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ABNORMAL DISCRETIONARY EXPENSES AND FINANCIAL PERFORMANCE OF LISTED MANUFACTURING FIRMS IN NIGERIA

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ABSTRACT:

This study examined the effect of abnormal discretionary expenses on financial performance of listed manufacturing firms in Nigeria for a period of ten (10) years covering from 2013-2022. Sudden collapse of companies that once appeared viable and futuristic is a serious concern. Panel data were used in this study, which were obtained from the annual reports and accounts of twenty (21) sampled listed manufacturing firms for the period 2013-2022. Ex-Post Facto research design was employed. Inferential statistics using Pearson correlation coefficient, Multicollinearity test, Panel Least Square (PLS) regression analysis and Hausman test were applied to test the hypotheses of the study. The results revealed that abnormal corporate social responsibility cost has a significant and positive effect on cash value added (β_3=0.011970; p-value = 0.0088); abnormal employee benefit has a significant but negative effect on cash value added (β_4=-0.036034; p-value = 0.0010) of listed manufacturing firms in Nigeria at 5% level of significance respectively. In conclusion, the study found that abnormal discretionary expenses has a significant effect on financial performance of listed manufacturing firms at 5% level of significance. The study recommended amongst others that firms should discretionally utilize both ACSRC and EAB to improve and sustain performance.
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1. INTRODUCTION

The abnormal discretionary expenses refers to discretionary expenses that is unusually high or low, compared to what is expected. Discretionary expenses are those that are not essential to a company's operations and they can be reduced or eliminated if needed (Bergstresser & Phillippon, 2006). Some examples of discretionary expenses includes corporate social responsibility cost, employee abnormal benefit, equipment maintenance cost, advertising , travel and entertainment. So abnormal discretionary expenses would be when these types of expenses deviate from its usual levels (Zhang & Abraham, 2020). Accordingly, these could also be viewed as those expenses

that would be expected to deviate from normal levels if a decision were to be made in opposite direction. The empirical research on earnings management has substantial evidence of the manipulation of the earnings on three main components of cash flows namely operating, financing, and investing activities and discretionary expenditure such as production expenses, inventory, and sales to ensure the financial target is met. Some managers might reduce the fluctuation in cost from one period to another period in ensuring that stable earnings are disclosed to the investors (Lisboa & Kacharava, 2018). Earnings management occurs when managers uses abnormal discretionary expenses transpire to adjust financial reports to either mislead stakeholders about the underlying economic performance of the company or to control the contractual outcomes that depend on reported accounting figures. In essence, sudden collapse of some companies that once appears viable and futuristic through its financial report has been an issue that calls for serious attention. It is against this backdrop that this study tends to ascertain the effect of abnormal discretionary expenses on financial performance of listed manufacturing firms in Nigeria.

1.1 Objectives of the Study

The main objective of this study is to examine the effect of abnormal discretionary expenses on cash value added. Specifically, the objectives are to:

1. ascertain the effect of abnormal corporate social responsibility expenses on cash value added of listed manufacturing firms in Nigeria
2. evaluate the effect of employees abnormal benefit on cash value added of listed manufacturing firms in Nigeria

1.2 Research Hypotheses

Similarly two research hypotheses, in its null forms, were formulated to help achieve the objectives of this study.

Ho_1: Abnormal corporate social responsibility cost has no significant effect on cash value added of listed manufacturing firms in Nigeria.

Ho_2: Abnormal employees benefit has no significant effect on cash value added of listed manufacturing firms in Nigeria

2. LITERATURE REVIEW

2.1 Conceptual review

2.1.1 Abnormal Discretionary Expenses

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2.1.2 Abnormal Corporate Social Responsibility

Abnormal corporate social responsibility cost refers to the cost that a company incurs in order to engage in CSR activities that go beyond what is considered normal for the industry. The costs could include things like environmental protection, employees training and development, and charitable giving. So, abnormal corporate responsibility cost is essentially the cost of going above and beyond what is expected of a company in terms of its social responsibility. (Dung, & Dang, 2021). There are many different types of corporate social responsibility (CRS) costs that companies may incur. For example, companies may spend money on initiatives like community development, employee training, environment protection, and disaster relief. Companies may also donate money to charitable causes or invest in sustainability initiatives (Saeed, Mudliar & Kumari, 2023). Some example of CRS cost that have been studied by researchers include advertising expenses related to social responsibility, philanthropic donation, and expenditures on environmental protection (Johansson, Hiswåls, Svennberg & Macassa, 2022).

