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Impact of COVID-19 Pandemic on the Earnings Quality of Deposit Money Banks in Nigeria

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Abstract

The study examines the earnings quality of the Nigerian deposit money banks during the COVID-19 pandemic for the period of 2017 – 2020. A sample size of fourteen (14) listed banks was selected using the purposive sampling technique. DMBs as the independent variable was proxy by dummy 0 and 1 representing the data before and during the pandemic respectively, while the residuals from the Modified Jones Model by Kothari et al., (2005) were used as a proxy of earnings quality. The study adopts the techniques of multiple panel regression and the data were sourced from secondary sources of data collection through the accounts and annual reports of the banks. Return on equity and return on assets are used as control variables in the study, as they constitute vital indicators of the financial performance of the banks. The findings reveal that DMB as a variable of interest has no significant relationship with the earnings quality of the Nigerian banks during the COVID-19 pandemic, while return on the asset has a significant negative impact on the earnings quality of the banks during the pandemic. Return on assets has no significant relationship with the earnings quality of the Nigerian banks. The study recommends that the federal government interventions in the banking industry and the economy as a whole should be sustained to further cushion the effect of the COVID-19 pandemic. With low economic activity currently in the country due to the pandemic, a further investment of stockholders' equity should be put on halt, to avoid the risk of loss or low return that could result in earnings management.

Keywords: Earnings Quality, Earnings Management, Return on Equity and Return on Assets

1.0 Introduction

The position of the Nigerian economy and certainly the global economy has been exacerbated due to the covid-19 pandemic. The Nigerian economy had been on an awful path, before the COVID-19 emergence, which is characterised by a 2% GDP growth after the recession (Augusto 2020). Therefore, the economy of Nigeria after the recession could be well described as being delicate even before the effect of the COVID-19 pandemic.

The banking industry has faced its fair share of macroeconomic challenges for the past two years, resulting in substantial write-offs and declining margins of weakened credits (Augusto 2020). However, while trying hard to recover, the industry is now

confronted with the COVID-19 pandemic, which presents greater unpredictability of events and uncertainties in today's business environment.

The year 2020 began with a high hope from people in Nigeria, who envisioned measuring an increased financial inclusion by the year-end. Consequently, the COVID-19 pandemic dealt a serious blow to the economy as the country is now faced with US dollar shortages as a result of the current crash in the prices of oil (Temitope, 2020). In a bid by the federal government to curb the spread of the virus, certain measures were taken; which impacted negatively the low-income earners and businesses. Public gatherings have been banned and all schools and major markets were closed in most of the states. The federal government announced lockdowns in Ogun, Lagos, and Abuja. The measures had severe implications on the financially excluded population and low-income earners who rely highly on their daily business transactions for survival.

The agents of financial services are as well affected due to the experience of diminishing transactions and income as a result of low economic activity and the closure of major businesses (Temitope, 2020). Other challenges include limited assistance from the financial service providers that engaged them since the financial institutions remotely carry out their work. The financial service agents are now faced with cash withdrawal charges which invariably increase their cost to serve due to reliance on the use of Automated Teller Machines (ATMs).

However, despite the devastations of the covid-19 pandemic, Godwin Emefiele, governor of the Central Bank of Nigeria (CBN) said the Nigerian banking industry is still strong and resilient to support the economy (Bassey 2020). He further stated that the various interventionist actions of the CBN have significantly helped to ease the effect of the COVID-19 pandemic on households and businesses as well as reduce the level of shrinkage in the economy.

Therefore, relating to the effect of the pandemic on loans in the accounts of the banks that are not performing, the banking industry regulators were proactive in anticipating the possible consequences on the citizens and the inability of the companies to generate revenue to pay salaries of their workers, which would, in turn, make it difficult for bank loans to be serviced by debtors (Bassey 2020). The CBN not only provided support for banks for households and businesses impacted by the COVID-19 pandemic, but it also mandated the banks to restructure under fresh terms the loans that debtors were unable to service.

A review of the banking industry performance revealed that the capital adequacy ratio in August 2020 has stayed at 15.3% since June 2019, whereas non-performing loans dropped from 9.4% in June 2019 to 6.1% in August 2020. Also, in June 2019 the liquidity ratio stood at 48%, but dropped to 36% in August 2020, despite the increase in credits from the injection of N3.7 trillion into the economy over 13 months (Bassey, 2020). Return on equity of the banks, which in June 2019 was about 24%, dropped to 21% in August 2020, and the banks return on assets which stood at about 2.3 per cent in June 2019, was about 1.9% in August 2020.

