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Research Paper

Corporate Reputation And Earnings Quality of Listed Firms in Nigeria

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ABSTRACT
Purpose: *There is contention in financial reporting literature on the nature of relationship between corporate reputation and earnings quality of firms. The differences in findings on the relationship between corporate reputation and earnings quality linkage are empirically traceable to firm characteristics and capital market. To our knowledge, the association between corporate reputation and earnings quality is limited in Nigeria, Thus, we examine the nature relationship between corporate reputation and earnings quality of listed firms in Nigeria.*
Design/ Methodology/ Approach: *The expo facto design was adopted for this study on 21 listed firms selected from the consumer sector, manufacturing sector and financial sector on the Nigeria Stock Exchange. The primary estimation method for the regression equation is pooled-OLS.*
Finding: *We found that corporate reputation has no significant positive association with earnings quality of listed firms in Nigeria.*
Originality/ Value: *To the best of our knowledge, this is the first study that investigates the relationship between corporate reputation and earnings quality across three sectors in Nigeria. The result has implication on capital market, firm reputation, auditor type and earnings quality. Thus, this study will be useful to capital market regulators, standard setters and future researchers.*
Keywords: *Corporate Reputation, Earnings Quality*

I. INTRODUCTION

Investors' confidence and the quality of financial information are primary issues in financial reporting environment especially after the financial scandals of the Enron, Arthur Anderson, Tyco, Quest communications, Xerox, Waste Managemnt, and World.com of the early 2000s. Enron Corporation's use of special-purpose identities allow it to keep billions of dollars worth of debt off its balance sheet. Similarly, World.com used a simple scheme to capitalize over $11 billion of expenditure as assets as against expenses. Tyco International has been charged with failure to disclose millions of dollars of low interest and interest-free loans to its executives. Quest Communications International was compelled to restate its revenue by $2.4 billion when US SEC discovered that it used swapping network capacity to grow its earnings. Waste Management capitalized all sorts of expenditures, which should have been expensed to income statement. Xerox Corporation grew its earnings by prematurely booking revenue from long-term leases of copiers and printers, and by establishing "cookie jar" reserves during acquisitions that were later used to make up operating short falls. These were attributable to persistence use of inappropriate earnings practice for several years.

In Nigeria, 26 banks were liquidated and Cadbury Nigeria Plc financial scandal was reported in 2006. Thus, earnings quality has attracted several interests (investors, financial press, academics, analysts and regulators) and, today it has been the focus of parliamentary, regulatory and financial statement users' discussion (Myer, Myers & Omer, 2003). Further, the development, adoption and implementation of a set of "high quality" standards, for example, International Financial Reporting Standards (IFRS), raised research interest to examine accounting practices across the globe. Prior studies (Francis, Huang, Rajgopal & Zang, 2008., Luchs, Stuebs & Sun, 2009., Gaio, 2010 & Cao, Omer & Myers, 2011) have identified several factors that are associated with earnings quality. These factors include Corporate reputation, Firm size, Firm leverage, Firm operating cycle, Sales growth, Board size and independence, Auditors type, Fees and tenure, Audit committee independence and expertise, Legal regime, and Politics. However, financial reporting literature indicates that the nature of association between these factors and earnings quality are not the same in all countries around the world. Francis et al. (2008) asserts that the users of financial statement consider the reputation of a firm to be important in assessing the quality of financial report. They furthered that firms that are reputable place emphasis on accountability, credibility and trustworthiness, and integrate these values into its corporate culture such that these values are reflected in formal rules, structure, unwritten rules and traditions. Thus, corporate culture is assumed to induce employees to take appropriate action when contracts do not specify all possible outcomes.

Dowling (2001) claim that a firm's performance is the main driver of corporate reputation that is embedded inside the firm. Reputation is a perceptual representation of a firm's past actions and future prospects that describe the firm's overall performance to all its stakeholders when compared to other leading competitors (Fombrum, 1996). Cao et al. (2011) explain that the reputation mechanisms indicate that the concern for reputation affects stakeholders' action, and that the reputation effect can assist in minimizing agency problem.

