CORRUPTION, FINANCIAL STATEMENT FRAUD, AND BUSINESS FAILURE IN NIGERIA

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ABSTRACT

This research paper investigated the role of corruption and financial statement fraud in business failure in Nigeria. Data for the study was collected through the issuance of a structured questionnaire to professional accountants and auditors and analyzed using descriptive statistics and the OLS method of multiple regression analyses. The results of the analyses showed a positive relationship between the prevalence of corruption and the phenomenon of business failure as well as a positive relationship between financial statement fraud and business failure in Nigeria. From the findings, it was concluded that corruption increases the risk of business failure by causing an increase in the cost of doing business. It was also deduced that the menace of financial statement fraud significantly increases the risk of business failure. Thus, a reduction in institutional corruption will have a considerable effect on the ability of businesses to survive and thrive. It is recommended that the government take serious measures to curb the problem of corruption to guarantee safe economic environment for businesses to navigate. It is also recommended that regulators take proactive measures to reduce the incidences of financial statement fraud perpetrated in the country.

Keywords: Corruption, Financial Statement, Fraud, Business Failure

1. INTRODUCTION

Researchers have mostly failed to provide a concise and generally acceptable definition of business failure, as some define it from the perspective of bankruptcy and discontinuance others (Peat, 2007; Perry, 2001), and others prefer to consider it from the point of view of underperformance in critical processes or a deviation from expected and desired result (Cannon and Edmondson 2005; Gulst and Maritz (2009). Still others like Meyer, Zacharakis, and DeCastro (1999) see business failure in terms of negative return on investment. Definitional challenges notwithstanding, what is not in doubt are the consequences of business failure.

According to Artur and Aurora (2014), the consequences of business failure can be categorized into social, psychological, financial and economic costs. The social costs of business failure may include what Ucbasaran, Shepherd, Lockett, and Lyon (2013) referred to as negative discrimination and stigma towards those linked to the failure of what was once regarded as a thriving business. Such discrimination and stigma may result in psychological problems for the individual who may find it difficult to engage in other perceived risky ventures in the future. More apparent and debilitating is the financial loss that may be occasioned by business failure, in the event of which investors and creditors may never recover their financial resources. The wider economic consequences will include lost tax revenue to the government and loss of jobs to an individual. According to Casey and Bartczak (1985), the economic cost of business failures is relatively large with widespread consequences for all categories of economic agents.

In Nigeria, the phenomena of business failure are commonplace that it no longer raises eyebrows when once thriving enterprises go under. The recent past has witnessed a large number of business failures in Nigeria. Whether micro, small, medium or large, none has been left out of the scourge. The most recent high profile in this category would be Skye Bank which was rechristened Polaris Bank and taken over by the regulator. Others include Starcoms, African Petroleum, Etisalat, Intercontinental Bank PLC, Konga Nigeria Ltd among so many other low profile but equally economically important ones. Most worrying is the huge loss of jobs that accompany business failures in Nigeria where the rate of unemployment is already at alarming levels. In addition to job losses, there are several other economic costs associated with business failure including loss of tax revenue to the government in addition to the loss of investors' confidence, loss of capital to creditors and other funds providers.

Causes of business failure can be broadly categorized in two namely internal and external causes and as noted by Nuray (2016), in most cases, a complex mixture of causes contributes to the failure. While the internal causes are those related to the failure in management within the firm (failure in activities/actions within the control of the management), external causes are those that are not within the control of the firm's management.

One of the most prominent external contributing factors to business failure especially in Nigeria is the menace of corruption. This takes many forms including the procurement of dubious court decisions, influencing political decisions as it relates to business using illegal payments, making policies for the benefits of self and political cronies and outright strangulation of businesses refusing to comply with bribery and graft. As noted by Abdul (2015), corruption adversely affects business operations by forcing an increase in operational costs, reduces enterprise growth, efficiency, productivity while driving small vulnerable businesses underground into the shadow economy.

