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CEO POLITICAL CONNECTION, FINANCIAL LEVERAGE AND REAL EARNINGS MANAGEMENT OF LISTED OIL AND GAS FIRMS IN NIGERIA

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Abstract

In this study, we investigated how CEO political connection and financial leverage could lead to increased real earnings management of listed oil and gas firms in Nigeria. Secondary data on CEO Political Connection(1 if CEO has political connection and 0 if otherwise), Financial Leverage (debt to equity ratio) and Real Earnings Management (addition of abnormal cash-flow operating activities, abnormal selling, general and administrative expenses, and abnormal production costs) were obtained and computed from the yearly audited financial statements of 10 listed oil and gas firms from 2013-2022. Data obtained were analyzed using descriptive, diagnostics and panel regression models. Findings indicated that CEO political connection and financial leverage jointly significantly influence the level of real earnings management of listed oil and gas firms in Nigeria. Given the findings, the study recommends that the regulators of firms in Nigeria should discourage CEOs with political affiliations. The study contributes to knowledge by showing that with the inclusion of politically connected CEOs, real earnings management practices will increase significantly.

Keywords: *Board political connection; Real earnings management; Financial leverage; Oil and gas firms; Nigeria*

JEL Classification: *M41; M49*

1. INTRODUCTION

Chief executive officer (CEO) is one of the critical players in the corporate sector. Sitting at the top positions of the management teams in firms, CEOs are able to guide the firms to actively pursue opportunities and control the structures and strategies of the firms (Dwlharti & Adhariani 2018). In like manner, the CEO is the "center" of policy in the company. Researchers, analysts, and the business media indirectly agree to view CEOs as the person who is responsible and accountable for policies in a company (Dalton & Kesner, 1995). Specifically, CEOs pursue important and strategic decisions that can influence the performances of their firms. Egwakhe, Akpa and Ajayi, (2019) claimed that the most important determinant of the survival and success of a firm are based on the performance and quality of the top managers in the firm.

The mindset that leads to success as a CEO is characterized, then, by elements that appear to be a combination of personal traits and attitudes that are formed by experience. In a corporate firm, CEO is one of the key players sitting at the top position of firms‘ management team and can assist the companies to vigorously track opportunities (Song, Van, Hoof, & Park, 2017), and regulate the structures and policies of the firm (Aguinis, Martin, Gomez Mejia, O‘Boyle, & Joo, 2018; Edwin & Benjamin, 2017). Consequently, Ding, Li, and Wu (2018) was of the view that, a firm‘s success or failure is a significant role that is to be exercise by CEOs considering the fact that they hold a very sensitive position in the firm.

In Nigeria, CEO is a part of the board of directors who is assigned the task of the shareholders to lead and determine the company's strategy. The appointed CEO can control the authority over company decisions and be responsible for performance within the company (Chou & Chan, 2018). 10 However, the pressure from shareholders can encourage CEO to take opportunistic actions and impair the stock holder in a company. In Nigeria cases related to manipulation in the presentation of financial statements have also caught the public's attention (Laucereno, 2019). A CEO is selected and appointed in a different way from an ordinary employee, where the succession of members of the Board of Directors is carried out at the GMS (General Meeting of Shareholders), then the selection of a new CEO will consider the various interests of each shareholder by looking at the track record of

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the candidate. CEOs who work in the labor market will increase the incentive for them to demonstrate their abilities to market participants and avoid the penalties given. This situation can increase motivation for the CEO to sacrifice shareholder interests and defend his own interests (Jensen & Meckling, 1976).

Consequent upon the above, CEO performance can be reflected in the performance of the company he leads, especially the amount of profit reported by the company, so this condition will affect the incentives that the CEO will receive in the future (Gibbons & Murphy, 1992). The CEO will tend to overstate profits in the first year, so as if he shows his ability to manage the company and indirectly increases the CEO's career potential and compensation in the future, and the result of the CEO can avoid dismissal when shareholders are still not confident in his abilities (Ali & Zhang, 2015).

