



# Firm characteristics and financial performance in quoted manufacturing companies in Nigeria



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## ABSTRACT

The aim of this study was to examine the impact of firm characteristics on the financial performance of quoted manufacturing firms in Nigeria. Descriptive and cross sectional research design were adopted to investigate the relationship between variables of firm characteristics and financial performance of quoted manufacturing firms in Nigeria over a period of 14 years. Secondary Data were obtained from annual reports of five selected quoted manufacturing firms. Panel least square regression model was used to test the formulated hypothesis. Findings showed that all the independent variables jointly and strongly have impact on the financial performance of manufacturing firms in Nigeria measured by return on assets. It was concluded the explanatory variables (Firm Age, Firm Size, Sales Growth, Liquidity and Leverage) were significantly associated with the dependent variable (Return on Asset). The Study then recommends that, the managements of manufacturing companies should find ways to improve and acquire the optimal utilization of their assets, while making maximum use of their resources during the production processes and distribution of finished products as this would help them in improving their profits.

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## INTRODUCTION

The manufacturing industry plays a major role in the economy as they motivate the nation at large. This is because the sector is part of protected and restoration system of an economy and successful operation of the industry can set vigour for other industries and development of an economy (Abate, 2012). Indeed, a well-developed and evolved manufacturing industry is critical to conditions for economic development as it provides long term funds for long term investment for the country.

Firm characteristics are those incentives variables that affect the firm's decisions both internally and externally. They refer to ownership structure internally and externally, levels of diversification, financial leverage,

profitability and liquidity (Lang and Lundholm, 2013). A firm is required to maintain a balance between liquidity and profitability while conducting its day to day operations. Liquidity is a precondition to ensure that firms are able to meet its short-term obligations and its continued flow can be guaranteed from a profitable venture. The importance of cash as an indicator of continuing financial health should not be surprising in view of its crucial role within the business (Collett and Hrasky, 2015).

This requires that business must be run both efficiently and profitably. In the process, an asset-liability mismatch may occur which may increase firm's profitability in the short run but at a risk of its insolvency. On the other hand, too much focus on liquidity will be at the expense of profitability (Bhattacharya, 2010).

The primary desire of any firm is to earn more profits and enhance the wealth of its stakeholders. The performance of any organization not only plays the role to

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increase the corporate value of that particular entity but also points toward the development of the whole sector and the overall success of the economy (Ahmed et al., 2011). In this regards, there should be constant sound financial management including the efforts to improve profitability in order to meet the goal of business owners (Gitman, 2007).

However, due to challenges in internal and external environment, most organizations are unable to meet their objectives. In other words, performance is a function of the ability of an organization to gain and manage its resources in several different ways so as to develop competitive advantages (Iswatia and Anshoria, 2007).

Profitability is an important issue to various stakeholders who have a direct or indirect interest in the entity. In spite of these critical roles that profit plays in the going concern of manufacturing firms, the profitability position of most manufacturing companies operating in Nigeria in relation to firm age, firm size, firm growth, loss ratio, liquidity and leverage of the firm have not drawn much consideration of researchers in area of finance (Alhassan et al., 2015).

This may be ascribed to absence of comprehensive assessment of factors that play important role in profit realization and maximization of manufacturing firms in Nigeria. Therefore, it is of interest to know the extent to which firm specific characteristics affect the financial performance of listed firms with a major focus on manufacturing companies in Nigeria.

## LITERATURE REVIEW

### Conceptual clarifications

Shehu (2011) noted that one major factor that influences the optimal size of a business is the availability of workers and other resources in the surrounding community. In fact, he suggested that it is possible for business to outgrow the communities in which they operate, particularly when they are located in a remote area. In this case, it may be difficult to attract talented workers from outside the immediate area, forcing the company to pay abruptly higher wages.

In addition, some communities cannot afford to provide services to growing companies or provide top schools, pack, and other quality of life elements that attract high-quality employees necessary for successful business expansion (Schipper, 2007). Firm performance is a way to satisfy investors and can be represented by profitability, growth and market value (Cho and Pucik, 2005). These three aspects complement each other. Profitability measures a firm's past ability to generate returns. Growth demonstrates a firm's past ability to increase its size. According to Gupta et al. (2013),

increased size, even at the same profitability level, will increase its absolute profit and cash generation. Larger size also can bring economic of scales and market power, leading to enhanced future profitability. Market value represents the external assessment and expectation of firms' future performance.

Bello (2010) opined that identifying and analyzing those factors that influences financial performance of entities is of great relevance both to practitioners. He asserted that profitability is the ability to make profit from all the business activities of a business enterprise. It shows how efficiently the management can make profit by using all the resources available in the market. In the same vein, Alsaeed (2016) suggested that profitability is the ability given investment to earn a return from its use. It is the ability of a business to earn a profit.

