Growth Opportunities and Earnings Quality from Emerging Economies
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ABSTRACT
We examined the causality between growth opportunities and earnings quality of the emerging economies. We develop an argument that growth opportunities should lead to high-quality earnings of the developing economies against the prior studies from developed economies which posit that growth opportunities result in a lower quality of earnings. The findings revealed that Growth Opportunities had a positive significant effect on Earnings Quality (EQ). Thus, the study concluded that growth opportunities are useful in determining the quality of earnings of corporate firms in Nigeria. The study recommends that managers should take advantage of their firms’ growth opportunities to provide quality accounting information which will directly provide expanded opportunities for business growth. Though literature confirms that generally, earnings management might not be necessarily bad in business operational practice; managers are advised to avoid extreme aggressiveness in managing earnings as this may culminate into negative manipulation of accounting information.

Keywords: Earnings quality, Growth opportunities, Discretionary accruals, corporate age, corporate size.

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1.0 INTRODUCTION
Prior research in accounting and finance show that Growth opportunity is one of the factors considered in determining the survival or stability of the firm (Nwaobia, Kwarbai, Jayeoba & Ajibade, 2016; Pranesh 2017). Firms with growth opportunities are more striking to investors because of the higher potentials for profits and capital appreciation/gains. Teoh and Wong (1993)
documented in their studies that the quality of earnings is positively related to growth opportunities. This further means that growth is an important phenomenon in every business. One of the basic assumptions of business is going concern that a business will continue to exist into a foreseeable future without threat to close down. Hence, their survival essentially depends on their power to participate in the market with other bigger companies (Akintoye 2008; Rauch & Rijskik, 2013; Kwarbai, 2018, Akintoye, Adegbie, Nwaobia & Kwarbai, (2019). This implies that investors are more sensitive to information about growth opportunity firms.

Prior researches also suggest that firms that are not growing may be enthused to engage in aggressive earnings management to conceal their distress (Garcia, Gracia & Neophytou, 2009; Li, Abeysekera & Ma, 2011). On the other hand, Pranesh (2017) provides evidence that firms with growth opportunity have lower earnings quality, implying the fact that firms in a bid to show that they are growing might engaged themselves in accounting choice exercised by the earnings management while reporting the earnings figure. Hence, managers of firms with relatively more investment opportunity set would have wider opportunity or more discretion to manage earnings. (Prihat, Zaki, Indra and Supriyadi, 2006).

It is a commonly contestation that firms with high growth opportunity with a lower asset value are hardly observed and monitored by managers, and this give room for opportunistic reporting behavior leading to aggressive earnings management which beneficiary to the owners of the firm and future investors (Skinner, 1993; Skinner & Sloan, 2002). We advance this argument through this study as we provide our view from emergent economies in Africa. Our study is related to so many works, but different from previous studies that examine the effect of growth opportunities on the quality of earnings in the developed nations (Skinner, 1993; Ainajjar, & Belkaoui, 2001; Pranesh, 2017). Our study considers the level of firm’s investment opportunity as condition that represents the opportunity to a wider practice of earnings management from developing nations. Based on our knowledge, there are no empirical papers which analyzed the relationship of growth opportunities and earnings quality in the Nigerian context. Hence, in this paper, we argue that growth opportunities do not improve the opportunistic behavior of managers and reduces the quality of earnings but should rather improve the quality of earnings. First, in determining earnings quality, we used the discretionary accrual to proxy earnings quality. Secondly, we analyzed the growth opportunities effect on earnings quality in the Nigerian financial market. Thirdly, we include corporate age and corporate Size to evaluate their moderating effect on the growth opportunities earnings management relationship.

The paper is organized into sections consist of this introduction. Section 2 Literature and theoretical underpinning, Section 3 explains the empirical methodology. Section 4, Results and findings. Discussion, the implication to research and Practice, conclusion and future research in section 5, 6, 7 & 8 respectively.

2.0 LITERATURE AND THEORETICAL UNDERPINNING

It is believed that firms with good investment opportunity comprised of high intangible growth option and are hardly monitored effectively compared to others with more assets in place. Pranesh (2017) posit that such firms are more difficult to monitor, or less observable. On the other hand, if the firm is comprised largely of asset-in place it is relatively easy for an outsider to monitor the activities of the firms. This simply means that there will be disproportionate information level for investors or prospectus investor between firms, given rise to earnings management in firms with growth opportunity (Prihat, Zaki, Indra and Supriyadi, 2006; Ambarish et al., 1987; Skinner, 1993).