Based on the impact of COVID-19 on the banking industry and the various interventions by the federal government through the CBN to ameliorate the difficulties posed by the pandemic, this study is aimed at ascertaining the earnings quality of the Nigerian banks during the pandemic, using discretionary accrual model by Kothari 2005 as a proxy of earnings quality. Discretionary accrual is used to determine the level of earnings management in the financial statements of the banks.

Return on equity and return on the asset are also used as control variables to establish their relationships to the earnings quality of the banks. The study covers four years period; 2017 and 2020. Dummy variable 1 is used to represent the data during the pandemic for the years 2019 and 2020, while 0 represents data before the pandemic for 2017 and 2018.

2.0 Literature Review

2.1 Earnings Quality

There is no consensus reached on the definition and measures of earnings quality despite considerable research (Zhou, 2008). For Dechow *et al*. (2012), earnings quality should represent accurately the current operating performance of a company. The operating performance of the company should be effectively indicated in its future activities as well as the provision of useful measurement of the company's value assessment. Alternatively, Schipper and Vincent (2003) focused on the usefulness of decision-making as they defined earnings quality as the level at which reported earnings are the reflection of accurate income.

Ismail, Dunstan, and Van Zijl (2010) defined earnings quality as the absence of earnings management. Therefore, earnings are the outputs of all transactions in a company that reflect the quality of policies and plans set by managers, which are considered as the main standard of evaluating the directors of the company. Considering the above assertion, the earnings should be a true and fair reflection of the company's image.

Earnings management is used as a proxy of earnings Quality. The higher the earnings management, the lower the earnings quality, and the lower the earnings management, the higher the earnings quality (Dechow *et al.,* 2012). Earnings management is the process whereby the financial reporting processes of a company are managed or changed to obtain private benefits (Fiechter & Meyer 2010; Radzi, Islam, & Ibrahim, 2011; Sun, 2012).

Earnings management is divided into two types. Firstly, the accrual-based earnings management, where management manages earnings through accruals; the non-discretionary accruals which are out of the management's control and the discretionary accruals (DA) which are within the management estimative power and therefore use to mislead the users of financial statement to obtain benefits that are personal to them or to achieve the set target. Secondly, real earnings management is defined as a total departure from usual operational practices due to the desire to mislead stakeholders into believing that certain financial reporting goals have been achieved in the course of operation (Sun, 2012; Ozili, 2020).

Discretionary accrual as a proxy of earnings quality is measured using the Modified Jones Model by (Kothari, *et al.,* 2005); $TACit = a0\ \beta1(\Delta REVit-\Delta RECit) + \beta2PPEit + \beta3ROAit + \varepsilon it$

2.2 Dummy variable (DMB)

In econometrics and statistics, mainly in regression models for analysis, a dummy variable is the variable that assumes the value 1 or 0 to show the presence or absence of some definite effect that might be anticipated to swing the outcome or result (Gujarati 2003). Dummy variables are numeric replacements or proxy variables for qualitative realities in a regression model. In regression analysis, the dependent variable may not only be influenced by quantitative variables, but also by qualitative variables. A dummy independent variable (also referred to as dummy explanatory

variable) which for some observations take the value 0 will cause the coefficient of that variable to possess no role to influence the dependent variable, while where the dummy assumes or takes the value 1 the coefficient of that variable will act to alter the intercept Gujarati (2003).

Dummy variables are frequently used in regression analyses, they are tangled in various studies for forecasting economic, response modeling, credit scoring, biomedical studies, etc. For this study, a dummy variable would be applied to determine the impact of COVID-19 on the earnings quality of deposit money banks in Nigeria.

2.3 Return on Equity

Return on Equity (ROE) explains the percentage of profit a company is making for every monetary unit of equity invested. Though, the amount of cash that would be returned to shareholders is not specified by ROE, since it is the exclusive right of the company to decide on how dividends will be paid depending on the appreciation of the stock price. However, it presents a worthy indication that the company is capable of generating returns irrespective of the risk the investment may face (Eya 2016). ROE is normally measured by dividing net profit by average shareholders' equity.

Taylor and Xu (2010) argued that the profits a company makes are not significant to investors except the extent to which they relate to other financial indicators of the company. Hence, they used return on equity, return on assets and return on sales to determine a relationship between effect and effort, where profit represents the effect and the effort is represented by either stockholders' equity, total assets, or total sales.