According to McDaniel et al. (2012), liquidity refers to the ease of which assets can be converted into cash. An asset is said to be liquid, if it is easy to buy and sell. Gitman (2004) said that the theory of corporate finance has been based on the idea that a company's market value is determined mainly by just two variables; the company's expect after-tax operating cash flows or earning, and argue that there is another important factor affecting a company's value; the liquidity of its own securities, debt as well as equity.

Barako et al. (2016) supported this argument by reviewing the large and growing body of evidence showing that differences and changes in liquidity can have major effects on the pricing of corporate stocks and bonds. The authors also suggested that the liquidity of a company's securities can be managed by corporate policies and actions. For those companies whose value is likely to be increased by having more liquid securities which is by no means true of all companies (mature firms that do not need outside capital many will benefit from having more).

Ofoegbu and Okoye (2016) also have found that an enterprise's growth is related to size as well as other specific characteristics like financial structure and productivity. They further added that the total assets which is one of the measure of the enterprise size has a direct impact on the sales revenue, but the number of employees, investment in research and development, and other intangible assets have no substantial influence on the enterprise's growth prospects.

Therefore, Combs et al. (2015) suggested that, if an enterprise adopts multi-strategy transformation initiatives, the probability of achieving the growth objectives increases.

Waweru and Riro (2013) viewed leverage as the percentage of debt financing in the capital structure of a firm and it is measured by long term debt-to-fixed asset ratio. They further asserted that highly leveraged firms are more likely to engage in earnings management than firms that are not highly leveraged.

## Theoretical framework

### *Stewardship theory*

The stewardship theory emerged as a result of the seminar work by Donaldson and Davis (1991). The theory is based on the assumption that the interest of shareholders and the interest of management are aligned; therefore, management is motivated to take decisions that would maximize performance and the total value of the organisation. The theory believes that there is greater utility in cooperative than individualistic behaviour and hence whilst the actions of management would be maximizing shareholders' wealth, it would at the same time be meeting their personal needs. The managers protect and maximize shareholders wealth through organisation performance, because by so doing, their utility functions are maximized (Davis et al., 1997).

To achieve this goal congruent, the shareholders must put in place appropriate empowering governance structures and mechanisms, information and authority to facilitate the autonomy of management to take decisions that would maximize their utility as they achieve organisational rather than self-serving objectives. For Chief Executive Officers (CEOs) who are stewards, their pro-organisational actions are best facilitated when the corporate governance structures give them high authority and discretion (Donaldson and Davis, 1991).

### *Stakeholders' theory*

One of the assumptions behind much financial theory is that the only goal of a company is to maximise its value, and thus maximise the wealth of the shareholders. This assumption implicitly states that shareholders are only interested in increasing their personal wealth. Any action taken by management that does not result in increased wealth is, therefore, not in their interest.

If management does not act according to the owners' preferences an agency problem occurs. Stakeholder theory holds that maximising the value of one's stakeholders will also maximise the value of the whole company. This was the original thought of Freeman (1984), but there is still some doubt whether this is, in fact, true. So far the evidence linking stakeholder theory with improved financial performance is limited, and only few have attempted a thorough analysis of the relationship.

Jensen (2001) emphasises that, management should only focus on maximising the total value of the company. By total value he refers not only to the value of the equity, but also the value of all other financial claims such as debt and preferred stock. He argued further that, for management to be effective, the objective function of the company must contain only one objective.

Therefore, he allows this broader term to define the objective of the corporate objective function, and after all, to some extent, adopts a stakeholder approach - or at least a broader definition of shareholder capitalism. He therefore suggests what he calls enlightened stakeholder theory. This enlightened value maximisation focuses on the long term maximisation of the company's total value by taking other stakeholder interests into account, while only striving to maximise shareholder value.

### **Empirical review**

Olowokure et al. (2016) examined firm structural characteristics and financial reporting quality of listed deposit money banks in Nigeria. Using secondary data from the published reports of thirteen listed deposit money banks in Nigeria for over a period of ten years between 2015 and 2014, they sought to find the determinants of financial reporting quality and reports the findings of the impact of structural characteristics like age, size and level of leverage on financial reporting quality. Using prior studies as a guide, they also developed a model for loan loss provisions and generated the residuals, using these residuals know as abnormal loan loss provisions as the dependent variable for the multiple regression analysis, the study did not find any evidence of significant relationship between firm age, size, leverage and financial reporting quality.