2.1.3 Employee Abnormal Benefit

Abnormal employee benefits are those that are not usually provided by a company, for example, a company may offer an employee benefit like paid parental leave, which is not considered a normal benefit in most industries. Other examples of abnormal employee benefits could include paid volunteer time, or educational assistance and so on (Lin, Tang, Li & He, 2023). It can be a way for a company to manage its earning by increasing its expenses. For example, company may offer more generous benefits than usual in order to lower its taxable income which could include things like offering more vacation days, higher salaries, or increased retirement contributions. By so doing, the company may be able to reduce its taxes and improve its financial performance (Bryson & Freeman, 2019). There are many different types of employee benefit that companies may offer. Some common examples include health insurance, paid time off, retirement plans, and life insurance. In addition, some companies may offer more unique benefits like onsite child care or tuition reimbursement (Zhang & Ning, 2021).

2.1.4 Financial Performance

The financial performance identifies how well a company generates revenues and manages its assets, liabilities, and the financial interests of its stakeholders and stockholders (Kenton, 2023). Analysis of financial performance metrics can be used to identify internal investment opportunities, like automating repetitive processes to increase productivity, and can help maintain positive cash flow. In other words, it can keep the business's operational and financial aspects in sync (Murry, 2023). In other words, it is a complete evaluation of a company's overall standing in categories such as assets, liabilities, equity, expenses, revenue, and overall profitability. It is measured through various business-related formulas that allow users to calculate exact details regarding a company's potential effectiveness. For internal users, financial performance is examined to determine their respective companies' well-being and standing, among other benchmarks. For external users, financial performance is analyzed to dictate potential investment opportunities and to determine if a company is worth their while (Luther, 2023). Financial performance is **a** subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Kenton, 2023).

There are many stakeholders in a company, including trade creditors, bondholders, investors, employees, and management. Each group has an interest in tracking the financial performance of a company. When a business examines its financial performance, many factors come into play, including measures like profitability, liquidity and efficiency. The business may be profitable, but inefficient accounts receivable processes could leave it without the cash to pay bills on time. So, for example, even with strong growth in sales, a company that lacks efficient cash management may not have the cash on hand to pay employees, restock inventory or pay suppliers. Financial performance takes all these aspects into account when determining a company's financial strength by analyzing the business's financial statements and other data (David, 2023).A company in good financial health will pay its bills on time and maintain good business credit.

2.1.5 Cash Value Added

Cash value added (CVA) is a measure of a company's ability to generate cash flow above and beyond the required return to its investors (Bloomenthal, 2022). Cash value added is the measure of company performance that looks at how much money a company generates through its operations (Kvilhaug, 2022). A high cash value added figure is beneficial for both companies and investors, as it demonstrates a company's ability to generate cash from one financial period to another. (Richards, 2023). The cash value added metric is one way to measure the real profitability of a business, beyond what is required to pay the bills and satisfy the investors (Leigh, 2023).

Generally speaking, a high CVA indicates a company's ability to produce liquid profits from one financial period to another.

CVA = gross cash flow - economic depreciation - capital charge

Where:

1. Economic depreciation is [WACC / (1+WACC)^n -1]
2. Gross cash flow is adjusted profit + interest expense + depreciation
3. The capital charge is the cost of capital x gross investment
4. Gross investment is net current assets + historical initial cost

A value of more than 1.0 indicates that a company is profitable, while a value below 1.0 suggests it is failing to return a profit (Knueven, 2023).