The association between corporate reputation and earnings quality depends on the economic perspective of scholars (Francis et al., 2008). It assumed that manager's action is matched with the firm. The matching argument is based on the assumption that managers are selected by boards of directors and the board of directors is assumed to select people that will occupy top positions using reputation. In addition, firms that desire quality earnings are expected to hire reputed managers, directors and auditors that will guarantee accountability. Given that reputation is costly to rebuild once impaired, firms with higher reputations may have greater incentives to protect their reputation and behave differently from those with lower reputation.

Nevertheless, these claims have not been tested using firms from two or more sectors among listed firms in Nigeria.

1.1.1 Statement of the Problem

Corporate reputation is acknowledged as one of determinants of earnings quality; however, to our knowledge the assumed association has not been tested in Nigeria. This is because preliminary examination of empirical studies indicates that most of the studies were undertaken in developed economies. Further, empirical evidence shows that the results on the association between corporate reputation and earnings quality are inconsistent. The observed inconsistency in research findings indicate that the results are context-specific and may not be applied in other firms and sectors. In addition, prior research examining the determinants of earnings quality is based on single – sector, and considerable feature of either a single performance measure or a pair of measures. To the knowledge of the researcher, there is no study that investigates the impact of corporate reputation on earnings quality of listed firms (different sectors) in Nigeria. This is the first broad cross-sectional study to explicitly consider earnings quality of listed firms in Nigeria as proxied by measures of accounting accruals and cash flows.Against the above, it is important to investigate the association between corporate reputation and earnings quality.

1.1.2Objectives of the Study

The main objective of this study is to examine the association between corporate reputation and earnings quality of listed firms in Nigeria. Other specific objectives are:

1) To access the nature of relationship between corporate reputation and earnings quality of listed firms in Nigeria financial sector.
2) To evaluate the relationship between corporate reputation and earnings quality of listed firms in Nigeria manufacturing sector.
3) To examine the relationship between corporate reputation and earnings quality of listed firms in Nigeria consumer sector.

1.1.3 Research Questions

The study objective will be addressed by the following questions:

i) How does corporate reputation influence earnings quality of listed firms in Nigeria?
ii) In what way(s) does corporate reputation influence earnings quality of listed firms in Nigeria financial sector?
iii) Does corporate reputation influence earnings quality of listed firms in Nigeria manufacturing sector?
iv) How does corporate reputation influence earnings quality of listed firms in Nigeria consumer sector?

1.1.4Hypotheses of the Study

The following null hypotheses will be tested in the course of this study:

HO_1: Corporate reputation has no significant influence on the earnings quality of listed firms in Nigeria.

HO_2: Corporate reputation has no significant influence on earnings quality of listed firms in Nigeria financial sector.

HO_3: Corporate reputation has no significant influence on earnings quality of listed firms in Nigeria manufacturing sector.

HO_4: Corporate reputation has no significant influence on earnings quality of listed firms in Nigeria consumer sector.

The remaining part of this work is organized as follows: review of related literature, methodology, discussion of findings, recommendations and conclusion

II. LITERATURE REVIEW

2.1.1 Conceptual Framework

Earnings

Earnings are summary indicators of financial reports and the most important aspect of an accounting system that is used for decision making (Schipper & Vincent, 2003; Graham, Harvey & Rajgopal, 2005). In addition, Kothari and Watts (1998) asserts that earnings are summary measures that provide information about a firm's future cashflows and profitability.

The credibility and quality of financial reports by firms will improve the overall market efficiency and stimulate investment decisions, facilitate credit and other forms of resource allocation (IASB, 2008). Thus, the quality of earnings is important to both shareholders and creditors.

Earnings Quality

Cosmikey and Mulford (2000) define earnings as high quality if the contemporaneous cashflows are graeter (less) than the recognized revenues or gains (expenses or losses), and low quality if the associated cashflows are less than (greater than) the recognized revenues or gains (expenses or losses). They view a firm with reasonable level of unearned revenue and deferred expenses to have high quality earnings and a firm with significant accrued revenue and prepaid expenses to have low quality earnings. Similarly, Balsam, Krishnam and Yang (2003) define earnings quality as the most comprehensive measure of financial reporting that is differently interpreted. According to Schpper and Vncent (2003), earnings quality is defined by its predicted power. They assume that reported earnings will provide useful information that will aid the process of scrutinizing a firm's performance. In addition, they explain that earnings quality is a reflection of firms' transparency and reputation.