The study of Pranesh (2017) revealed that firm’s growth opportunity had positive significant effects on discretionary accruals of Indian non-financial firms. This is signifying that an increased growth of a firm may lead to an increase in the accounting choices exercised by the management while reporting the earnings figure.

The growth opportunity of a Firm has a significant effect on its value, because of intense competition, management may be inclined to take higher risks to increase a company’s market
share and to promote the growth of performance. Myers and Turnbull (1977) stated that companies with more growth opportunities adopt a more traditional strategy in regards to the formulation of financial policies. However, when earnings target cannot be realized to meet the market expectations, it becomes a challenge and management may be involved in window dressing in order to meet up with the expectation of the public to remain in market (Roychowdhury, 2006). McNichols and Stubben (2008) further opined that firms have a potential spur to employ earnings management to minimize distortions in earnings to satisfy the investors’ expectations of future growth and product demand.

There is a higher tendency of growing firms to use more accrual items on its earnings determination for enhancing future growth, they engage in such activities in order to present a good picture of the firm in other to attract more investment (McNichols, 2000). Since the expectations of future growth are based on information that includes revenues and earnings.” Consequently, earnings misstatements are likely to influence the expectation of future growth. Jones (1991) model demonstrated that the variation in current sales revenues would be enough to capture the changes in the current accrual items. Prior research has compared companies that have lower expectations for future growth based on earnings and other companies that have higher expectations of their growth opportunities in terms of earnings.

Further, Cohen and Zarowin (2009 & 2010) found that overinvestment firms or seasoned equity offerings firms actually engage in more earnings management activities. Wongsunwai (2012) also showed that external monitoring, and venture capitalist quality, affect firms’ earnings management behavior around initial public offerings. Chung (1993) found that when high growth opportunities and high risk existed simultaneously in a company, management tended to increase debt, which caused the company to lose growth opportunities to prevent bankruptcy. The study of Richardson, Tuna, and Wu (2002) indicated that growing firms may attempt to report an increase in earnings by restating financial results. As a result, it is possible that management is likely to manipulate earnings for pursuing the growth target. On the other hand, AlNajjar and Riahi-Belkaoui (2001) showed that firms’ growth opportunities affect net income and worth and thus produce political costs and risk. Therefore, firms with high growth opportunities and high risk might use income decreasing accruals.

Agency theory could explain the reason for corporate management use of accounting policies based on past experience and quality of earnings. However, Positive Accounting theory explains the different motives for using different accounting policies and it can explain the sign of the effect on the quality of earnings as affected by the growth opportunity of firms. Myers (1977) indicated the value of a company could be determined based on its future growth opportunities. However, companies with high growth opportunities also face more uncertainties, because the future values of a company primarily rely on R&D expenses, advertising and marketing expenses, talent recruitment, training expenses, et cetera. Although these expenses benefit a company’s future growth, they are difficult to quantify in the current value of the company. Skinner and Sloan (2002) suggested that high levels of growth opportunities in a company might generate information asymmetry between the company and investors. Consequently, companies with higher growth opportunities are more likely to manipulate earnings to gain more benefits. Hence, this study hypothesized that:

\[ H_01: \text{Growth opportunities do not significantly influence the level of earning quality of firms in emerging economies} \]

We draw upon prior research to identify other factors that can affect the causality of quality earnings and firms growth. We, therefore, include Corporate Age and Corporate Size to the model. According to Nwaobia, Kwarbai and Ogundajo (2016) Size and age variables could be used to control for the economic factors that influence a firm’s growth.
3.0 METHODOLOGY
3.1 Research Design, Sample and Data
The ex-post facto research design was adopted in this study. Secondary data were extracted from the annual reports and accounts of twenty-six (26) companies for a period of 21 years (1996-2016) representing 546 firm-year observations. To achieve the objective of this paper, three variables were identified. The description and measurement of these variables are presented in section 3.3.