2.2 Theoretical Review

2.2.1 Income Smoothing Theory

Income smoothing theory is the idea that companies try to smooth out their earnings over time, so that their financial results are more predictable and less volatile. This theory suggests that companies may engage in activities like assets sales or debt insurance in order to achieve smoother earnings. Income smoothing is an aspect that is usually considered when discussing about real earnings management. It has been noted that smoothing occurs either intentionally or during recognition, measurement and disclosure of financial information (Almeida, Neto, Bastianello & Moneque, 2012). There are various models that have been developed over time to measure income smoothing practices among companies. The most notable model is the Eckel's model which was developed in 1981. According to his model, income smoothing is divided into: designed smoothing - which is the management's intentional practice to manipulate earnings and; natural smoothing - that which occurs naturally without resulting in the manipulation of a firm's profits. Eckel's model is based on the assumption that revenue and costs tend to become linear over a period of time. This means that they grow and decline at the same rate therefore, in a situation where a linear relationship is not observed means that management may have engaged in income smoothing. When the coefficient for profits fall below that of revenues then it goes to show that the company is engaging in artificial smoothing of the profits This study is anchored on this theory because in a quest to meet up with their desired goal/profit, managers do some manipulations in the its discretionary expenses

2.3 Empirical Review

Earning manipulation activities like abnormal discretionary expenses is not new in research world, a lot of scholars has done some research on issues that has to do with manipulation of earnings and abnormal discretionary expenses.

Xie, Cheng, and Zang (2011) examined the effect of abnormal discretionary expenses and profitability, and found out that abnormal discretionary expenses are negatively related to future profitability.

Gomes and Rahman (2019).They examined the relationship between abnormal discretionary expenses and future firm value, and found that high abnormal discretionary expenses are associated with lower firm value

Okafor, Ezeagba, and Onyali (2018) examined how earnings management affects performance of Nigerian firms. 17 firms were sampled. A simple regression technique was used in analyzing data. The findings showed that the independent variable negatively and insignificantly affect the dependent variable. The recommendation made was that further research should be done in all the sectors to find out the industries in which the subject matter significantly affects their performance, which will help management by exception. Significantly affects their performance, which will help management by exception.

Ghozali, Harto and Yuyetta (2018) researched on free cash flow, investment inefficiency, and earnings management. The study was aimed at testing investment inefficiency of fixed assets in mediating the relationship between free cash flow and earnings management and to test the controlling shareholders in moderating the relationship between free cash flow and fixed assets investment inefficiency. The research problem proposed in this study is whether the use of free cash flow for the investment inefficiency of fixed assets is able to ultimately improve the managerial performance. The research investigated new empirical evidence related to management earnings practices caused by free cash flow fixed assets investment inefficiency. The study was conducted on all the manufacturing firms listed on the Indonesia stock exchange from 2010 to 2015. The data used are secondary data in the form of the firms' financial statements. Using purposive sampling, 314 units were analyzed from 69 manufacturing firms. The estimation of the path model was completed using Structural Equation Modeling (SEM) by Warp PLS program version 5.0. The results showed that free cash flow is positively related to earnings management. Fixed assets investment inefficiency is able to mediate the relationship between free cash flow and earnings management.

Osma, Grande-Herrera, and Vázquez (2017) worked on the role of independent directors on earnings management: Evidence from individual incentives, the role of independent directors on earnings management. The authors presumed that independent directors' behavior hinges critically on their individual incentives. Using a large US sample for the period 1997 to 2013, the study constructed a measure of within-board heterogeneity among independent directors' incentives that is exogenous to a single firm's choices. Using this measure, it was found that individual incentives influence boards of directors' ability to constrain earnings management. In particular, it was shown that boards composed of independent directors with greater individual incentives lower real earnings management and increase informative accrual-based earnings management. Moreover, it was also believed to have provided an evidence of individual incentives influencing the firm information environment. The evidences highlight the importance of independent directors' individual incentives to carry out their fiduciary duty to monitor the financial reporting process.

