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INFLATIONARY PRESSURE AND EXECUTIVE COMPENSATION: IMPLICATIONS FOR EARNINGS MANAGEMENT IN NIGERIAN DEPOSIT MONEY BANKS

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ABSTRACT: *This study examines the effect of inflationary pressure and executive compensation on earnings management in Nigerian commercial banks. The study is motivated by the persistent concern that managerial incentive structures and macroeconomic instability may jointly influence financial reporting quality in emerging economies. Using an ex-post facto research design, the study employs balanced panel data from twelve listed deposit money banks over the period 2012–2022. Earnings management is measured using discretionary accruals derived from the modified Jones model, while inflationary pressure is proxied by the consumer price index inflation rate. Executive compensation is measured using directors' remuneration scaled by firm performance indicators. The study applies the fixed effects regression model to control for unobserved heterogeneity across banks and over time, while interaction terms are included to capture moderating effects. The results reveal that executive compensation has a statistically significant positive effect on earnings management, indicating that higher remuneration incentives encourage discretionary financial reporting behavior. Inflationary pressure, however, shows a positive but statistically insignificant effect on earnings management, suggesting limited direct influence. Furthermore, the interaction between inflation and executive compensation is insignificant, implying that inflation does not significantly moderate the compensation–earnings management relationship. The model is jointly significant, confirming that the explanatory variables collectively influence earnings management behavior. The study concludes that earnings management in Nigerian commercial banks is primarily driven by internal incentive structures rather than macroeconomic conditions. The findings support agency theory and have implications for corporate governance reforms and executive compensation design. The study recommends stronger regulatory oversight of compensation contracts to reduce earnings manipulation incentives.*

KEYWORDS: Inflationary Pressure; Executive Compensation; Earnings Management; Nigerian Banks; Agency Theory; Panel Data Regression.

INTRODUCTION

The stability and credibility of financial reporting remain central to the efficient functioning of capital markets, particularly within emerging economies characterized by macroeconomic volatility and institutional fragility. In recent years, the resurgence of inflationary pressures across both developed and developing economies has intensified concerns regarding the reliability of corporate earnings and the integrity of financial disclosures. Inflation, as a sustained increase in the general price level, introduces significant distortions into accounting measurement systems, especially those grounded in historical cost conventions. These distortions manifest through cost escalation, asset mis-valuation, and temporal mismatches between revenues and expenses, thereby expanding managerial discretion in financial reporting (Chen et al., 2021; López & García, 2022).

In such inflationary environments, the quality of reported earnings becomes increasingly susceptible to manipulation. Firms may engage in strategic financial reporting to offset the adverse effects of rising costs, declining real profitability, and heightened market expectations. This behavior, commonly conceptualized as earnings management, involves the deliberate use of accounting judgment or real operational decisions to influence reported financial outcomes in ways that may not reflect underlying economic performance (Healy & Wahlen, 1999; Scott, 2020). The prevalence of earnings management is particularly pronounced in sectors characterized by complex financial structures and high regulatory sensitivity, such as commercial banking.

The Nigerian banking sector presents a compelling context for examining these dynamics. Operating within an environment marked by persistent inflation, exchange rate volatility, and evolving regulatory frameworks, Nigerian commercial banks face significant pressure to maintain profitability, capital adequacy, and investor confidence. Inflationary trends in Nigeria have remained structurally elevated in recent years, increasing uncertainty in financial reporting and creating incentives for income smoothing, provisioning adjustments, and other forms of earnings manipulation. These conditions are further compounded by the inherent complexity of banking operations, including loan loss provisioning, fair value accounting, and risk-weighted asset estimation, all of which provide substantial latitude for managerial discretion.

Beyond macroeconomic pressures, executive compensation structures constitute a critical internal driver of earnings management behavior. Drawing from agency theory, compensation mechanisms; particularly those tied to financial performance indicators, can create incentives for managers to manipulate earnings in order to maximize personal rewards. Performance-based remuneration schemes, such as bonuses linked to profit targets or return metrics, may induce short-termism and opportunistic reporting practices. Empirical literature consistently demonstrates that executive compensation is significantly associated with earnings management, as managers respond rationally to incentive structures embedded within contractual arrangements (Jensen & Meckling, 1976; Li et al., 2026).

In the Nigerian context, directors' remuneration often benchmarked against financial performance indicators, may reinforce such incentives, particularly in an inflationary environment where maintaining nominal performance becomes increasingly challenging. The ratio of directors' remuneration to Total Operating Income provides a useful proxy for

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capturing the intensity of compensation incentives relative to firm output. When combined with inflationary pressures, these incentives may amplify managerial motivation to engage in earnings manipulation, thereby undermining the credibility of financial reporting.