The percentage of stockholders' equity is the amount of net income returned. ROE calculates a company's profitability by examining how much profit it generates from the monies invested by the stockholders. Based on this notion, ROE is seen as the most important of all ratios (Taylor & Xu 2010). It reveals the gain a company earned when compared to the total amount of stockholders' equity shown on the statement of financial position.

2.4 Return on Assets (ROA)

Return on Assets (ROA) constitutes one of the financial performance indicators of a firm in terms of profitability, as the ratio is most often emphasized in financial statements analysis, because of its ability to indicate a firm success towards creating profits. A company's ability to generate profits in the past and the future projections of such profits can be measured with ROA (Lawrence 2015; Ozili & Arun 2020). The asset itself is the entire property owned by the company, which is obtained from the company's capital or from foreign capital that is converted into the assets of the company for corporate sustainability.

Better company performance is indicated by a higher value of ROA, due to the higher return on the rate of investment. The ROA value is the reflection of the company's return on all the assets that a company is provided with (Wild et al, 2005). ROA is affected by some of these factors; (i) Liquidity Ratio, the ratio that measures the ability of a company to meet its short-term liabilities, it is calculated by comparing the company's current assets with current liabilities; (ii) Asset Management Ratio, measures the rate at which a company manages its assets effectively (Brigham & Houston, 2001); and (iii) Debt Management Ratio, this ratio avails the company with the information of knowing the levels at which it can meet up with its long-term debt (obligations) that was deployed to finance all the activities of the company.

ROA is measured by dividing earnings before interest and tax by total assets.

2.5 Empirical Review

Several studies have been empirically conducted on earnings quality and financial performance of different sectors and economies; some are discussed under this heading. A study conducted by Ijeoma (2014), examined the impact of earnings management in the financial statements of the Nigerian banking industry, where primary data were collected and the multiple bar chart and Kruskal-Wallis statistical tool were used to analyse the data. The finding revealed that the main motive for practising earnings management in the Nigerian banking industry was to increase the cost of operation, reduce exposure to taxes as well as boost prices of shares to reduce borrowing levels to make the trend of less risk and financial performance appear good. Another study conducted to examine the effect of earnings management on the financial performance of deposit money banks listed on the Nigerian Stock Exchange by Hauwa, Ocheni & Jamila (2017), revealed that earnings management exists in the Nigerian banking industry. However, the ROA was found not to impact significantly the earnings management of the banks. Secondary data from the annual reports of the sampled banks were used, where provisions for loan loss were used to proxy earnings management and ROA to proxy financial performance. Abubakar, Abdu, and Abdulmaroop (2014) also found a positive and significant relation between loan loss provision and earnings quality of the Nigerian banks.

The study conducted by Musa and Muhammad (2018) on the earnings management of listed deposit money banks in Nigeria revealed that all the variables (loan loss provision, loan charge off, total assets, and beginning balance of loan loss of earnings management used in the study were found to have a significant effect on the discretionary loan of loss provision of the deposit money banks. The data were sourced from secondary sources and the panel data regression technique was used in analyzing the data. Similarly, in a study conducted by Adebimpe et al., (2018) where they examined the influence of accrual-based earnings management on the financial performance of deposit money banks in Nigeria, it is found that discretionary accrual significantly and negatively influenced the ROA of deposit money banks in Nigeria.

The study of Taylor and Xu (2010) examined the negative association between the financial performance of US companies and real earnings management, where EPS, ROE, and PE ratios are taken as measures of financial performance and sales manipulation as a proxy of real earnings management and ROA. The findings of the study revealed the following: negatively significant impact on ROA of the companies, showing earnings manipulation by manipulating sales; also, a negatively significant effect on ROE of the companies, revealing manipulation of earnings through manipulating sales; EPS and PE ratios both show negative relationship indicating the presence of real earnings management.

This is the study that to the best of my knowledge, tries to examine the earnings quality of the Nigerian banks before and during the impact of the COVID-19 pandemic. The study uses a dummy variable to represent the period before and during the pandemic.

3.0 Methods of Data Analysis

This is a quantitative study that adopts the ex-post facto design. The data for the study is sourced from the financial statements of the selected banks from 2017 to 2020. A purposive sampling technique was used to select the sample size of fourteen (14) deposit money banks in Nigeria. The techniques for data analysis comprised of

descriptive statistics, correlation matrix, and multiple regression, with the aid of STATA 13.