Mungai (2021) conducted a study, utilizing a regression evaluation of the sum of all current accruals (constant) and other variables that were independent, which were interest rates, inflation, and money supply. The investigation revealed a nuanced association between the predictor variables and earnings management. As a result, Mungai postulated that there may be supplementary factors that influence the decision-making process of managers with regard to managing earnings beyond those that were accounted for in the study. This finding emphasizes the need for further investigation to gain a more thorough understanding of the underlying dynamics at play. According to Li et al., (2020) the empirical research suggests that companies that face financial distress are inclined to undertake accrual earnings management while avoiding real earnings management. Additionally, it has been established that internal control mechanisms can be essential in lessening the connection between financial hardship and earnings management by constraining both accrual and actual earnings management practices. These results emphasize the significance of implementing efficacious internal controls to thwart financial statement misrepresentation during periods of financial distress. Furthermore, it has been found that the practice of earning management and the provision of subsidies have no significant impact on the financial distress experienced by state-owned enterprises. The management of such entities has been observed to engage in earnings management activities, but only within a certain threshold, so as not to adversely affect their financial stability (Sayidah et al., 2020). This underscores the importance of maintaining a delicate balance between the desire to maximize profits and the need to ensure sustainable financial performance.

Akintoye et al. (2021) investigated how sustainability reporting affected abnormal operating cash flows in multinational companies operating in Sub-Saharan Africa. The study focused on five multinational companies from each of the ten countries, covering the period between 2010 and 2019. The results showed that sustainability disclosure had a significant impact on abnormal operating cash flows in these corporations, suggesting that it also influenced their earnings management. The authors suggested that management of international companies in Sub-Saharan Africa should strictly adhere to sustainability reporting practices to improve their earnings quality and reduce the need for earnings management practices.

Hashim, Salleh, and Ariff (2013) carried out a study on the underlying motives for earnings management: directors' perspective. The paper provided evidence on the motives for directors to manage earnings. Adapting theory of reasoned actions, we examine three different motives (i.e. altruistic, speculative, and pressure from affiliated parties) for directors to manage earnings. It was found that the primary motive for directors to be involved in earnings management activity is derived from altruistic motivation, which referred to the motive that involves concern about the benefits of company. Directors work hard to meet market expectations and are more concerned about their company's reputation rather than their own personal benefits. Regarding the application of GRAR metric, it was found that only 11 publications used the isolated model of actual activities. In contrast, 39 publications applied together GRAR and models based on accruals. In view of these results, it is assumed that the theme and the model proposed by

3. MATERIAL AND METHOD

The research work employed *ex-post facto* research design using secondary data, for ten (10) years from 2013—2022. The justification using this type of methodology is that the statistical relationship of interest is thought to be causal, but the researcher cannot manipulate the independent variable because it is impossible, impractical, or unethical (Kurawa& Ahmed, 2020). Of the population size of 59 listed manufacturing companies in Nigeria as at December 31st 2022, 21 firms was purposively sampled. To this end, the Panel least square regression analysis technique was used to test the relevant hypotheses in this study.

Table 1 Operationalization of Variables

Variable Type	Indicators	Variable Symbols	Measurement
Independent Variable *Abnormal Discretionary Expenses*	Abnormal Corporate Social Responsibility Expenses	ACSRC	If a firm reports on ACSR item; We score 1 otherwise 0
	Employees Abnormal Benefit	EAB	If a firm reports on EAB item; We score 1 otherwise 0
Dependent Variable *Financial Performance*	Cash Value Added	CVA	Gross Cash Flow - Depreciation - Capital Charge

Researchers' concept, 2023.