Notwithstanding the growing body of literature on earnings management, significant gaps persist. First, extant studies have largely examined earnings management either from a corporate governance perspective (e.g., board characteristics, audit quality) or from a macroeconomic standpoint (e.g., inflation, economic uncertainty), with limited integration of these dimensions within a unified analytical framework. Second, while executive compensation has been widely investigated as a determinant of earnings management, insufficient attention has been given to its interaction with macroeconomic variables such as inflation, particularly in emerging economies where economic instability is more pronounced. Third, empirical evidence from Sub-Saharan Africa and Nigeria in particular remains relatively sparse, despite the region's susceptibility to both inflationary shocks and governance challenges (Mensah & Boachie, 2024).

More critically, the Nigerian banking sector embodies a unique convergence of macroeconomic instability and incentive-driven managerial behavior, yet there is a dearth of empirical studies that systematically examine how inflationary pressure and executive compensation jointly influence earnings management. Existing research has not adequately addressed whether inflation exacerbates opportunistic reporting behavior, nor whether compensation structures intensify or mitigate such effects within the banking industry. Consequently, the central problem motivating this study is the absence of integrated empirical evidence on the combined effect of inflationary pressure and executive compensation on earnings management behavior in Nigerian commercial banks. This gap limits the ability of regulators, investors, and policymakers to design effective governance and macro-prudential policies aimed at enhancing financial reporting quality. Addressing this problem is essential for strengthening market discipline, improving transparency, and fostering sustainable financial sector development.

Accordingly, this study seeks to interrogate the interplay between inflationary pressure and executive compensation (proxied by directors' remuneration to gross earnings) in shaping earnings management behavior in Nigerian deposits-money banks. By integrating macroeconomic and governance perspectives within a single analytical framework, the study contributes to advancing the frontier of accounting research in emerging market contexts.

CONCEPTUAL REVIEW

Inflationary Pressure and Earnings Management

Inflationary pressure represents a persistent increase in the general price level, which significantly alters the economic and financial reporting environment within which firms operate. In accounting terms, inflation undermines the reliability of historical cost measurements by distorting asset valuations, inflating nominal revenues, and creating mismatches between costs and revenues across reporting periods. These distortions introduce substantial estimation uncertainty into financial statements, thereby expanding managerial discretion in the application of accounting policies and judgments (Chen et al., 2021; López & García, 2022).

Within such a context, earnings management becomes a rational and often strategic managerial response. Earnings management refers to the deliberate intervention in financial reporting processes through accrual manipulation or real operational decisions to achieve specific reporting objectives, such as meeting earnings benchmarks, smoothing income, or avoiding losses (Healy & Wahlen, 1999; Scott, 2020). Inflationary environments intensify these incentives because firms face increased pressure to maintain stable performance indicators in nominal terms despite declining real profitability.

From a theoretical standpoint, the relationship between inflationary pressure and earnings management is grounded in both agency theory and positive accounting theory. Agency theory posits that managers, acting as agents, may exploit information asymmetry to pursue self-interest, particularly when external monitoring is weak. Inflation exacerbates this asymmetry by increasing the complexity and opacity of financial reporting. Similarly, Positive Accounting Theory suggests that managers choose accounting methods that maximize their utility under given contractual and economic constraints. In periods of high inflation, managers are more likely to adopt income-increasing or income-smoothing accounting strategies to meet compensation targets, avoid debt covenant violations, or reduce political costs (Watts & Zimmerman, 1986; Fields et al., 2001).

Empirically, a growing body of literature supports a positive association between inflationary pressure and earnings management behavior. Chen et al. (2021) find that inflation uncertainty significantly increases discretionary accruals among firms in Asian markets, indicating higher levels of accounting manipulation during periods of macroeconomic instability. Similarly, López and García (2022) report that firms operating in inflation-prone European economies engage in both accrual-based and real earnings management to mitigate the adverse effects of rising costs and economic volatility. These findings are further reinforced by Zhang et al. (2022), who demonstrate that macroeconomic volatility, including inflation shocks, encourages income smoothing and opportunistic reporting across U.S. and European firms.

In emerging economies such as Nigeria, the effect of inflation on earnings management is likely to be more pronounced due to weaker institutional frameworks, limited enforcement of accounting standards, and higher economic volatility. Inflation in Nigeria has remained structurally high, increasing uncertainty in financial reporting and creating incentives for firms, particularly in the banking and financial services sectors, to engage in discretionary accounting practices. Banks, in particular, possess significant flexibility in areas such as loan loss provisioning, fair value measurement, and revenue recognition, all of which can be strategically adjusted in response to inflationary pressures.

Moreover, inflation not only increases the opportunity for earnings management but also strengthens the motivation to engage in such practices. Firms may attempt to preserve investor confidence, maintain credit ratings, and meet regulatory thresholds by smoothing earnings in the face of macroeconomic shocks. This behavior, while potentially beneficial in the short term, undermines the transparency and credibility of financial reporting, thereby increasing information risk for stakeholders.