Hassan (2014) investigated firm attributes and earnings quality of listed oil and gas companies in Nigeria for the period of 2007-2011. The listed oil and gas firms are nine (9) in numbers out of which a sample of seven (7) were used for the study. Firm attributes as the independent variable was proxy with firm size, leverage, institutional ownership, profitability, liquidity and firm growth, while the residuals from the modified Jones model was used to proxy earnings quality. The study adopts multiple panel regression techniques and data were collected from secondary source through the annual reports and accounts of the firms. The findings revealed that leverage, liquidity and firm growth has a significant positive impact on earnings quality while firm size, institutional ownership and profitability have a significant but negative influence on earnings quality of listed oil and gas companies in Nigeria. It is recommended among others that the oil and gas companies may choose to go for more debt especially where the interest rate is considerably low and also increase their liquidity asset and turnover as it has been found empirically to enhance the quality of the firms reported earnings.

Waweru and Riro (2013) while studying earnings management and firm characteristics using 37 listed firms in Kenya for five-year period 2016 to 2010 and employing accounting accrual approach to measure earnings management finds that the financial reporting quality of

firms that are not highly geared were not compromised. They therefore concluded that investors can rely more on the financial reports of firms with lower debt to equity ratio.

Shehu and Ahmad (2013) also studied firm characteristics and financial reporting quality in Nigeria using 24 listed firms and adopting correlation research design. Their regression result shows that leverage has significant effect at 5percent level on earnings quality. Valipour and Moradbeygi (2011) also studied the relationship between corporate debt financing and earnings quality collecting data from 81 firms listed on Tehran Stock Exchange (TSE) during the period 2015-2009 and using multiple regression analysis, they reported a significant negative relationship between debt and earning quality. However, the work of Nedal et al. (2010) did not find any significant positive relationship between leverage and financial reporting quality.

Chalaki et al. (2012) investigated the effect of corporate governance attributes on financial reporting quality in 136 firms listed on TSE during the period of 2016-2011 using a descriptive-correlation design, the study used McNichols (2002) for financial reporting quality measurement while considering institutional ownership, ownership concentration, board independence and board size as corporate governance attributes and audit size, firm size and firm age as controlled variables, the result of the study showed that there is no significant relationship between firm age and financial reporting quality. Huang et al. (2012) also documented an insignificant relationship between firm age and financial reporting quality using the year of incorporation of such firms to measure the firm age. There is a paucity of research in this area and we are yet to come across any work with a divergent result. This study will like to validate or refute these previous findings using data from deposit money banks.

**METHODOLOGY**

The data for this study was obtained from secondary sources. In order to investigate the firm characteristics, information from the annual reports concerning firm age, firm size, sales growth, liquidity and leverage of five quoted manufacturing firms (Unilever Nigeria Plc., Cadbury Nigeria Plc., Nestle Nigeria Plc., Dangote Flour Mills and Nigerian Breweries Plc.) in Nigeria covering the period of 2005-2018 (14 years) was used.

The technique of data analysis which the study employed is multiple regression analysis. The study adopted this technique to ascertain the impact of firm specific characteristics (firm age, firm size, sales growth, liquidity and leverage) on the performance of listed manufacturing firms in Nigeria which is proxied as ROA. The data was analyzed using econometric views and the

outcome was used to test the hypotheses of the study after conducting necessary tests. In view of this, panel data regression analysis was adopted for the study. A panel data contains cross-sectional unit (firms) over a same time period (Wooldridge, 2009). This current study adopts the model specified in the work of Dioha et al. (2018).

The model used is expressed mathematically as follows in Equations1 and 2:

$$FCs = \{FAG, FSZE, SAG, LIQ, \text{ and } LEV\} \tag{1}$$

$$ROA = f\{FAG, FSZE, SAG, LIQ, \text{ and } LEV\} \tag{2}$$

Where: FCs, Firm characteristics; FAG, firm age; FSZE, firm size; SAG, sales growth; LIQ, liquidity; LEV, leverage. Multivariate Regression model would be:

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 \dots + \beta_nX_n + \epsilon$$

$$ROA = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \epsilon$$

Where: X<sub>1</sub>, FAG; X<sub>2</sub>, FSZE; X<sub>3</sub>, SAG; X<sub>4</sub>, LIQ; X<sub>5</sub>, LEV; Y, the value of dependent variables; α, the constant term; β, the coefficient of the function; X, the value of independent variables; e, error term.