The failure of many businesses has also been linked to financial statement fraud which in itself is a form of corruption albeit perpetrated by the business owners. According to Perols and Lougee (2011), firms in distress and at the brink of failure get involved in financial statement fraud more than healthy firms, in a bid to mask their distress status. Fraudulent financial reporting in itself can also lead to business failure as negative media coverage, litigations and loss of investors'/creditors' confidence resulting from the uncovering of such acts may lead to investment funds drying.

Thus, business failure whether as a result of financial statement fraud or corruption or both has far-reaching negative consequences on not only the concerned organizations but also the economy at large as the effect cascades down. It is pertinent that the contribution of these factors to business failure be unraveled so as to stem the tide. To this end, this research proposes to investigate the role of corruption and financial statement fraud in business failure.

Bearing in mind that business failure can be as a result of a myriad of factors both internal and external, the present research chose to focus on two factors (corruption and financial statement fraud) which are pervasive in the context of the geographical scope of the study. Thus, this research paper aimed to investigate the role of corruption and financial statement fraud in business failure in Nigeria.

The objectives of this research paper are as follows:

1 To examine the relationship between corruption and business failure in Nigeria

2) To examine the relationship between financial statement fraud and business failure in Nigeria

Research Questions

1) What is the nature of the relationship between corruption and business failure in Nigeria

2) What is the nature of the relationship between financial statement fraud and business failure in Nigeria

The research hypotheses are as follows:

Ho_1: Corruption does not have a significant relationship with business failure in Nigeria

Ho_2: Financial statement fraud does not have a significant relationship with business failure in Nigeria

2. LITERATURE REVIEW

2.1 Theoretical Framework

Industry Life Cycle Theory: According to Klepper (1997), the Industry Life Cycle Theory (ILC) proposes that firms follow a planned sequence strategy and management established by the firm. The basic principle is that organizational failure is a natural and objective phenomenon in consequence of the efficient operation of markets. Thus, organizational failure becomes inevitable where the organization fails to attain a level of efficiency preset by the markets. However, considering that the level of efficiency required by the markets is not observable, every firm is left to its individual machinations in order to survive. As noted by Boulding (1950), "organizations follow the path of irreversible movement toward the market equilibrium of death". The ILC Theory suggests that organizations like organisms will eventually fail either by natural progression or due to missteps by the organization. In a bid to survive and continue in operations, some organization may tend to take actions that will ensure its survival but which may be frowned by society as being unacceptable or questionable. As an example, a struggling organization may decide to doctor its financial records to make it activities more attractive to prospective investors. In such a case, the organization may artificially inflate its revenue in order to report higher profits.

Further, the course action may be geared towards reducing the tax liabilities of the firm by concealing revenue. In the hypothetical cases mentioned here, the organization is undoubtedly indulging financial statement fraud in order to meet the expectations of certain stakeholders at the detriment of others. In order case especially in developing countries, business organizations are known to covertly and overtly bribe government officials in order to receive preferential/favourable treatment in contract selection processes and even to reduce tax liability. Even though it can be argued these ethically questionable activities is a reaction where the survival of the organization is threatened as a result of in-equilibrium in the external environment (Schumpeter, 1942). However, numerous cases exist where the organization is driven by mere greed by members of the organization (LaPalombara, 1994; Abdul, 2015). For example, organizations may get involved in financial statement fraud in order to benefit from performance-based remuneration. In order cases, the executive may be involved in bribing government officials because it is an easy route to achieving results and not necessarily because the organization's survival depends on it.

However, the Industrial Organization (IO) perspective proposed by Schumpeter (1942) is of the view that organizational failure is more a result of in-equilibrium originating from the external environment. Again high failure rate among organizations just like high mortality rate in organisms may be symptomatic of dysfunction in the external environment. Where this is the case, organizations may be forced to cut corners in order to stay in business. If government policy on taxation were to change in such a way that organizations think is unfavorable, some may decide to circumvent the law in order to reduce their tax liability – through financial statement or other malfeasance. Again, organizations not favoured by changes in government procurement and contract laws may also find indulging in corruption as a means of avoiding business failure

2.2 REVIEW OF CONCEPTS

2.2.1 Corruption

The Longman Dictionary of Contemporary English (5th edition) defines corruption as dishonest, illegal or immoral behaviour especially from someone with power. Corruption is one of the greatest challenges of our time, as it undermines good governance, leads to a systematic misallocation of scarce resources, weakening private as well as public sector developments and affects mostly the poor in society. Corruption is especially a problem in Sub-Saharan African and other underdeveloped countries with Nigeria ranking high in the corruption index. Corruption is so pervasive in Nigeria that it is literarily impossible to find a government institution that is not affected or accused of deep seethed corruption.