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However, the relationship between inflationary pressure and earnings management is not purely deterministic; it is contingent upon the strength of corporate governance and monitoring mechanisms. Strong governance structures, such as effective boards and independent auditing, can mitigate the extent to which managers exploit inflation-induced discretion. Conversely, weak governance environments may amplify the impact of inflation on earnings manipulation.

Executive Compensation and Earnings Management

Executive compensation constitutes a central mechanism in aligning managerial actions with shareholder interests; however, it simultaneously represents a potent source of incentive-driven opportunism in financial reporting. Within the framework of agency theory, as advanced by Michael C. Jensen and William H. Meckling, compensation contracts are designed to mitigate agency conflicts by linking managerial rewards to firm performance. Yet, when performance metrics are derived from accounting-based measures such as earnings, these contracts may inadvertently motivate managers to manipulate reported figures to maximize personal benefits.

Executive compensation typically comprises fixed salaries, bonuses, stock options, and other performance-based incentives. Among these, variable compensation tied to short-term financial performance is particularly associated with earnings management behavior. Managers facing compensation thresholds or bonus targets may engage in accrual manipulation or real activity management to ensure that reported earnings meet or exceed specified benchmarks (Healy & Wahlen, 1999; Scott, 2020). This behavior reflects the rational response of self-interested agents operating under incentive structures that reward accounting outcomes rather than underlying economic performance.

From the perspective of positive accounting theory, developed by Ross L. Watts and Jerold L. Zimmerman, managerial choice of accounting policies is driven by contractual motivations. The bonus plan hypothesis explicitly predicts that managers whose compensation is linked to reported income are more likely to adopt income-increasing accounting methods. This prediction has been widely validated in empirical literature, which demonstrates that firms with high executive compensation sensitivity to earnings exhibit greater levels of discretionary accruals and income smoothing (Fields et al., 2001; Li et al., 2026).

Empirical evidence across global markets consistently supports a positive relationship between executive compensation and earnings management. For instance, Li, Gupta, and Moura (2026) find that abnormal executive compensation is significantly associated with higher levels of earnings manipulation, suggesting that compensation structures can incentivize opportunistic reporting. Similarly, recent studies in emerging markets indicate that managers adjust accounting estimates and real activities to meet compensation-driven targets, particularly in environments characterized by weak governance and limited monitoring mechanisms (Al-Duais et al., 2023; Baatwah et al., 2023).

In the specific context of financial institutions, and particularly commercial banks, the relationship between executive compensation and earnings management is further intensified by the complexity of financial reporting. Banks possess considerable discretion in areas such as loan loss provisioning, fair value estimation, and revenue recognition,

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which can be strategically manipulated to influence reported earnings. When executive compensation is tied to profitability or return-based metrics, these discretionary areas become critical tools for achieving desired financial outcomes.

The Nigerian banking sector provides a compelling setting for examining this relationship. Executive compensation structures in Nigerian banks are often linked to key financial performance indicators, including profit after tax, return on equity, and asset growth. The use of directors' remuneration-to-Gross Earnings ratio as a proxy captures the relative magnitude of managerial rewards in relation to firm output, thereby reflecting the intensity of compensation incentives. In such an environment, managers may be motivated to engage in earnings management to justify high remuneration levels, sustain market confidence, and meet stakeholder expectations.

However, the relationship between executive compensation and earnings management is not unidirectional. While compensation incentives can encourage opportunistic reporting, they can also be structured to discourage manipulation through long-term performance metrics, clawback provisions, and governance oversight. Thus, the effectiveness of compensation as a governance mechanism depends on its design and the broader institutional environment within which firms operate.

Moreover, recent literature suggests that the interaction between executive compensation and external economic conditions such as inflation may further influence earnings management behavior. In inflationary environments, where maintaining nominal performance becomes more challenging, compensation-driven incentives may amplify managerial propensity to manipulate earnings. This interaction underscores the importance of examining executive compensation not in isolation, but as part of a broader framework that incorporates macroeconomic pressures.

Macroeconomic Conditions and Internal Governance Mechanisms

The Interplay between Executive Compensation and Inflationary Pressure on Earnings Management

The interaction between inflationary pressure and executive compensation provides a more comprehensive explanation of earnings management than considering either variable independently. Inflationary pressure expands managerial discretion by increasing uncertainty in financial reporting through cost escalation, asset valuation complexities, impairment assessments, and judgment-based accounting estimates (Chen et al., 2021; López & García, 2022). Executive compensation, particularly when linked to accounting-based performance measures such as profitability and return on equity, supplies the economic incentive for managers to exploit this expanded discretion (Healy & Wahlen, 1999). Consequently, the interaction between these variables creates a multiplicative rather than merely additive effect, whereby inflation serves as a catalyst that strengthens compensation-driven incentives to manipulate reported earnings. Mathematically, this interaction is represented by the product term (INF × DIR), indicating that the marginal effect of inflation on earnings management depends on the level of directors' remuneration, and vice versa.

