals that accounting conservatism, as measured by the Asymmetric Timeliness Measure, plays a crucial role in this relationship. (AT), Market-to-Book ratio (MTB) and Negative Accruals Measure (NA) significantly influences the financial performance of industrial companies listed in Nigeria.

Decision

Given the possibility of the F-test (ρ-value of 0.00) which is lower than the selected threshold of importance for this study at 5%, thus, this study rejected the null hypothesis which stated that conservative accounting has no significant effect on Return on asset of manufacturing companies listed in Nigeria; and hereby accepted the alternate hypothesis which says Consequently, Accounting conservatism has a significant effect on Return on asset of manufacturing companies listed in Nigeria.

Implications of Findings

Regulators: This research can be valuable for regulators and accounting standard-setters, including financial authorities like the Securities and Exchange Commission (SEC) and the Central Bank of Nigeria (CBN). It is particularly relevant for manufacturing industry regulators in shaping policies, as well as for standard-setters in defining the boundary between the principles of neutrality and accounting conservatism.

Management: As regards management practices, knowing if there are any consequences of accounting conservatism on financial performance measures allows the management, through the guarantee of trust of the reported financial reports, to boost performance and maximize the competitive advantage for the company. Providing clients with valuable details on conservatism levels in order to ensure the transparency, objectivity and creditability of financial records which are perceived to be the source of essential information for decision-makers inside and outside the company.

Investor: Studying and analyzing the effect of accounting conservatism helps investors who put accounting standards and accounting principles in identifying the effects of the accounting estimates and the personal judgement taken by the administration on the financial statements, to enable them to protect users of financial reports and reduce the abusive use of some administrations to the available flexibility of the acceptable accounting requirements in the management of it.

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Future Research: The study contributes to the expanding body of literature on accounting conservatism within the manufacturing industry. Its significance extends beyond merely enriching accounting knowledge by clarifying the concept of accounting conservatism. It also offers fresh insights into the analysis of the effects of accounting conservatism on the performance of manufacturing companies.

Conclusion and Recommendations

The study concluded that accounting conservatism has a significant effect on financial performance of manufacturing firms in Nigeria. The result showed that accounting conservatism has a positive significant effect on return on assets of manufacturing firms in Nigeria. The following recommendation was made based on the results:

Managers of manufacturing firms should use conservatism in their financial management practices to handle information asymmetry. This is due to conservatism's positive effect on the manufacturing firm’s performance by increasing their return on assets. Accounting conservatism is sometimes defined as an equilibrium reaction used to minimize valuation reduction caused by knowledge asymmetry or confidential data between investors and managers.

Contribution to Knowledge

Several studies have been carried out on accounting conservatism and financial performance but this study’s achievement is the use of Return on Assets as a measure of financial performance.

In addition, this study happens to be one the most recent study on accounting conservatism and financial performance of manufacturing companies listed in Nigeria with the inclusion and the usage of up to date data (2011 to 2022) in its scope and time frame.

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