Corruption no doubt is present in virtually all countries but heavily linked to countries with underdeveloped institutions. According to Ebegbulem (2012), developed nations have an effective system of control which ensures a minimal level of corruption. Such control mechanisms are not well developed or effective in developing countries. As listed by Afolabi (2007), the diverse forms of corruption prevalent in Nigeria include money laundering, advance-fee scam, bribery, fraudulent business practices, abuse of office, and misappropriation of funds, under and over invoicing, false declarations and collection of illegal tolls.

2.2.2 Financial Statement Fraud

Financial statement fraud is the calculated insertion of misleading information in financial reports intended to deceive users of such information. All categories of financial information users are likely to face problems when financial statement fraud is pulled off (Cooper, 2005). According to Raab (1987), even a small amount of financial statement fraud can affect both investors and creditors and erode confidence in the financial reporting process as a whole. In addition, Arshad, Iqbal, and Omar (2015) asserted that falsified financial reporting practices wear away public confidence in the growth and decision making of the firm in the foreseeable future. It could indicate financial statement fraud may not be the problem in itself but more of a symptom of deeper problems which the organization's management is trying to cover up with fraudulent reporting. Spathis (2002) agrees with this opinion by stating that when firms underperform management is incited to take to fraudulent financial reporting.

Brennan and McGrath (2007) identified the motivating factors for financial statement fraud to include: the desire to positively influence the organization's share price; raise cheap external capital; earn more by way of compensation packages based; minimize tax liabilities; avoid violations of debt agreements and pressure to meet forecasts.

2.2.3 Business Failure

Efforts to provide a concise and generally accepted definition of business failure have over time proved difficult as authors tend to define the term in the context of their research endeavors. Thus, most definitions of the term in literature have been source of controversy and protracted debates. The most vocal in this group are those see who it from the perspective of bankruptcy and discontinuance (Peat, 2007; Perry, 2001). However, this definition gained some ground as a result of the fact that it is more observable and hence more measurable than others.

Other researchers like Cannon and Edmondson (2005) and Gulst and Maritz (2009) prefer to look at it from the point of view of underperformance in critical processes or a deviation from expected and desired result. Thus, this view even though it is somewhat ambiguous as the said organization may continue in business despite being classified as failed, this classification seems a lot more acceptable to a certain category of investors who may cite as a reason for divestments and even demand for tough measures to rescue the situation. Still, others like Meyer, Zacharakis, and DeCastro (1999) see business failure in terms of negative return on investment.

There is however a broad agreement on the concept of business failure. For example, Cameron, Sutton, and Whetten (1988) in Mellahi (2008) defined business failure as the decline in a firm’s ability to fit its micro-niche and the attendant diminution of resources within the firm. Similarly, Artur and Aurora (2014) consider that business failure takes place when a business closes, either for financial-related reasons or willingly due to owners not achieving their expectations or negative growth, or other poor performance. From the foregoing, it can be noted that defining the concept of business failure is better accepted when it includes death, liquidation of the organization or its exit from the market.

No matter the definition adopted, most researchers are more in agreement as to the factors that may lead to business failure. Drawing from the assertion of Meyer, et al. (1999), there are two broad causes of business failure: These are internal (individual/organizational) and external (environmental) factors. While the internal causes are those related to the failure in management within the firm (failure in activities/actions within the control of the management), external causes are those that are not within the control of the firm's management such as taxation, inflation, interest rate, negative government policies or such other issues. On the whole, business failure is usually caused not by a single factor but interplay of different causes both internal and external.