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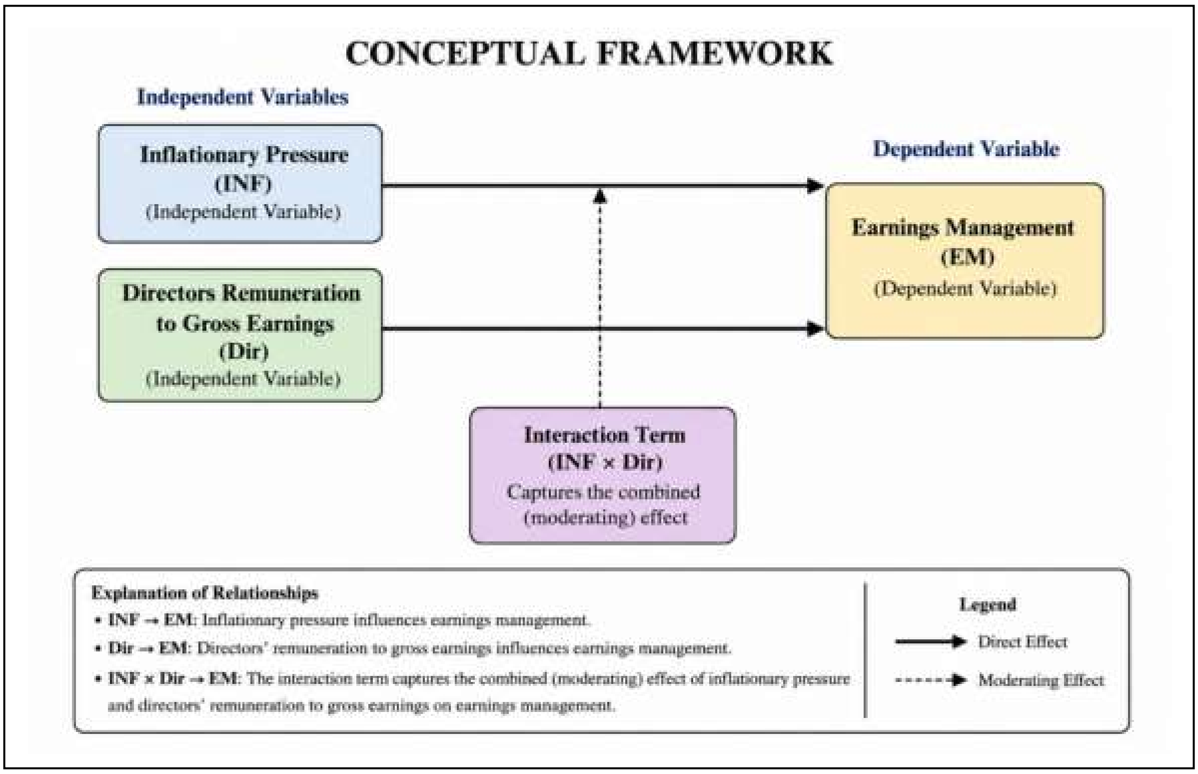
Behaviourally, managers facing both heightened inflationary pressure and strong performance-based compensation are more likely to engage in discretionary accruals and real earnings management to preserve reported profitability, satisfy market expectations, and secure remuneration tied to accounting outcomes. In such circumstances, inflation reduces the transparency of financial reporting while compensation increases the motivation to exploit that reduced transparency. Thus, firms with relatively higher directors' remuneration are expected to exhibit a stronger positive relationship between inflationary pressure and earnings management than firms with lower remuneration incentives. Empirical evidence indicates that macroeconomic uncertainty encourages opportunistic financial reporting (Chen et al., 2021), while performance-sensitive executive compensation increases managers' propensity to manipulate accounting numbers (Li et al., 2026). Their interaction therefore intensifies earnings management by simultaneously increasing both the opportunity and the motivation for manipulation.

In the context of Nigerian commercial banks, this interaction is particularly important because persistent inflation coincides with compensation structures that reward short-term financial performance. Banks possess considerable discretion in loan loss provisioning, fair value measurement, expected credit loss estimation, and income recognition, providing managers with multiple channels through which compensation-driven incentives can be exercised under inflationary conditions. Accordingly, this study posits that directors' remuneration does not merely exert a direct influence on earnings management but also amplifies the effect of inflationary pressure, making the interaction term (INF × DIR) a critical explanatory variable for understanding managerial reporting behaviour in Nigeria's banking industry.

Conceptual Framework



***Source**: Authors' Conceptualization 2026*

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The 2.1 conceptual frameworks illustrate the relationship between inflationary pressure (INF) and directors' remuneration to gross earnings (Dir) as independent variables influencing earnings management (EM) as the dependent variable. Both INF and Dir have direct effects on EM, indicating that macroeconomic conditions and executive compensation independently shape managerial reporting behavior. The interaction term (INF × Dir) captures the moderating effect, showing how executive compensation strengthens or weakens the impact of inflation on earnings management. Overall, the model suggests that earnings management in Nigerian deposits-money banks is jointly driven by macroeconomic pressure, incentive structures, and their combined interactive effect.