Thus, regression equation becomes;

$$ROA = \alpha + \beta_1[FAG] + \beta_2[FSZE] + \beta_3[SAG] + \beta_4[LIQ] + \beta_5[LEV] + \epsilon$$

**RESULTS AND DISCUSSION**

**Descriptive Analysis**

In Table 1, the mean values of all the variables as shown ranges from minimum of 0.3779 for leverage to a maximum of 17.554 for firm size. The average financial performance as proxied by ROA for quoted manufacturing firms during the study period is about 4.569 with standard deviation of 3.6178. This implies that there is a significant variation among the values of profitability across the quoted manufacturing firms in Nigeria during the period.

In respect of firm age, its average value shows 3.061 with a standard deviation of 0.5282. This implies that there is moderate variation among the age values due to its standard deviation. The mean value of firm size is 17.554 with a standard deviation of 0.954. This shows that there is large variation across the sample of listed manufacturing companies in Nigeria. Hence, the highly deviated size may have significant impact on the financial performance of listed manufacturing firms in Nigeria as this will be reflected in our regression results.

The sales growth of consumer goods companies in

**Table 1.** Summary of descriptive statistics.

Variables	ROA	FAG	FSZE	SAG	LIQ	LEV
Mean	4.569	3.061	17.554	8.4556	4.506	0.3779
Minimum	0.109	1.569	15.345	-50.495	0.17	0.09
Maximum	14.175	3.273	19.484	109.490	3.49	1.75
Skewness	1.3543	0.113	-0.7680	2.7960	2.211	2.553
Std. dev.	3.6178	0.5282	0.954	0.6065	5.034	0.2901
Observations (N)	70	70	70	70	70	70

Source: Researcher's Computer Output, E. Views 7.0

Nigeria shows an average value of 8.456% increase in sales with a standard deviation of 23.14. This implies that the sales growth of the manufacturing firms within the study period deviates from its mean value up to 17.61 times. The analysis of liquidity ratio shows a mean value of 4.506 with the value of standard deviation of 5.034. This implies that liquidity ratio through the analysis of its standard deviation revealed that liquidity of the firm deviates from its mean value up to 5.08 times. Finally, the mean value of leverage is 0.3779. This implies that there were moderate differences among the values of leverage as measures by total liabilities to total assets across the sample of listed manufacturing firms under the study and this is confirmed by its standard deviation of 5.034. Therefore, this study is conducted to determine the extent to which the variation in factors affect the financial performance of listed manufacturing firms in Nigeria. Finally, the skewness result revealed that data obtained for all the variables including dependent and independent are not abnormal, that is, they are normally distributed. Hence, the study is considered valid. Therefore, the result from the normality test signifies the normality of data and further substantiates the validity of the regression results.

## Regression results

### *Hausman Specification Test*

Hausman specification test shows the extent to which statistical models correspond to the data under study. This regression analysis tests for endogeneity, also called the Durbin-Wu-Hausman test, is helpful in determining whether a model will ultimately be effective in calculating probability values which basically, is the bottom line for statistical significance or non-significance. In panel data analysis (the analysis of data over time), the Hausman specification test can help to choose between fixed effects model or a random effects model. The null hypothesis is that, the preferred model is random effects; the alternate hypothesis is that the model is fixed

effects.

To choose between the fixed effect model and the random effect model of analysing the panel data, the Hausman specification test was carried out. Result of the test revealed that, there was no substantial difference between the estimators using either the fixed or random effect model. Furthermore, the result of statistical analysis showed a probability value of 0.3494 or 34.94 percent and a Chi Square statistic of 5.578581 meaning that the result was not significant and the null hypothesis was accepted (Table 2). Thus, the result meant that, random effect model was appropriate and it was adopted for the analysis of the study data.

### Test of hypothesis

**H<sub>0</sub>:** Firm characteristics have no significant effect on financial of listed manufacturing firms in Nigeria.

Findings from the panel data regression analysis using random effect model for the selected firms as shown in Table 3 indicated that, R<sup>2</sup> (coefficient of determination, which refers to a goodness of fit measure for linear regression models and indicates the percentage of the variance in the dependent variable that the independent variables explain collectively) of the variables was 0.728.

As a measure of the overall fitness of the model, the R<sup>2</sup> indicated that, the model was capable of explaining about 73% of the systematic variation in the value of dependent variable which could be traced to the independent variables and that about 27% of the variations in financial performance of the sampled manufacturing firms were accounted for by other factors. This result was complimented by the adjusted R<sup>2</sup> (adjusted R-squared) of 72%, which was the proportion of total variance that could be explained by the model.