2.4 EMPIRICAL REVIEW

Abdul (2015) investigated the effect of corruption on Small and Medium Enterprises (SMEs) with emphases on its effect on price, profit, growth, productivity, wages, and employment using qualitative and quantitative research methods. The results from the study indicated that corruption is positively related with the price but negatively associated with growth, productivity, and employment. The findings also showed that corruption reduces SMEs access to finance.

Ajie and Oyegun (2015) investigated the impact of corruption on economic growth in Nigeria for the period 1996–2013. Data for the study which was collected from secondary sources and analyzed using multiple regression analyses showed that there is a negative relationship between the economy proxied as gross domestic product and the level of corruption in

Nigeria. It was recommended that the activities of the anti-corruption agencies in the country be strengthened and the public educated on the ills of corrupt practices create on the economy and the society.

Arshad, Iqbal, and Omar (2015) after identifying fraud as a major concern for many corporate managers and regulators, examined whether a collective prediction tool can be used to predict business failure and fraudulent financial reporting, and whether business failure is associated with fraudulent financial reporting for firms listed in the Malaysian stock market. Using a business failure tool based on ratio analyses and Beneish M-score model, they showed that financial statement fraud contributes significantly to business failure. The model accurately classified predictors of business failure and predictors of fraudulent financial reporting as 96 and 83.3 percent respectively.

In another study, Urien (2012) investigated the impact of corruption on the socio-economic development of Nigeria. The study revealed that the country's appalling underdevelopment in spite of her huge revenue and the security challenges are as a result of a failed system occasioned by corruption.

Arasti (2011) carried out an empirical study on the causes of business failure in Iran. This study identified lack of good management, lack of support from banks and financial institutions, inadequate economic sphere, and deficient governmental policies as the main causes of business failure in Iran.

Raab (1987) investigated the role of reporting companies and independent auditors in detecting and preventing financial statement fraud. The study which was descriptive in nature showed that fraudulent financial reporting have a significant impact on the public's confidence in the integrity of not only the affected company but also of the entire financial reporting system. Decreased public confidence in the reliability of financial information affects all financial statement issuers, since investors and creditors will demand higher rates of return in the face of greater uncertainty about the accuracy of financial reports.

Kurant (2014) examined the consequences corporate fraud in related industries in the US. of fraudulent misreporting of SEC enforcement actions' target companies and its impact on their industry competitors. Using recent data for U.S. financial markets, the research concentrated on changes of firms' returns and risk. The results of the study show that fraud disclosure causes an increase in total risk and residual risk but a decrease in systematic risk - implying that fraud increases firm's exposure to firm specific risk but reduces its exposure to industry wide risk.

Udeh and Ugwu (2018) examined the effect of fraud on the performance of banks in Nigeria. Using ex-post facto research design and collecting data relating to fraud, bank profit, bank assets and bank deposits from Nigeria Deposit Insurance Corporation (NDIC) annual reports. Descriptive analysis and Ordinary Least Square (OLS) method of regression analysis were used for the data analysis. Findings of the research showed that fraud has negative but insignificant relationship with bank profit amongst others. This finding implied that event though fraud reduced bank financial performance; the magnitude of the effect was not enough to cause bank failure. The study thus recommended that banks make full disclosures about fraud in their financial reports as well as entrench good corporate governance as the key to lock the fraud -risk factors as contained in fraud diamond.

From the empirical literature reviewed in this section, it can be observed that research on business failure cited in the study is noted for its absence. This is not an oversight on the part of the author because very little research exists in Nigeria on the subject matter. Furthermore, most studies on corruption take the direction of the macro-economy while its existence in corporate organizations even though it is rampant is given very little coverage academic research. Thus, the present research which is focused on examining how corruption and financial statement fraud relates with business failure in Nigeria is aimed at filling this obvious gap in research in Nigeria.