Theoretical Underpinning and Hypotheses Development

Theoretical Framework

The relationship between inflationary pressure, executive compensation, and earnings management in commercial banks is grounded in the predictions of agency theory and tournament theory.

Agency Theory

Agency theory provides the foundational theoretical lens for explaining the relationship between inflationary pressure, executive compensation, and earnings management in deposits money banks. The theory, originally developed by Jensen and Meckling (1976), conceptualizes the firm as a nexus of contracts between principals (shareholders) and agents (managers), where agents are expected to act in the best interest of owners. However, due to information asymmetry and divergent objectives, managers may engage in opportunistic behaviors such as earnings management to maximize personal utility, particularly when compensation contracts are linked to reported accounting performance. This suggests that managers, when motivated by self-interest and weak monitoring structures, may engage in opportunistic earnings manipulation to maximize compensation outcomes (Li et al., 2026; Efezino, 2025).

In the context of Nigerian commercial banks, inflationary pressure intensifies agency conflicts by increasing economic uncertainty, reducing real income predictability, and exerting pressure on firms to maintain stable earnings signals to investors and regulators. Under such conditions, executives may be incentivized to manipulate accounting figures to protect compensation-linked outcomes such as bonuses, stock-based rewards, and performance contracts. Recent empirical evidence supports this view, showing that executive compensation structures can either constrain or encourage earnings manipulation depending on governance strength and incentive design (Li et al., 2026). In emerging economies like Nigeria, where institutional monitoring may be relatively weaker, agency problems are more pronounced, and earnings management tends to increase during periods of macroeconomic instability, including inflationary shocks (Efezino, 2025). Thus, inflation not only affects firm profitability but also indirectly shapes managerial reporting behavior through compensation incentives embedded in agency relationships.

Tournament Theory

Tournament Theory, advanced by Lazear and Rosen (1981), provides a complementary explanation of executive compensation dynamics in hierarchical organizations such as

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commercial banks. The theory argues that compensation structures resemble a "tournament," where executives compete for promotion, higher remuneration, and prestige. Rewards are based not only on absolute performance but also on relative performance compared to peers. The theory further argues that executive compensation systems structured as competitive reward hierarchies encourage managers to engage in performance-enhancing or appearance-enhancing behaviors, including earnings management, to secure promotion and financial rewards (Lazear & Rosen, 1981).

Within this framework, inflationary pressure alters the competitive environment by increasing the difficulty of achieving superior reported performance. As inflation distorts costs, revenues, and profit margins, managers may strategically engage in earnings management to outperform peers in the internal "tournament" for bonuses, promotion, or retention. This is particularly relevant in banking systems where executive compensation is heavily performance-sensitive and benchmarked across institutions.

Recent corporate finance literature supports the relevance of tournament-based incentives in explaining earnings manipulation, noting that performance-contingent compensation systems can unintentionally encourage managers to engage in both accrual and real earnings management to secure competitive advantage over other executives (Li et al., 2026; Dechow et al., 2010). In inflationary environments, such competitive distortions are amplified because inflation reduces the clarity of true performance signals, making accounting numbers more manipulable and strategically valuable. Thus, tournament theory explains earnings management not only as a response to principal–agent conflicts but also as a strategic behavior driven by intra-managerial competition under distorted macroeconomic conditions.

Therefore, the empirical research on inflationary pressure, executive compensation, and earnings management in banking institutions has expanded significantly in developed and emerging economies. However, most studies examine these variables in isolation, with limited integration of macroeconomic shocks such as inflation into executive incentive–earnings management dynamics, particularly in African banking systems. The following studies provide relevant evidence.

Uygur (2013) examined the effect of executive compensation on earnings management in the U.S. banking industry using data spanning 1995–2009, a period covering pre- and post-financial deregulation episodes. The study employed panel data regression (fixed effects and OLS models) with discretionary loan loss provisions as a proxy for earnings management and CEO compensation components (salary, bonus, and equity-based incentives) as explanatory variables. The study found a significant positive relationship between equity-based compensation and earnings manipulation, indicating that managers with higher stock-linked incentives tend to engage more in income-increasing accounting practices. The study confirmed the incentive alignment problems within banking institutions, showing that compensation contracts can unintentionally encourage financial misreporting. The study is limited by its exclusion of macroeconomic variables such as inflation, interest rate volatility, and economic uncertainty, which are critical in explaining earnings behavior in unstable environments like Nigeria.