On the other hand, CEO may sometime be conservative in managing revenue while managing the company in the initial period, then the CEO to be aggressive in managing income after working a few years later, so that the earnings management conducted by the CEO reaches the maximum level in fifth and sixth years. When the CEO has reached the maximum point of earnings management, the CEO will return to be conservative and less aggressive in reporting the company's earnings. Arising from the above, this study investigated the effects of CEO political connection and financial leverage on real earnings management of listed oil and gas firms in Nigeria.

2. REVIEW OF RELATED LITERATURE

2.1 Board Political Connection

Chief executive officer (CEO) political connection is when a CEO has occupied a political position before becoming a CEO. One of the major factors which influence a firm‘s earnings management is CEO political connections. The rationalization here is that, the characteristics of CEO can affect the value of the company, the selection of the company's strategy, and the company's financial reporting decisions. This is because CEOs with high political connections can use such position to take undue advantage of others in the firm thereby increasing the earnings management tendencies information (Martín Ugedo, Mínguez- Vera, & Palma- Martos. 2017).

Sani, Abdul Latif, and Al-Dhamari (2020) examined the influence of CEO discretion on the real earnings management and to explore whether the discretion of the CEO to ensure accurate and reliable financial reports is influenced by the political connection of board members. Using the generalized method of movement to control the potential endogeneity on the sample of listed companies in Nigeria, the study conducted several checks using Driscoll–Kraay panel data regression with standard error to robust the main findings. The study evidenced that CEO Discretion reduces the tendency of real earnings management and improve the reporting quality. However, the CEO‘s discretion to provide reliable financial reports and to reduce the likely earnings manipulation is overturn by the presence of politically connected directors.

2.2 Financial Leverage

Financial leverage represents the amount of assets owned by the company which is financed by debt. It is expressed as the proportion of total debt to total equities. Financial leverage is a financial ratio to identify how much the firm is financed with external capital or debt. It represents the amount of assets owned by the company which is financed by debt. In this case, the debt used to finance the company's assets comes from creditors, not from investors or shareholders. This indicates that the higher the leverage ratio, the higher the risk that causes the company's ability to pay off debts to creditors is getting lower (Florencia & Susanty 2019).

Consequently, companies that have high leverage ratios tend to take earnings management actions because the company is threatened with default, which means they cannot fulfill their debt repayment obligations on time and the company will try to avoid it by creating policies that can increase revenues and profits by providing a relatively better bargaining position in negotiating or rescheduling the company's debt (Almalita, 2017). Following the debt contract hypothesis explains that when things change and a company‘s debt payment date approaches, managers pass next year‘s earnings into the current period and choose accounting policies. This is to ensure that the company does not neglect to pay (Debnath, 2017).

2.3 Real Earnings Management

Real earnings management (REM) are management operational activities to alter reported earnings in a particular direction, which is achieved by overproducing inventory to lower the cost of goods sold or cutting discretionary expenses (i.e., advertising expenditures, research and development expenditures, selling, general and administrative expenditures) to improve reported margins. Yahaya (2022) investigated how different CEO traits impact Nigeria's earnings management. Ten years of data (from 2012 to 2021) from 57 firms listed on the Nigerian Exchange Group were used for the analysis. This research found a statistically significant correlation between CEO tenure and earnings management. Earnings management among Nigerian companies was not affected by the length of time between CEO changes.

Similarly, Arslan-Ayaydin, Thewissen, and Torsin (2022) examined whether CEO risk aversion (proxied by their political affiliation) explains the method used to manage earnings. The study sampled 20,000 firm-year observations. The study find that firms led by Republican (i.e., more risk-averse) CEOs tend to manage their earnings through real activities manipulation, while those led by Democratic (i.e., more risk-taking) CEOs tend to favor accrual-based earnings management. We also show that the positive (negative) relation between Republican-leaning managers and real (accrual-based) earnings management is more positive (less negative) for CEOs whose compensation is more oriented toward risk-taking.