3.2 Model Specification
AQUA$_{it}$ = α0 + α1GOOP$_{it}$ + α2CORPAGE$_{it}$ + α3CORPSIZE$_{it}$ + µ$_{it}$

where:
AQUA = accrual quality of the sample firms (used as proxy for earnings quality) 
GOOP = growth opportunity of firms 
CORPAGE = corporate age of the firms 
CORPSIZE = corporate Size of firms

3.3 Measurement of Variables
3.3.1 Dependent Variable: Earnings Quality
In determining the quality of earnings, we adopted the accrual quality model of Dechow and Dichev (2002) modified by McNichols (2002) and used by Kothari et al. (2005) and Nwaobia, Kwarbai, Jayeoba and Ajbadi (2016), based on the unexplained accruals or residuals of the model, to estimate earnings quality of sampled firms. The residual value estimates the magnitude of the deviation from the expected level of investment. The deviation is captured by the positive or negative residuals from the expected accrual model and is denoted as the level of high and/or low earnings quality. The model adopted is mathematically presented as follows:

TCA$_{it}$ = β0 + β1CFO$_{it-1}$ + β2CFO$_{it-1}$ + β3CFO$_{it+1}$ + β4∆REV$_{it}$ + PPE$_{it}$ + ε$_{it}$, scaled by Total Assets

Where: TCA$_{it}$ = Total Current Accrual: the firms’ accruals in year t, which AQUA???? the current assets change in year t minus current liability changes, minus the changes of cash and cash equivalent year t plus a change of short-term liability with interest in year t, 
ΔCA$_{it}$ = the change in current assets, 
ΔCash$_{it}$ = the change in cash/cash equivalents, 
ΔCL$_{it}$ = the change in current liabilities, 
ΔSTDBET$_{it}$ = the change in short term debt. 
CFO$_{it}$ = represents the firms operating cash flow. 
ΔREV$_{it}$ = the change in revenue; while 
PPE$_{it}$ = Property, Plant and Equipment

3.3.2 Independent Variable: Growth Opportunity
According to Raymond (2010), there are several measurements of growth opportunities in accounting and finance literature. These include Tobin’s Q given as the market value of assets to the book value of assets, Dividend to share price ratio, research and development to sales ratio and Sales growth. In this study, we made use of a sales growth rate. Jones (1991) model demonstrated that the variation in current sales revenues would be enough to capture the changes in the current accrual items. According to Alonso et al (2005), growth opportunities within a firm are the realized growth. The study of McNichols and Stubben (2008) indicate that expectations of future growth are based on information that includes revenues and earnings. The expectation is that a high level of sales growth is related to a low quality of earnings. Hence, the expectation is that a firm with a high
level of increasing sales has relatively more discretionary accruals. Therefore this paper expects a negative relationship between the sales growth rate and the quality of earnings.

3.3.3 Control variables
In this study, we used corporate age and corporate size of firms as control variables. While Corporate age (CORPAGE) was estimated as the absolute number of years of incorporation, Corporate Size (CORPSIZE) was estimated as a natural logarithm of total assets.

4.0 RESULTS AND FINDINGS
Table 1 provides the descriptive statistics of the variables used in the study. It presents the mean, maximum, minimum and standard deviation. From the reported descriptive statistics, corporate age (CORPAGE), the age of the sampled firms used are within the range 10 years to 93 years of existence. This indicates that the firms under consideration are experienced in their respective areas of business endeavours due to the long duration of their corporate existence. Our thinking is that firms’ age and experience in an industry may affect the quality of their reporting. There is also an indication that the firms under consideration have a large assets base (CORPSIZE) using log of the total asset as proxy. CORPSIZE has a minimum value of 4.036 billion and a maximum value of N10.14 billion suggesting that the firms are large firms. Firm size can influence reported earnings quality either way positively or negatively.

The descriptive statistics also indicate that growth opportunity (GOPP) has reported minimum value of -0.998 and a maximum of 999.00. The reported mean and standard deviation values are 2.238 and 43.011 respectively. Thus, the minimum and maximum values as well suggest a broad variation away from the mean and as such the variable is volatile in nature.