3. RESEARCH METHODODOLOGY

The study adopted the survey research design. The population of the study comprises of professional accountants in Port Harcourt and its environs, however, the paucity of data makes it rather difficult to ascertain the size of the population. Consequently, the sample of the study was determined on the basis of convenience (those accountants available and willing to take part in the study). Data were collected from primary sources through the issuance of structured questionnaires to a sample of sixty-four (64) professional accountants and auditors on the basis of the convenience sampling technique. Data were collected on the prevalence of corruption (PCRUPT) Financial Statement Fraud (FSFRAUD) and business failure (BUSFAIL) in corporate organizations in Nigeria by a series of questions in the research instruments. Professional accountants were chosen considering their broad-based knowledge and experience on issues relating to the challenges of corporate organizations as it relates to the financial misdemeanor and how it affects organizational survival in Nigeria. Data were analyzed using descriptive statistics and multiple regression analyses of the form:

y = a + b1x1 + b2x2 +.... + bnxn + ei . . . . (1)

Where the relationship between the variables is stated functionally as:

Business Failure = f (corruption and financial statement fraud) . . . . (2)

Where corruption is denoted as PCRUPT, Financial Statement Fraud is denoted as FSFRAUD and business failure as BUSFAIL, equation 2 is restated as:

BUSFAIL = F (PCRUPT, FSFRAUD) . . . . . . (3)

We have that:

BUSFAIL = A + β1PCRUPT + β2FSFRAUD + U . . . . (4)

Where

BUSFAIL = Business Failure

PCRUPT = Prevalence of Corruption and

FSFRAUD = Financial Statement Fraud

It is expected that the prevalence of corruption and financial statement fraud will predict an increase in business failure. Thus, BUSFAIL = A + β1 and β2 > 0

4.1 DATA PRESENTATION AND ANALYSES

Table 1: Descriptive Statistics for Prevalence of Corruption, Financial Statement Fraud and Business Failure

	PCRUPT	FSFRAUD	BUSFAIL
Mean	14.90483	14.56345	12.69897
Median	14.58500	12.21500	10.95500
Maximum	30.43000	36.39000	30.70000
Minimum	4.480000	1.550000	2.810000
Std. Dev.	6.206215	9.960598	7.702849
Skewness	0.699164	0.619958	0.830299
Kurtosis	3.466271	2.286063	2.713967
Jarque-Bera	5.250761	4.947149	4.861887
Probability	0.072412	0.084283	0.092356
Sum	864.4800	844.6800	736.5400
Sum Sq. Dev.	2195.475	5655.170	3382.032
Observations	58	58	58

Source: Field Survey 2018 and the Researcher's Computation

Table 1 shows the results of the descriptive statistics which indicates that the skewness of the data set gave values of 0.699, 0.620, and 0.830 respectively for the prevalence of corruption (PCRUPT), financial statement fraud (FSFRAUD) and business failure (BUSFAIL). From the result, we infer that all three variables have properties of positive skewness. However, these values are close to the normal skewness value of 0. Furthermore, the result also shows that the kurtosis values for the data set gave values of 3.466, 2.286 and 2.714 respectively for the prevalence of corruption (PCRUPT), financial statement fraud (FSFRAUD) and business failure (BUSFAIL). Considering that the normal kurtosis value is 3, we can conclude from the result that the prevalence of corruption has a positive kurtosis while financial statement fraud and business failure have properties of negative kurtosis. Finally, the Jarque-Bera statistic for the variables gave values of 5.251, 4.947 and 4.862 and Probability values of 0.072, 0.084 and 0.092 respectively for the prevalence of corruption (PCRUPT), financial statement fraud (FSFRAUD) and business failure (BUSFAIL). Considering that the null hypothesis for the Jarque-Bera statistic is that the data set is normally distributed around the mean, we do not reject the null hypotheses and conclude that all the variables are normally distributed.