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In the same vein, Seraj, Nikoomaram, Yaghobnezhad, and Vakilifard (2022) examined whether political connections are associated with earnings management (both accrual-based and real) and whether the association is influenced by corporate governance and external auditing qualities. Empirical evidence on the association between political connections and earnings management remains unclear and offers mixed results. Using a sample of Indonesian firms, we find that political connections are negatively related to accrual-based (AEM) and real (REM) earnings management. In addition, the negative relationship between political connections and earnings management is more pronounced in better-governed firms and those audited by one of the Big 4 auditors.

In another context, Al-Zaqeba, Ineizeh, Hussein, and Albawwat (2022) investigated the effect of corporate governance mechanisms on earnings management in Malaysian manufacturing companies (MMCs). Data was collected from 2010 to 2019 for MMCs. The panel data methodology was adopted. The study reported that, Earnings management (EM) firms produce less predictable accounting earnings that do not reflect the company's genuine financial success Aji (2022) studied the moderating role of family ownership as on the effect of political connections on profit management in family companies. The total observation was 129 companies using the mining sector in Indonesia in the 2016-2019 periods. The panel data methodology was adopted. The results of the tests carried out simultaneously or partially explained that political connections have no effect on profit management. Family ownership negatively affects profit management.

3. METHODOLOGY

Ex-post facto research design was used and the study population comprised 10 listed oil and gas firms in Nigeria. The study sampled 10 oil and gas firms because of the population size. The study obtained data from published financial statements and accounts of 10 oil and gas firms from the year 2013 to 2022.

Panel data regression was employed in estimating the significant influence of CEO Political connection, financial leverage on real earnings management of the listed Nigerian oil and gas firms. The study examines the influence of characteristics of firm (board political connection and financial leverage) on real earnings management (REM) using multiple regression model. The functional form of the multiple regression models is as given below:

$$REM = f(CEOP, FLV)$$

$$REM_{it} = \alpha_0 + \beta_1 fCEOP_{it} + \beta_2 FLV_{it} + \varepsilon_{it}$$

REM is real earnings management; CEOP is chief executive officer political connection; FLV is financial leverage; *i* is individual firms; *t* is time frame; ε is stochastic error; α_0 is constant; β_1-β_2 is parameters of regression estimates.

Table 1: Variables Measurement

Variables	Measurement	Source	A-priori
Real earnings management (Dependent)	Abnormal Cash-Flow Operating activities (ABN_CFO) + Abnormal selling, general, and administrative expenses (ABN_SG&A) +Abnormal production costs(ABN_PROD)	Na, and Hong (2017); Ahmad, Faisal, Riaz, and Rahman (2022)	**N/A**
CEOP (Independent)	If the CEO has political connection, I is denoted as 1 otherwise 0	Ahmad, Faisal, Riaz, & Rahman (2022); Seraj, Nikoomaram, Yaghobnezhad, & Vakilifard (2022)	-
FLV (Independent)	**Debt divided by equity**	**Ahmad, Faisal, Riaz, & Rahman (2022).**	-

Source: Compiled by the Researcher (2025)

4. EMPIRICAL RESULTS

Table 2: Descriptive Statistics

Variables	Mean	Median	Maximum Value	Minimum Value	Std. Dev.
REM	0.226	0.169	0.777	0.000	**0.146**
CEOP	0.740	1.000	1.000	0.000	**0.440**
FLV	**1.507**	**1.563**	**2.918**	**0.116**	**0.783**

Source: Compiled by the Researcher (2025)

Table 2 revealed that the oil and gas firms had an average mean of 0.226 with deviation by 0.146 for REM. This shows low volatility because estimates of the standard deviation were less than mean values for CEOP and FLV. Also, the minimum and maximum values were 0.000 and 1.000 respectively for CEOP while 2.918 and 0.116 for FLV respectively; this indicates a low variability because the estimates of the standard deviation were less than mean values.