Corporate Reputation

There is no consensus on the definition of corporate reputation among researchers. It is perceived as an ambiguous assemblance of hunches. The differences have been attributed to the individual views of reputation: awareness and assessment, economic, strategic, marketing, organization, sociological and accounting, each with its tradition (Fombrum & Van Riel, 1997).

According to Goldberg, Cohen and Fregenbrum (2003), corporate reputation is an intangible resources. Collaborating with the above, Chun (2005) asserts that, a representation and basis of judgment. Similarly, Roberts and Dowling (2002) defines corporate reputation as a perceptual representation of a company's past actions and future prospects. It is a summary of the impression or perception hold by external stakeholders (Davies & Miles, 1998). Drawing on economic view point, Fombrum (2001) asserts that corporate reputation is an economic asset and a representation of past actions and future prospects that involves a subjective and collective assessment of firm's effectiveness, which makes it attractive. Finally, Barnett, Jermier and Lafferty (2006) defines corporate reputation as observers' collective judgements of an organization based on assessments of the financial, social and environmental impacts attributed to the organization over time.

2.1.2Theoretical Explanation

This study is theoretically linked with the agency theory. Agency Theory (AT) is rooted in the work of modern firm and private property on the separation of firm ownership from the management. It is linked with the theory of the firm: management behaviour, agency costs and ownership.Jensen and Meckling (1976) explain that most firms and legal frictions that serve as the nexus for a set of contracting relationship between individual underpin the importance of AT. It is assumed that agency relationships are built into contracts, and the benefits, monitoring devices, bonding and other forms of social interaction used to minimize agency costs constitute the components of the contract.

The proponents claim that agency problems will always emanate from situations where the owners and shareholders (principals) employ managers (agents) to act on their behalf for a reward. Therefore, the management and the board owe the shareholders the duty of care and trust to operate the firm in the best interest of the shareholders for a reward. In this study, AT is considered more appropriate as it provides the standard against which the supervisory and management roles are measured. It is assumed that firms' reputation will influence the choice of managers, auditors and the credibility of financial reports that conveys information about a firm's cashflows.

2.1.3 Empirical Review

Corporate Reputation and Earnings Quality

There are few studies that have investigated the association between corporate reputation and earnings quality. To our knowledge, the existing empirical studies include those discuss below.

Luchs, Stuebs and Sun (2009) evaluate the relationship between corporate reputation and earnings quality on a sample of 223 firms in the U.S. Using the modified Jones (1991) model and regression analysis. They reported that corporate reputation has positive significant relationship with earnings quality. In addition, Cao, Myers and Omer (2011) examine the association between company reputation and the likelihood of a financial statement restatement on 8,081 observations of U.S firms, from 1995 – 2009. Using discretional accruals and regression analysis, they show that firms with higher reputation scores are less likely to misstate their financial statements. They reveal that company reputation is positively associated with financial reporting quality.

III.METHODOLOGY

3.1.1Research Design

Ex-post facto design was used in conducting this study. This design relies on previously generated data that was used in exploring the relationship between corporate reputation and earnings quality of listed companies in Nigeria.

3.1.2Research Population

This study population consists of all listed firm that have traded on the Nigerian Stock Exchange (NSE) between 2005 – 2015. As at 28 June, 2016, NSE has 176 listed firms with a total market capitalization of ₦8.5 trillion in Nigeria.

3.1.3Sample Size and Technique

Twenty one (21) listed companies, seven representing each of industrial goods sector, consumer goods sector, and financial sector constitute the sample for the study. These sectors play important roles in the economy as they contribute significantly to national earnings as such there is need to give close monitoring to their reported earnings. The sample size for this study was drawn using the purposive sampling technique. This technique was adopted because of unavailable of relevant data for other companies within the sectors. In addition, the selection criterion is that these firms have their annual reports with the domain of the NSE between 2005 and 2015.

3.1.4Sources of Data

The data for this study was obtained from NSE. In addition, descriptive content analysis was adopted in extracting the required data from the audited annual reports of the selected firms. The content analysis was divided into two sections: (1) Corporate reputation and (2) Earnings quality.