3.1 Model Specification

The following model will be adopted by the study;

$EQit = \beta0 + \beta1DMBit + \beta2ROEit + \beta3ROAit + \mu it$

Where EQit – earnings quality; DMBit – banks represented by a dummy variable, ROEit – return on equity ROAit – return on assets; β0 – constant, β1 – β3 – estimated coefficient; μit – error term

3.2 Variables Measurement

Earnings quality is measured using the discretionary accrual model based on the Modified Jones Model by Kothari et al. (2005). Discretionary accrual as a proxy for earnings management/quality has been extensively used in most researches. Modified Jones Model by (Kothari, *et al.,* 2005) is $TACit = \beta0\ \beta1(\Delta REVit-\Delta RECit) + \beta2PPEit + \beta3ROAit + \varepsilon it$. Where TACit – total accrual, ΔREVit – change in revenue, ΔRECit – change in receivable, PPEit – property, plant and equipment, ROAit – return on assets, β1 to β3 – estimated coefficient, εit – error term.

DMB as the variable of interest is measured by assigning dummy 1 to financial statements of the year 2019 and 2020 and dummy 0 to financial statements of the year 2017 and 2018 to establish the impact of COVID-19 on the earnings quality of the banks, as used in the following studies (Gujurati 2003; Sabo 2019).

Return on equity is normally measured by dividing net profit by total shareholders' equity of the bank (Gugong et al., 2014; Ikpefan & Owolabi 2014; Eya 2016; Joseph et al., 2016).

Return on assets is measured by dividing the earnings before interest and tax (EBIT) by the total assets of the bank (Ikpefan & Owolabi 2014; Gugong et al., 2014; Eya 2016).

3.3 Research Hypotheses

The study formulated the alternate form of hypotheses which are stated below:

H_{1a} There is a positive significant relationship between earnings management and deposit money banks in Nigeria during the covid-19 pandemic.

H_{1b} There is a negative significant relationship between earnings quality and deposit money banks in Nigeria during the covid-19 pandemic.

4.0 Results and Discussion

This section presents and discusses the estimates from the econometric test. The statistical properties of the data were analysed to reveal the basic descriptive parameters, whereas the correlations among the variables were examined to show the extent to which they interact with each other.

4.1 Descriptive Statistics

The descriptive statistics of the data are presented in Table 1.

Table 1. Descriptive Statistics of the Variables

Variables	Obs.	Mean	Std. Dev.	Minimum	Maximum
EQ	56	5.5819	4.9321	0.0284	20.7734
DMB	56	0.5000	0.5092	0.0000	1.0000
ROE	56	7.1229	4.4496	1.2300	16.4000
ROA	56	0.0221	0.0170	-0.0255	0.0584

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The estimates in Table 1 show that the average earnings quality for the fourteen banks is about 3 per cent, while the deviation of the series from the mean is about 5 percent. This shows that the estimate is capable of varying from its means by about 5 percent. The minimum and maximum values of the EQ estimated by the study over the period are 0.0284 and 20.7733 respectively. The bank is the variable of interest has a mean of 0.5000 with a standard deviation of 0.5092, with a minimum value of 0.0000 and a maximum value of 1.0000. The mean value of the ROE is 7.1229 and a standard deviation of about 4.4500, with a minimum value of 1.2300 and a maximum value of 16.4000. The ROA has an average value of 0.0220 with a standard deviation of about 0.0170, with minimum and maximum values of about -0.0255 and 0.0584 respectively

4.2 Correlation Matrix

Table 2 shows the matrix of how the variables in the model relate to one another. Although, for this study, much emphasis would be laid on the relationship between the independent variable and the dependent variable. The matrix's diagonal will be set at 1 because the correlation between one variable and another is always 1. In a nutshell, a correlation matrix is symmetrical, and the coefficient of the correlation ranges from -1 to 1.