Table 3: Test of Normality

Variables	Jarque-Bera	Probability	Remark
REM	82.47	0.000	**Not Normality Distributed**

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CEOP	22.64	0.000	**Not Normality Distributed**
FLV	**4.851**	**0.088**	**Normality Distributed**

Source: Compiled by the Researcher (2025)

Table 3 revealed that CEOP deviates from normality except FLV that is normally distributed. Thus, to correct this, the model was subjected to panel corrected standard error, yielding a residuals of a value that is slightly above 5 percent.

Table 4: Karl Pearson Correlation

Variables	REM	CEOP	FLV
REM	1.000		
CEOP	0.112	1.000	
FLV	-0.147	0.194	1.000

Source: Compiled by the Researcher (2025)

Table 4 revealed that CEOP has a coefficient of 0.112 which indicates that CEOP has a weak positive correlation with REM. Meanwhile, FLV has a coefficient of -0.147; this indicates that FLV exerts a negative weak correlation with REM.

Table 5: Result of VIF

Variable s	efficient	Uncentered	Centered
REM	1.000		
CEOP	0.006	1.000	
FLV	0.130	1.016	1.000

Source: Compiled by the Researcher (2025)

The result of VIF offers evidence that the mean VIF is below 10; thus indicating that the model do not show signs of multicollinearit and on the basis of this, the model can be relied upon

Table 6: Fixed and Random Effect Results

Parameters	Coefficient	Std. Error	t-Values	Prob.
Constant	1.341	0.244	5.485	0.000
CEOP	0.371	0.076	4.841	0.000
FLV	-0.035	0.015	-2.239783	0.027
R^2	0.563			
Adjusted R^2	0.539			
F-Value	5.574	Durbin Watson (DW)		1.888
Prob-F	0.000			

Source: Compiled by the Researcher (2025)

Table 6 revealed that the F-score is 5.57 with P-value of 0.000, indicating that variables of the study jointly explained REM and that the independent variables jointly explained about 54 percent of the systematic variation in the dependent variable of the study. The Durbin-Watson statistics is 1.888 indicating absence of serial correlation in the empirical model of the study. The analysis result of CEOP, FLV and REM revealed that they are statistically significant hence, board political connection and financial leverage influence the level of real earnings management practices of oil and gas firms in Nigeria.

Furthermore, the analysis result of CEO political connections and real earnings managements showed a coefficient value of 0.371412, and a p- value of 0.0000. The coefficient value of 0.371412 reveals that, CEO Political connections contributed positively about 37.14% on real earnings managements. This implies that a percent increase in CEO political connections will lead to CEO Duality to increase by 37.14% increase in real earnings management (REM). This further reveals that, if CEOs have political connections, it may result to misalignment of interest which in turn will increase REM tendencies. This is in tandem with the A-priori Expectation of the study.

The p- value of 0.0000 shows that, CEO Political connections has a statistical significant effect on real earnings management since its p-value is less than 0.05% level of significant. Thus, CEO Political connections have significant effect on real earnings managements among oil and gas firm in Nigeria. This further suggests that, CEO political connections are a major predictor of REM among quoted oil and gas companies in the periods under investigation.

5. CONCLUSION AND RECOMMENDATIONS

This study examined the influence of CEO political connection and financial leverage on the level of real earnings management of listed Nigerian oil and gas firms from the year 2013 to 2022. Overall, the study answered questions linked to the influence of CEO political connection and financial leverage on real earnings management. To provide answers, panel data were collected for 10 listed oil and gas firms in Nigeria.

Findings of the study indicated that both CEO political connection and financial leverage significantly influence the level of real earnings management of listed oil and gas firms. Given the findings, the study recommends that the regulators of firms in Nigeria should discourage CEOs with political affiliations. The study contributes to knowledge by showing that with the inclusion of politically connected CEOs, real earnings management practices will increase significantly

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