Guo et al. (2014) analyzed international banks across Europe and North America from 2000–2011, focusing on executive compensation structures and risk-taking behavior. The

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study used panel regression techniques and interaction terms between compensation incentives and crisis periods. Findings revealed that performance-based compensation significantly increases risk-taking, especially during financial crises, and that incentive intensity worsens managerial opportunism in unstable environments. The study contributes by introducing a crisis-sensitive dimension to executive incentives, demonstrating that compensation effects are not static but vary with macroeconomic conditions. This is particularly relevant for inflationary economies where economic instability mimics crisis-like distortions. However, the study does not explicitly examine earnings management behavior or accounting manipulation, focusing instead on risk-taking, leaving a conceptual gap between risk incentives and reporting quality.

Farouk and Ahmed (2023) investigated the relationship between executive compensation, ownership structure, and earnings management in Nigerian deposit money banks over 2007–2018 using panel least squares regression and fixed-effects models. The study found that CEO compensation positively influences earnings management, while managerial ownership reduces it due to alignment of interests. Corporate governance mechanisms were found to moderate this relationship. This study is particularly important as it provides contextual African evidence, confirming that agency conflicts are more severe in emerging economies with weaker governance systems. It also highlights the moderating role of governance structures in mitigating earnings manipulation. Despite its relevance, the study fails to incorporate macroeconomic instability variables such as inflation, which is highly relevant in Nigeria's volatile economic environment.

These gaps justify the need for a study focusing on inflationary pressure and executive compensation as joint determinants of earnings management in Nigerian commercial banks. Based on this theoretical and empirical grounding, the following hypotheses are formulated:

$H0_1$: Inflationary pressure has no significant effect on earnings management in Nigerian commercial banks.

$H0_2$: Executive compensation has no significant effect on earnings management in Nigerian commercial banks.

$H0_3$: Inflationary pressure has no significant moderating effect on the relationship between executive compensation and earnings management in Nigerian commercial banks.

$H0_4$: There is no significant joint effect of inflationary pressure and executive compensation on earnings management in Nigerian commercial banks.

METHODOLOGY

This study adopts an ex-post facto research design because the study relies on historical financial and macroeconomic data, where the variables of interest cannot be manipulated by the researcher but are observed as they naturally occur (Kothari, 2004). The population of the study comprises all listed commercial banks in Nigeria, while a purposive sampling technique is used to select banks with complete and consistent annual financial statements

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over the period under review. The study covers a time frame from 2011 – 2022, allowing for sufficient variation in inflationary conditions, compensation structures, and earnings management behavior.

Data are obtained from secondary sources, specifically the annual reports and financial statements of selected banks, as well as macroeconomic indicators published by the Central Bank of Nigeria (CBN) and the National Bureau of Statistics (NBS). Inflationary pressure is measured using the annual consumer price index (CPI) inflation rate, while executive compensation is proxied by total directors' remuneration relative to gross earnings, consistent with prior empirical banking studies (Farouk & Ahmed, 2023). Earnings management is proxied using discretionary accruals, estimated through the Modified Jones model, which is widely recognized as a robust approach for capturing managerial discretion in financial reporting (Dechow, Sloan, & Sweeney, 1995). The model separates total accruals into non-discretionary and discretionary components, with the latter representing earnings management behavior.

Although the modified Jones model was originally developed for non-financial firms, subsequent accounting research has demonstrated that it can be appropriately adapted for banking institutions by recognizing the industry-specific nature of accruals. In commercial banks, total accruals are driven less by inventories and property, plant, and equipment than by financial assets and credit-risk estimates. Accordingly, this study employs a banking-modified version of the Modified Jones Model in which loan loss provisions (LLPs) the largest discretionary accrual in banks are explicitly incorporated into the estimation of non-discretionary accruals. Consistent with prior banking literature, the model controls for normal accruals arising from changes in performing loans, loan growth, and other credit-risk fundamentals, while the unexplained (residual) component is interpreted as discretionary accruals or earnings management. This modification enhances the model's relevance to the banking industry by reflecting the unique accrual-generating process of financial institutions and has been widely adopted in empirical studies examining earnings management in banks (Beaver & Engel, 1996; Kanagaretnam, Lobo, & Mathieu, 2003; Kanagaretnam, Krishnan, & Lobo, 2010; Ozili, 2017).

The study employs panel data regression techniques, specifically Fixed Effects and Random Effects models, to account for unobserved heterogeneity across banks. The Hausman specification test is used to determine the appropriate model. In addition, an interaction term (Inflation × Executive Compensation) is included to capture the moderating effect of inflation on the compensation–earnings management relationship. The general empirical model is specified as:

$$EM = \beta_0 + \beta_1 INFR + \beta_2 Dir + \beta_3(INFR \times Dir) + \varepsilon$$

Where EM represents earnings management, INFR denotes inflationary pressure, and Dir represents executive compensation. Overall, this methodological approach ensures consistency, reliability, and empirical rigor in capturing the dynamic interaction between macroeconomic conditions and managerial incentives in Nigerian commercial banks.