For Accrual Quality (AQUA), standard deviations from the mean indicate a wide dispersion and this is supported by the minimum and maximum values of -103.667 and 483.40 respectively.

| VARIABLE | OBS | MEAN  | SD   | MIN  | MAX  |
|----------|-----|-------|------|------|------|
| CORPAGE  | 546 | 43.615| 15.318| 10.000| 93.000|
| CORPSIZE | 546 | 6.828 | 1.053| 4.036| 10.014|
| GOPP     | 546 | 2.238 | 43.011| -0.998| 999.000|
| AQUA     | 546 | 6.77 | 60.290| -103.667| 483.406|

Source: Researcher, 2018

4.1 Diagnostic Tests
Diagnostic tests were performed on the model to validate the correctness of model estimation. The result of the post estimation tests on Table 2 shows that all the various tests are significant with probability values of 0.000, which is less than the acceptable 0.05 level of significance except hausman test. Specifically, the significance of hausman test shows that the null hypothesis to estimate random effect should not be rejected; as such the model was tested for the appropriateness of random effect using the testparm option on Stata. The series indicated the presence of heteroskedasticity, first-order autocorrelation and cross sectional independence. Hence we used robust option to handle the presence of first-order autocorrelation and heteroskedasticity.

| VARIABLE | Coefficients | Std Error | t-Stat | Prob.  |
|----------|--------------|-----------|--------|--------|
| C        | 1.5682       | 0.0393    | 39.85  | 0.000* |
| CORPAGE  | -0.8536      | 0.0351    | -24.34 | 0.000* |
| CORPSIZE | 0.5989       | 0.0812    | 7.37   | 0.000* |
Multiple regression estimates showed that the growth of sales as proxy for growth opportunities is significantly related to the level of accrual quality at a 5% percent level. This means that the actual growth in sales is related to the level of accrual quality. This is a positive association. Although with a lower magnitude of less than 5%. It is consistent with the *A priori* expectation that growth opportunities should positively relate to accrual quality. This implies that company with higher growth opportunities is not more inclined to use discretionary accrual items to manipulate earnings. 

Corporate Age exerted a negative effect while corporateSize had a positive effect on the quality of earnings. This is indicated by the sign of the coefficients, that is $\alpha_1 = -0.8536 < 0$, and $\alpha_{2-3} = 0.5989$, and $0.0406 > 0$ respectively. This is indicative of the fact that companies can use the age and experience shield to act opportunistically and manipulate their earnings while the firm size could constrain such behavior in order to avoid reputational loss.

Additionally, the adjusted R-squared showed that 5% variations in earnings quality proxy by accrual quality is caused by the use discretionary accrual items to manipulate earnings due to growth opportunities of the sample firm and the control variable of CORPAGE and CORPSIZE while the remaining 95% variations in Accrual quality are caused by other factors not included in this model. Hence, the coefficient of determination shows that the model has an average explanatory power in explaining the variation seen in the accrual quality. This is further emphasized by the probability of the F-statistic of 0.000 which shows that the regression result is statistically significant because this is less than 5%, the level of significance adopted for this study. Therefore, from the regression estimates, growth opportunities corporate age and corporate size of the firms jointly have a significant positive effect on the quality of earnings of firms in Nigeria.

Our findings is consistent with our *a priori* expectation as we suggest that growth opportunities lead to high-quality earnings in the developing economies against the prior studies from developing economies posit that growth opportunities result in a lower quality of earnings. Our study is inconsistent with the study of Beaver, (1968) that showed that growth opportunities provide managers with an incentive to smooth earnings as earnings volatility increase perceived firm risk which adversely affect the cost of capital needed by the firm. Also inconsistent with AlNajjar and Riahi-Belkaoui (2001) showed that firms’ growth opportunities affect net income and worth and thus produce political costs and risk, Richardson, Tuna, and Wu (2002) documented that growing firms may attempt to report an increase in earnings by restating financial results. As a result, it is possible that management is likely to manipulate earnings for pursuing the growth target. The result also is consistent with Pranesh (2017) that growth of the firm is positively associated with accrual quality and also indicate that firm's size and age were statistically significant influencing variables.
on the relationship of growth opportunities and earnings quality although our result indicate that corporate age exerts negative influence. The study implication is that managers should take the advantage of growth opportunities to provide quality accounting information which will directly provide expanded opportunities for business growth. As identified earlier that earnings management might not be necessarily bad in business operational practice but managers should avoid extreme aggressiveness which connotes negative manipulation of accounting information.

7.0 CONCLUSION
The study provided an insight into the causality between Growth opportunities and earnings quality in an emerging economy. Thus, the study concluded that growth opportunities are useful in determining the earnings quality of firms. Also, the controlling variable used in the models also affects the relationship between earnings quality and the firm’s growth although depending on the association under consideration. We suggest in further research that proxy other than growth in sales should be used to capture growth opportunity to evaluate its impacts on financial reporting quality.

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