4. RESULT AND DISCUSSIONS

4.1 Data Analysis

Table 2 Abnormal Discretionary Expenses and Financial Performance

Dependent Variable: CVA

Method: Panel Least Squares

Date: 11/17/23 Time: 11:20

Sample: 2013 2022

Periods included: 10

Cross-sections included: 21

Total panel (balanced) observations: 210

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.912422	1.199926	5.760707	0.0000
ACSRC	0.011970	0.004475	2.674807	0.0088
EAB	-0.036034	0.010653	-3.382468	0.0010

R-squared	0.769055	Mean dependent var	3.464000
Adjusted R-squared	0.740813	S.D. dependent var	2.669567
S.E. of regression	1.996270	Akaike info criterion	4.278563
Sum squared resid	374.5990	Schwarz criterion	4.434873
Log likelihood	-207.9282	Hannan-Quinn criter.	4.341825

F-statistic	46.60855	Durbin-Watson stat	1.692356
Prob(F-statistic)	0.000000		

Source: E-Views 10 Regression Output, 2023

Table 2 shows the output of regression on the effect of abnormal discretionary expenses on cash value added and the result of the model is written as:

$CVA_{it} = 6.912422 + 0.011970ACSRC_{it} - 0.036034EAB_{it} + \mu_{it}$

The model infers that 1% increase in ACSRC will exert 1.20% increase on CVA, while 1% increase in EAB will cause CVA to reduce by 3.60% of listed manufacturing firms in Nigeria respectively. It also shows that ACSRC (β_3=0.011970) have a positive relationship towards CVA, while, EAB (-0.036034) negatively relates with CVA. The slope coefficients reveal that; P(x_1=0.0088; x_2=0.0010;). The model delineate that at 95% confidence level, there is a significant positive relationship between ACSRC and CVA; a negative but significant relationship between EAB and CVA. The Durbin-Watson Value of 1.692356 buttressed the fact that the model does not contain auto-correlation, thereby, making the regression fit for prediction purpose since it is not more than 2.0 approximately. The adjusted R-Squared of 0.740813 shows that 74.08% of the systematic variation in CVA could be explained by ACSRC and EAB while the remaining 25.92% is explained by the error term as part of the CVA which is not interpreted by the regression model.

4.2 Test of Hypotheses

4.2.1 Hypothesis One

Ho_1: Abnormal corporate social responsibility cost has no significant effect on cash value added of listed manufacturing firms in Nigeria.

Table 2 above reveals that while the outcome of the t-statistics (2.674807) indicated a positive and strong effect of abnormal corporate social responsibility cost on financial performance of the sampled manufacturing firms, herein proxied with cash added value, the p-value indicator of 0.0088 further lend credence to the earlier observation made that such effect is statistically significant in every sense.

4.2.1.1 Decision

Since the p-value obtained (0.0088) is less than 0.05, the alternate hypothesis is accepted, and this implies that Abnormal corporate social responsibility cost has a strong, significant and positive effect on cash value added of listed manufacturing firms in Nigeria at 5% level of significance (t-statistics = 2.674807; p-value = 0.0088).

4.2.2 Hypothesis Two

Ho_2: Abnormal employees benefit has no significant effect on cash value added of listed manufacturing firms in Nigeria

Table 2 above reveals that while the outcome of the t-statistics (-3.382468) indicated a negative but strong effect of abnormal employee benefit on the financial performance of the sampled manufacturing firms, herein proxied with cash added value, the p-value indicator of 0.0010 further lend credence to the earlier observation made that such effect is statistically significant in every sense.

4.2.2.1 Decision

Since the p-value obtained (0.0010) is less than 0.05, the alternate hypothesis is accepted, and this implies that abnormal employee benefit has a strong, significant but negative effect on cash value added of listed manufacturing firms in Nigeria at 5% level of significance (t-statistics = -3.382468; p-value = 0.0010).

CONCLUSION AND RECOMMENDATIONS

Based on the findings made by the study that abnormal corporate social responsibility cost has a significant and positive effect while employee abnormal benefit has strong, significant but negative effect on financial performance of listed manufacturing firms at 5% level of significance, Based on the findings of this study, the following recommendations were made:

1. Firms should discretionally utilize abnormal corporate social responsibility cost to sustain its cash value added.
2. Firms' management should also envisage policies that will attract, motivate and retain top talent so as to boost the cash value added for the period.

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