Also, the analysis returned a Durbin-Watson statistic value of 0.2745. Durbin-Watson statistic is used to detect the presence of autocorrelation in the residuals from a statistical regression analysis. The Durbin-Watson statistic determines whether there is autocorrelation in

**Table 2.** Result of Hausman specification test.

<b>Correlated Random Effects - Hausman Test</b>				
<b>Equation: Untitled</b>				
<b>Test period random effects</b>				
<b>Test Summary</b>	<b>Chi-Sq.Statistic</b>		<b>Chi-Sq. d.f.</b>	<b>Prob.</b>
Period random	5.578581		5	0.3494
<b>Period random effects test comparisons</b>				
Variable	Fixed	Random	Var(Diff.)	Prob.
FAG	9.353666	12.286715	1.995678	0.0379
FSZE	1.915093	1.822966	0.070641	0.7289
SAG	0.000000	0.000000	0.000000	0.0431
LIQ	-0.000000	-0.000000	0.000000	0.6817
LEV	-1.983443	-3.049405	0.814750	0.2376

Source: Computer Output, Eviews 7.0.

**Table 3.** Result of panel random effect test.

<b>Period random effects test equation:</b>				
<b>Dependent Variable: ROA</b>				
<b>Method: Panel Least Squares</b>				
<b>Date: 02/18/20 Time: 15:59</b>				
<b>Sample: 1 70</b>				
<b>Periods included: 14</b>				
<b>Cross-sections included: 5</b>				
<b>Total panel (unbalanced) observations: 70</b>				
<b>Variable</b>	<b>Coefficient</b>	<b>Std. Error</b>	<b>t-Statistic</b>	<b>Prob.</b>
C	1.814616	1.736103	1.045223	0.2976
FAG	9.353666	3.926858	2.381972	0.0185
FSZE	1.915093	0.982439	1.949324	0.0532
SAG	2.15E-07	4.50E-08	4.778240	0.0000
LIQ	-6.80E-09	2.97E-08	-0.229119	0.8191
LEV	-1.983443	3.250658	-0.610167	0.5427
R-squared	0.728157	Mean dependent var		9.826468
Adjusted R-squared	0.719818	S.D. dependent var		15.98217
S.E. of regression	14.61429	Akaike info criterion		8.322766
Sum squared resid	31395.90	Schwarz criterion		8.730208
Log likelihood	-681.2737	Hannan-Quinn criter.		8.488114
F-statistic	2.567658	Durbin-Watson stat		0.274521
Prob(F-statistic)	0.000536			

Source: Computer Output, E. views 7.0.

the residuals of a time series regression. The statistic ranges from 0 to 4. A Durbin-Watson number between 0 and 2 indicates positive autocorrelation and 2 to 4 indicates negative correlation. A value of 2 indicates no auto correlation in the sample. Thus, the result (0.2745) showed that the independent variables were positively auto correlated.

Similarly, findings from the Fishers ratio (that is, the F-statistic) which is a proof of the validity of the estimated model presented a p-value of (0.000536) less than 0.05; this invariably suggested clearly that simultaneously, the explanatory variables (firm age, firm size, sales growth, liquidity and leverage) were significantly associated with the dependent variable (ROA). In effect, these

independent variables strongly have impact on the behaviour of financial performance of quoted manufacturing firms in Nigeria. This therefore suggests that, firm characteristics significantly affect financial performance measured by ROA. Thus, this provides enough evidence to reject the null hypothesis of the study which states that: Firm characteristics have no significant effect on financial performance of listed manufacturing firms in Nigeria.

## **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

This Study has examined the effect of firm characteristics on financial performance of quoted manufacturing firms in Nigeria using panel regression model approach. The study used secondary data obtained from the annual reports and accounts of 5 of the quoted manufacturing firms in Nigeria. Multiple regression technique was used with the goal of forecasting empirically the effect of firm characteristics on financial performance of manufacturing companies. Emanating from the findings made in the study, it was concluded the explanatory variables (firm age, firm size, sales growth, liquidity and leverage) were significantly associated with the dependent variable (ROA). In effect, these independent variables strongly have impact on the behaviour of financial performance of quoted manufacturing firms in Nigeria. Therefore, the study concluded that firm characteristics have significant effect on financial performance in quoted manufacturing firms in Nigeria.

From the conclusion drawn, the study recommends that:

The management of manufacturing companies should be more desperate to finding ways to improve and acquire the optimal utilization of their assets, while making maximum use of their resources during the production processes and distribution of finished products as this would help them in improving their profits.

The management and shareholders of manufacturing firms should also be careful of their decisions as regards leverage. The financing decision of the companies should be more of equity than debt to in order to avoid high leverage and low profitability due to increased interests paid to debt holders. Thus, through issuing of more shares in the capital market and declining excessive loans and debentures, companies can improve their profitability level.

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