3.1.5 Model Specification

The models are expressed mathematically below:

$\Delta WC = a_0 + a_1 CFO_{t-1} + a_2\, CFO_t + a_3\, CFO_{t+1} + E_1$------------------------(i)

Where

ΔWC = Changes in working capital accounts as disclosed on the statement of cash from operations, measured as the increase in accounts receivable.

CFO_1 = Cash from operations in year t assets.

$EQ = \alpha + \beta_1$ FREPUTATION it + ε --- (ii)

Where

EQ is earnings quality, FREPUTATION is corporate reputation measured by the type of external auditor hired β_1 is the coefficient of the parameter estimate, and

ε = the error term.

3.1.6Identification and Measurement of Variables

Drawing from the stakeholders' perspective, earnings quality was measured as accruals quality. On the other hand, corporate reputation was proxied using the type of auditor (one was assigned for those audited by the big 4 and 0 otherwise). To address the association between the corporate reputation and earnings quality, earnings quality is set as the dependent variable and corporate reputation as independent variable.

IV. INTERPRETATION OF RESULTS

Descriptive Statistics

Table 1 shows the descriptive analysis of the discretionary accruals computed using the DD (2002) model. Panel D of Table 1, reveals that the measure of earnings quality, accrual quality was well fitted with a statically significant F-statistics (F stat = 20.26, P = 0.000, P < 0.05). In particular, the explanatory power, adjusted R^2 has a positive value of 0.1579. This finding suggests that 15.79% of the listed firms in Nigeria represent the level of earnings quality, which is significant. Further, Jacque – Bata test was carried out for test of normality and P – value of 0.000 was obtained. In the financial sector, table 1 shows that charges in the working capital was skaved to the left while previous, current and future cash flows were all skeeved to the right, with excess Kurtosis of 24.53909. Similarly, the Kurtosis of 16.55475, 16.333 and 16.227 were obtained for previous, present and future cash flows respectively. This result indicates that these variables were not normally distributed. The accrual quality was well fitted with a statistically significant F-statistics (F = 6.89, P-value = 0.0003). The adjusted R^2, explanatory power, for the financial sector was 0.1541, which is significant.

In addition, the statistics in Panel B of table 1, reveal that the values of R^2, F-statistics and P were 0.086, 3.99 and 0.0107 respectively for the manufacturing sector. This result shows that the accrual quality was well fitted and better than that of the financial sector. Thus, it reveals higher earnings quality. Finally, Panel C of Table 1 indicates that there was positive association between previous, present and future cash flows. The adjusted R^2, F-statistics and P-value were 0.0495, 2.86 and 0.0406 respectively. This means that the accrual quality was well fitted and with quality earnings. The coefficient of consumer firms previous cash-flows to present cash-flows was 0.08 (0.411) and it is statistically significant at the 0.05 level.

Correlation Analysis

Table 4 presents a regression matrix for the variables (Corporate reputation and earnings quality) used in this study. Panel D of table 4 shows that corporate reputation and earnings quality of listed firms are insignificantly correlated. The P-value of the relationship between corporate reputation and earnings quality for the firm is 0.2392 (β = 0.1216, t-calculated = 1.1793, P > 0.05). In the financial sector, the P-value of the relation between corporate reputation and earnings quality is 0.2319 (β = 0.275032, t-calculated = 1.203, P > 0.05). Panel A of table 4 shows no significant relationship between corporate reputation and earnings quality of listed firms in Nigeria financial sector.Further, Panel B of table 4 documents that earnings quality is not significantly correlated with the proxy that measures corporate reputation. The P-value is 0.7463 (β =0.11269, t-calculated = 0.324, P > 0.05). Thus, the result presents that corporate reputation has no significant relationship with earnings quality of listed manufacturing firms in Nigeria.

Finally, Panel C of Table 4 reveals that the P-value of the relationship between corporate reputation and earnings quality is 0.1850 (β = 0.58056, t-calculated = 0.1850, P > 0.05). This result indicates that earnings quality has no significant association with the proxy that measures corporate reputation of listed consumer firms in Nigeria.

5.1 Summary of findings on the relationship between corporate reputation and earnings quality

The result of this study indicates that corporate reputation has no positive significant influence on earnings quality. This result is inconsistent with the findings of Lunchs etal. (2009) and Cao etal. (2011) that reported significant positive association between corporate reputation and earnings quality. The differences may be attributable to the proxies used for corporate reputation and earnings quality. However, the results reveal that model allowing yearly and sector variation in the intercept term is adequate. In general, the results show that agency theory can be used to some extent to explain auditor type internationally.