Table 2: Regression Analyses for the Prevalence of Corruption,

Financial Statement Fraud and Business Failure

Dependent Variable: BUSFAIL
Method: Least Squares
Date: 12/04/18 Time: 08:04
Sample: 1 58
Included observations: 58

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.016787	1.449132	0.701653	0.4859
PCRUPT	0.166198	0.087973	1.889204	0.0641
FSFRAUD	0.632063	0.054814	11.53112	0.0000

R-squared	0.741439	Mean dependent var	12.69897
Adjusted R-squared	0.732036	S.D. dependent var	7.702849
S.E. of regression	3.987396	Akaike info criterion	5.654492
Sum squared resid	874.4630	Schwarz criterion	5.761067
Log likelihood	-160.9803	Hannan-Quinn criter.	5.696005
F-statistic	78.85770	Durbin-Watson stat	0.627936
Prob(F-statistic)	0.000000		

Source: Field Survey 2018 and the Researcher's Computation

The regression results in Table 2 above shows that the coefficients of regression for the prevalence of corruption (PCRUPT) and financial statement fraud (FSFRAUD) gave values of 0.166 and 0.632. These indicate that there is a positive relationship between prevalence of corruption and financial statement fraud and business failure in Nigeria with the implication that increase in corruption and financial statement fraud would lead to increase in business failure while the reduction in corruption and financial statement fraud would lead to a reduction in business failure. However, while the relationship between financial statement fraud and business failure is statistically significant, indicating that financial statement fraud has a significant effect on business failure, the prevalence of corruption cannot be relied on to predict business failure in Nigeria.

4.2 DISCUSSION OF FINDINGS

This research paper investigated the role of corruption and financial statement fraud in business failure in Nigeria. The results from the analyses showed that there is a positive relationship between the prevalence of corruption and the phenomenon of business failure in Nigeria. This result implies that an increase in corruption leads to an increase in business failure in Nigeria. However, the result was not statistically significant implying that corruption does not have a significant effect on business failure.

Thus, while we agree that the prevalence of corruption increases the risk of business failure but, the role of corruption in the business failures experienced in Nigeria is minimal. Abdul (2015) who researched the effect of corruption on SMEs showed that corruption is positively related with the price - leading to a pressure to increase the prices of their products which lead to slow business growth. Their findings also showed that corruption is negatively associated with growth, productivity, and employment implying that the prevalence of corruption decreases the chances of business growth, productivity as well as employment.

The results indicate that there is a positive relationship between financial statement fraud and business failure in Nigeria. This result implies that an increase in financial statement fraud is predicted to lead to an increase in business failure in Nigeria. Furthermore, the result is statistically significant implying that the role of financial statement fraud in business failure is substantial. In a similar study, Arshad, Iqbal, and Omar (2015) identified financial statement fraud as a major concern for many corporate managers and regulators since many businesses that experienced business failures were victims of financial statement fraud.

Using a business failure tool based on ratio analyses and Beneish M-score model, they showed that financial statement fraud contributes significantly to business failure. However, another study by Arasti (2011) identified the main causes of business failure to include poor management and lack of financial support from banks and other financial institutions. A closer look at this finding shows that it does not disprove our finding as poor management can manifest in lack of adequate control of the financial reporting process which leads to the incidence of financial statement fraud.

5. CONCLUSION AND RECOMMENDATIONS

Corruption increases the risk of business failure by causing an increase in the cost of doing business and also causing delays and inefficiencies in the decision-making process. A reduction in institutional corruption will have a considerable effect on the ability of businesses to survive and thrive. We further conclude that the menace of financial statement fraud significantly increases the risk of business failure. From the conclusions, it is recommended that the government must take serious measures to tackle the problem of corruption in order to ensure that the economic environment is safe for private businesses to navigate. It is important that corruption is reduced considerably. This can be achieved by encouraging businesses that are victims of corruption to report the erring officials and where such reports are received, investigating allegations of corruption against public officials and if found culpable handed the severest punishment as a deterrence to others in the future. It is also recommended that regulators take proactive measures to reduce the incidences of financial statement fraud perpetrated in the country. Like in the case of corruption, where cases of the financial statement are reported, proper investigations are instituted and erring individuals severely punished as a deterrence to others in the future. Finally, it is recommended that business organizations review the processes involved in producing their financial statements in order to identify loopholes that may be exploited by fraudulent officials.

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