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RESULTS AND DISCUSSION

Descriptive Statistics

	EM	INFR	DIR
Mean	-0.054488	14.72250	0.527561
Median	-0.056946	13.70000	0.400000
Maximum	0.250923	28.92000	3.030000
Minimum	-0.282798	8.000000	0.000000
Std. Dev.	0.092978	5.834739	0.426175
Skewness	0.243362	1.015292	2.195164
Kurtosis	3.331562	3.488252	11.85442
Jarque-Bera	1.907584	23.98913	537.2168
Probability	0.385277	0.000006	0.000000
Sum	-7.192359	1943.370	69.63800
Sum Sq. Dev.	1.132488	4459.787	23.79286
Observations	132	132	132

The table 1 shows the descriptive statistics, which provide an overview of the distributional properties of the variables used in the study. The mean value of earnings management (EM) is -0.0545, indicating that, on average, Nigerian commercial banks engage in slight income-decreasing discretionary accruals, although the negative value is relatively small, suggesting that earnings manipulation is not strongly biased in one direction. The standard deviation of 0.0930 indicates a moderate level of variability, implying that earnings management practices differ across banks and over time. For inflationary pressure (INFR), the mean value is 14.72%, with a standard deviation of 5.83, reflecting a moderately volatile inflationary environment over the study period. The relatively wide range (8% to 28.92%) confirms that Nigerian banks operated under significant macroeconomic instability, which may influence financial reporting behavior.

The directors' remuneration (DIR) has a mean of 0.528, exhibits a relatively high standard deviation (0.426), with values ranging from 0 to 3.03, indicating substantial inequality in executive compensation structures across banks. The high skewness (2.20) and kurtosis (11.85) further suggest that compensation is highly concentrated in a few banks or executives, indicating possible incentive distortions. Overall, the Jarque–Bera statistics show that EM is normally distributed ($p = 0.385$), while INFR, and DIR are not normally distributed ($p < 0.05$), indicating the presence of non-normality in macroeconomic and firm-level variables, which is typical in financial panel data studies.

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Correlation Analysis

Table 2. Correlation Test Result

	EM	INFR	DIR
EM	1	0.01231	0.13088
INFR	0.01231	1	-0.08181
DIR	0.13088	-0.08181	1

The correlation matrix examines the linear association among the variables and helps assess multicollinearity risk. The result shows that earnings management (EM) has a very weak positive relationship with inflationary pressure (INFR = 0.0123), suggesting that inflation alone does not strongly explain earnings manipulation at the bivariate level. However, it is positively related to directors' remuneration (DIR = 0.1309), indicating that higher executive compensation is associated with increased earnings management practices. These values are all well below the conventional threshold of 0.80, indicating that multicollinearity is not a serious concern in the model. This supports the reliability of regression estimates.

Table 3. Panel EGLS Regressions Analysis Results

Variables	**Fixed Effect Model**			**Random Effect Model**		
Dependent variable:	**EM**			**EM**		
	coefficient	(t-statistics)	P-value	Coefficient	t-statistics	p-value
Constant	-0.112903	-3.598567	0.0005	-0.109798	-3.373222	0.0010
INFL	0.003013	1.482727	0.1408	0.002873	1.420498	0.1579
DIR	0.111923	2.265221	0.0253	0.105695	2.164525	0.0323
INFL*DIR	-0.005947	-1.700243	0.0917	-0.005663	-1.630888	0.1054
R^2	0.183958			0.042785		
R^2_{adj}	0.094055			0.020350		
F-statistic	2.046184			1.907082		
Prob(F-stat)	0.046184			0.131704		
Durbin-Watson Stat.	1.917818			1.912949		

Source: *Extracts from Appendix*

Table 4.3 Hausman Test

Correlated Random Effects - Hausman Test
Equation: Untitled
Test period random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Period random	6.953470	3	0.00734

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The Hausman test in table 4.3 is to enable us choose the most suitable result between fixed effect and random effect regression models. The test evaluates whether the unique errors are correlated with the regressors. Based on the estimation results, the fixed effects model is preferred because the Hausman test is statistically significant ($p < 0.05$), indicating that there is systematic correlation between the regressors and the unobserved bank-specific effects. Consequently, the study proceeds with the fixed effects results as the basis for interpretation and hypothesis testing, as it better captures the within-bank variations over time and aligned with the structure of the data. The results provide empirical evidence on the relationship between inflationary pressure (INFR), executive compensation (DIR) and earnings management (EM), including their interaction effects.

The model reveals an R-squared of 0.186, indicating that approximately 18.6% of the systematic variation in earnings management is explained by the included variables and time effects. Although moderate, this explanatory power is consistent with earnings management literature, where unobservable behavioral and institutional factors typically account for a large proportion of variation (Dechow et al., 2010). The overall model is statistically significant at the 5% level (Prob(F-statistic) = 0.0469), confirming that the regressors jointly influence earnings management behavior in Nigerian commercial banks.