V. CONCLUSION

The empirical evaluation of the nature of relationship between corporate reputation and earnings quality provides evidence that addresses the research problem, research objective and research hypotheses. Findings indicate that corporate reputation has no positive significant influence on earnings quality of listed firms in Nigeria. In conclusion, we show that corporate reputation has no positive significant influence in earnings quality of listed firms in Nigeria.

RECOMMENDATIONS

Drawing from the results of this study, the following recommendations were made:

1.This study reveals that corporate reputation has no positive significant influence on the earnings quality of listed firms in Nigeria. Thus, it is recommended that companies should consider the option of hiring the non big 4 auditors as the use of the big 4 does not have positive significant influence on the quality of earnings.

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Table 1: Summary Descriptive Statistics for each firm for observation between 2005- 2015

Panel A: Financial sector(2005-2015)							
Variables	Mean	Median	SD	Skewness	Kurtosis	JB	p-value
ΔWC	17210603	237833.50	4.41×10^8	-2.05292	24.53909	2003.293	0.0000
CFO_{t-1}	96417.37	69167.00	1.24×10^8	0.081970	16.55475	756.66	0.0000
CFO_t	10677964	87449	1.25×10^8	0.057990	16.333	725.9786	0.0000
CFO_{t+1}	9832675	54102.50	1.25×10^8	0.076577	16.227	714.4869	0.0000
Panel B: Manufacturing sector (2005-2015)							
	Mean	Median	SD	Skewness	Kurtosis	JB	p-value
ΔWC	691606	91561.50	653776	-0.098068	19.92622	1170.019	0.0000
CFO_{t-1}	14924697	2735475	38876510	4.455081	26.41959	2537.63	0.0000
CFO_t	15424772	2776927	38991141	4.352046	25.63893	2402.153	0.0000

CFO_{t+1}	15579536	2818379	39163425	4.328504	25.38675	2328.447	0.0000
Panel C: Consumer goods (2005-2015)							
	Mean	Median	SD	Skewness	Kurtosis	JB	p-value
ΔWC	604066.5	81695.00	764370395	3.070395	21.82157	1763.824	0.0000
CFO_{t-1}	9345554	1037786	28.972314	5.130213	29.5003	3633.95	0.0000
CFO_t	8809318	901108.50	28810291	5.249502	30.53597	3908.07	0.0000
CFO_{t+1}	7202464	901108.50	23287694	6.186519	43.36555	8021.114	0.0000
Panel D: Pooled (2005-2015)							
	Mean	Median	SD	Skewness	Kurtosis	JB	P-value
ΔWC	6323839	121541	25000000	-3.474281	75.11915	67586.72	0.0000
CFO_{t-1}	12153768	665998.0	75758737	0.325570	38.865	16567.14	0.0000
CFO_t	11885525	665998.0	665998.0	0.33248	38.63644	16356.38	0.0000
CFO_{t+1}	6323839	665998.0	23287694	6.186519	43.36555	8021.114	0.0000

Table 2: Correlation Result between

Panel A: Correlation for Financial sector				
	ΔWC	CFO_{t-1}	CFO_t	CFO_{t+1}
ΔWC	1			
CFO_{t-1}	0.257(0.011)	1		
CFO_t	-0.192(0.058)	0.192(0.059)	1	
CFO_{t+1}	0.182(0.073)	0.007(0.947)	0.193(0.057)	1
Panel B: Correlation for Manufacturing sector				
	ΔWC	CFO_{t-1}	CFO_t	CFO_{t+1}
ΔWC	1			
CFO_{t-1}	-0.153(0.137)	1		
CFO_t	0.046(0.656)	0.620(0.000)	1	
CFO_{t+1}	-0.172(0.094)	0.423(0.000)	0.624(0.000)	1
Panel C: Correlation for consumer goods				
	ΔWC	CFO_{t-1}	CFO_t	CFO_{t+1}
ΔWC	1			
CFO_{t-1}	-0.081(0.411)	1		
CFO_t	-0.060(0.538)	0.734(0.000)	1	
CFO_{t+1}	0.103(0.288)	0.473(0.000)	0.820(0.000)	1
Panel D: Pooled Result				
	ΔWC	CFO_{t-1}	CFO_t	CFO_{t+1}
ΔWC	1			
CFO_{t-1}	0.23(0.000)	1		
CFO_t	-0.178(0.000)	0.260(0.000)	1	
CFO_{t+1}	0.168(0.003)	0.072(0.205)	0.261(0.000)	1