Table 2. Correlation Matrix for the Variables

	EQ	DMB	ROE	ROA
EQ	1.000			
DMB	0.0455	1.0000		
ROE	-0.6114	0.0675	1.0000	
ROA	-0.3832	0.1113	0.7678	1.0000

Table 2 shows a positive and weakly significant relationship between EQ and DMB, with a coefficient of 0.0455. It also reveals a negatively insignificant relationship between EQ and ROE with a coefficient of -0.6114. Furthermore, the matrix shows a negative insignificant association between EQ and ROA with a coefficient of -0.3832. The correlation between DMB and ROE is weak and positively significant with a coefficient of 0.0675. A positively insignificant relationship is also observed between DMB and ROA at a coefficient of 0.1113. Lastly, the matrix shows a positive and insignificant relationship between ROE and ROA at a coefficient of 0.7678.

Hence, it is clearly shown from Table 2 that the relationship among the variables from the correlation matrix does not reveal a case of multi-collinearity, as indicated by reasonably moderate coefficient values of the variables in the correlation matrix.

4.3 Regression Analysis

The regression analysis based on the pooled OLS (Ordinary Least Square) method is presented in Table 3.

Table 3. Regression Estimates of the Model

EQ	Coefficient	t-value	p-value
DMB	0.7289352	0.47	0.641
ROE	-0.8529157	-3.11	0.005
ROA	57.66513	0.80	0.430
Number of Obs.			56
F (3, 24)			5.28
Prob > F			0.0061
R-squared			0.3976

Adjusted R-squared	0.3223

The regression result in Table 3 evaluates the impact of the independent variable on the earnings quality of deposit money banks in Nigeria. From the estimates, the impact of the covid-19 did not significantly affect the earnings quality of the banks. This is an indication that the various measures and interventions by the federal government through the CBN to curb the impact of the pandemic in the economy and the banking industry is working for the time being. The result shows that the coefficient of DMB is positive with a value of 0.7289352, indicating that the more the impact of the pandemic the more the earnings management which would have resulted in low earnings quality, but the p-value is 0.641 (64 percent), showing an absence of any relationship between the Deposit Money Banks in Nigeria and earnings management.

The coefficient for ROE reveals a negative value of -0.8529157, which implies that a 1 percent increase in stockholders' equity will cause the earnings quality to decrease by 0.01 percent. The p-value further confirms the relationship between ROE and EQ at 0.005 which is far less than 5 percent. The negative result is an indication that an increase in stockholders' equity would be counter-productive, as more equity is provided, with low economic activities due to the COVID-19 pandemic, managers may result to earnings management to make financial statements look good.

The estimate for ROA shows a positive coefficient value of 0.5766513 and a p-value of 0.430 which is greater than 5 percent. The result of the p-value in this estimate indicates that there is no relationship between the return on assets and earnings quality of the Nigerian banks during the COVID-19 pandemic.

The accounts of Wald chi^2 for the model's general significance. With p-value > 0.05, shows that the independent variable does not significantly explain the phenomenon under study. Therefore, the alternate hypothesis that there is a positive significant relationship between Nigerian deposit money banks (DMBs) during covid-19 and earnings quality (EQ) is rejected. The second alternate hypothesis that says there is a significant relationship between ROE and earnings quality of Nigerian banks during COVID-19 is accepted with a p-value which is less than 0.05, whereas the third hypothesis; there is a significant relationship between ROA and earnings quality of DMBs during COVID-19 pandemic is rejected with a p-value greater than 0.05.

5.0 Conclusion

The study reveals that the current wave of the COVID-19 pandemic that is ravaging the entire world economy has not significantly impacted the earnings quality of the Nigerian banking industry. This could be an indication that certain measures and interventionist activities are taken by the federal government through the CBN to cushion the effect of the pandemic is yielding results. However, the negative impact of return on equity on earnings shows that, as the pandemic is still ongoing, more investment of the stockholders' equity should be halted because of the low economic activity that is taking place. The result of the estimate shows that the higher the investment of stockholders' equity, the lower the quality of earnings in their financial statements. On the other hand, the return on assets despite revealing a positive coefficient does not relate to the earnings quality of the Nigerian banks during the COVID-19 pandemic.

Based on the findings above, the study recommends that more financial interventions should be injected into the banking industry and the economy as a whole to stimulate

economic activities. By so doing, the banks would be able to restructure their terms of loans to enable customers or borrowers to pay back without much stress. Furthermore, an additional investment of stockholders' equity should be put on halt, pending when the pandemic is over. This will eliminate the risk of low return that could result in earnings management in the financial statements of the banks. For return on assets, despite it not showing any significant relationship with the earnings quality of the Nigerian deposit money banks during the pandemic, it would not be advisable for any bank to embark on a new project because of the high risk that is involved.

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