Values in brackets are the p-values, bolded correlation means significantly related

Table 3: Regression of change in working capital on past, current and future cash flow form 2005- 2015.

$$\Delta W = \beta_0 + \beta_1 CFO_{t-1} + \beta_2 CFO_t + \beta_3 CFO_{t+1} + \varepsilon_t$$

	Panel A : Financial sector							
Model parameter	β	$s\beta$	SE	t stat	p-value	Adj. R^2	F-stat.	p-value
CFO_{t-1}	1.1094	0.3122	0.3386	3.2760	0.002*	0.1541	6.89	0.0003*
CFO_t	-1.0569	-0.2974	0.3448	-3.065	0.003*			
CFO_{t+1}	0.8434	0.2373	0.3382	2.4940	0.014*			
	Panel B : Manufacturing							
Model parameters	β_0	β_1	SE	t-stat	p-value	R^2 adj.	F-calc	p-value
CFO_{t-1}	-0.0465	-0.2773	0.0211	-2.21	0.030*	0.086	3.99	0.0107*
CFO_t	0.0691	0.41225	0.0242	2.84	0.006*			
CFO_{t+1}	-0.0520	-0.31041	0.0209	-2.49	0.015*			
	Panel C : Consumer goods							
Model parameter	β	$s\beta$	SE	t stat	p-value	Adj. R^2	F-stat.	P-value
CFO_{t-1}	0.015615	0.05639	0.0388	0.040	0.6882	0.0495	2.86	0.0406
CFO_t	-0.134058	-0.48407	0.060140	-2.229	0.028*			
CFO_{t+1}	0.160780	0.580564	0.057370	2.8025	0.006*			
			Panel D : Pooled results					
Model parameter	β	$s\beta$	SE	t stat	p-value	Adj. R^2	F-stat.	P-value
CFO_{t-1}	0.997369	0.3024	0.178775	5.578	0.000*	0.1579	20.26	0.000
CFO_t	-1.044202	-0.3166	0.184581	-5.657	0.000*			
CFO_{t+1}	0.753686	0.2280	0.178559	4.221	0.000*			

*significant at p<.05, β = unstandardized coefficients, $s\beta$ =standardized coefficients

Table 4: Regression between earning quality and firm reputation

	Panel A: Financial sector(n=100)								
	β	$s\beta$	SE	t stat	p-value	r^2	Adj. r^2	F-Stat.	p-value
Intercept	-0.205		0.221	-0.926	0.357	0.011	0.001	1.078	0.302
Firm reputation	0.257	0.105	0.248	1.038	0.302				
	Panel B: Manufacturing(n=98)								
	β $s\beta$		SE	t stat	p-value	r^2	Adj. r^2	F-Stat.	p-value
Intercept	-0.096		0.313	-0.307	0.7595	0.001	-0.010	1.075	0.304
Firm reputation	0.107	0.033	0.330	0.324	0.746				
	Panel C: Consumer goods(n=110)								
	β	$s\beta$	SE	t stat	p-value	r^2	Adj. r^2	F-Stat.	p-value
Intercept	-0.135		0.140	-0.969	0.3346	0.017	0.007	0.105	0.746
Firm reputation	0.235	0.129	0.191	0.1850	0.1850				

	Panel : Pooled Result(n =308)							F-Stat.	p-value
	β	$s\beta$	SE	t stat	p-value	r^2	Adj. r^2	1.7800	0.185
Intercept	-0.100		0.111	-0.897	0.371	0.004	0.0003		
Firm reputation	0.136	0.060	0.130	1.047	0.296				

*significant at p<.05, β = unstandardized coefficients, $s\beta$ =standardized coefficients

*Ferry Barineka Gberegbe. "Corporate Reputation And Earnings Quality of Listed Firms in Nigeria." Quest Journals Journal of Research in Business and Management 5.4 (2017): 14-22.