Inflationary Pressure (INFR): Inflationary pressure exhibits a positive but statistically insignificant relationship with earnings management ($\beta = 1.4827$, $p = 0.1408$). This suggests that although inflation increases earnings management direction, the effect is not strong enough to be statistically reliable. This finding implies that inflation alone does not directly drive earnings manipulation in Nigerian banks but may operate indirectly through incentive structures or institutional mechanisms. This aligns with prior evidence that macroeconomic instability influences financial reporting primarily through managerial incentives rather than direct accounting effects (Shu & Chen, 2017).

Executive Compensation (DIR): Executive compensation (DIR) has a positive and statistically significant effect on earnings management ($\beta = 2.2652$, $p = 0.0253$). This implies that increases in directors' remuneration significantly increase earnings management practices in Nigerian commercial banks. This result strongly supports agency theory, which posits that managers respond opportunistically to incentive-based compensation structures (Jensen & Meckling, 1976). It also aligns with empirical findings that performance-based pay increases financial reporting manipulation in banking institutions (Uygur, 2013; Farouk & Ahmed, 2023).

Inflation × Executive Compensation (INFR*DIR): The interaction between inflation and executive compensation is negative and statistically insignificant ($\beta = -1.7002$, $p = 0.0917$). This indicates that inflation slightly weakens the compensation–earnings management relationship, although the effect is not statistically reliable. This suggests that while inflation may exert economic pressure on banks, it does not significantly amplify the incentive effects of compensation contracts on earnings manipulation within the observed period.

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DISCUSSION OF FINDINGS

The empirical results of this study reveal important insights into the determinants of earnings management in Nigerian commercial banks, particularly the roles of inflationary pressure and executive compensation. First, the study finds that executive compensation has a statistically significant positive effect on earnings management. This indicates that higher directors' remuneration increases the likelihood of earnings manipulation through discretionary accounting choices. The result strongly supports agency theory, which posits that managers may act opportunistically when compensation is tied to financial performance indicators (Jensen & Meckling, 1976). It also aligns with prior empirical evidence in banking literature, which shows that incentive-based compensation structures can encourage earnings manipulation to meet performance expectations (Uygur, 2013; Farouk & Ahmed, 2023).

Second, inflationary pressure does not exert a statistically significant direct effect on earnings management. Although inflation is positive in direction, its insignificance suggests that macroeconomic instability alone is not sufficient to drive accounting manipulation in Nigerian banks. This implies that inflation may influence financial reporting indirectly through managerial incentives or institutional constraints rather than directly affecting earnings management behavior. This finding supports the argument that macroeconomic conditions affect accounting behavior primarily through behavioral and governance channels rather than mechanical accounting adjustments (Shu & Chen, 2017).

Third, the interaction effects between inflation and executive compensation are statistically insignificant, indicating that inflation does not meaningfully alter the compensation–earnings management relationship. This suggests that executive compensation structures in Nigerian banks are relatively rigid and not responsive to macroeconomic fluctuations. Consequently, managerial incentives remain largely driven by internal contractual arrangements rather than external economic conditions. Finally, although several individual variables are insignificant, the model is jointly statistically significant, indicating that the explanatory variables collectively influence earnings management behavior. This confirms that earnings management is a multi-dimensional phenomenon shaped by the interaction of managerial incentives and institutional factors rather than a single determinant.

CONCLUSION AND IMPLICATION

This study examined the effect of inflationary pressure and executive compensation on earnings management in Nigerian commercial banks. Based on panel data analysis using a fixed effects model, the study concludes that executive compensation is a significant driver of earnings management, while inflationary pressure has no direct statistically significant effect. The findings further reveal that inflation does not significantly moderate the relationship between executive compensation and earnings management, suggesting that managerial incentives in Nigerian banks are largely determined by internal compensation structures rather than macroeconomic fluctuations. The findings reinforce agency theory, confirming that executive compensation contracts create incentive misalignment that leads to opportunistic financial reporting behavior. However, the weak role of inflation suggests that traditional agency models may need to incorporate macro-institutional constraints more

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explicitly when applied to emerging economies. This study contributes to empirical banking literature by demonstrating the following: Compensation structures are more influential than inflation in shaping earnings management behavior. Macroeconomic variables may have indirect rather than direct effects on financial reporting quality. Interaction effects between inflation and compensation are weak in the Nigerian context, suggesting limited sensitivity of executive pay structures to macroeconomic conditions.

1. The findings have important implications for regulators such as the Central Bank of Nigeria (CBN) and the Financial Reporting Council of Nigeria (FRCN): Executive compensation frameworks should be more tightly regulated and aligned with long-term performance indicators rather than short-term accounting profits. There is a need for stronger disclosure requirements on compensation contracts to reduce opportunistic earnings manipulation. Regulatory focus should shift more toward governance structures rather than macroeconomic stabilization alone when addressing earnings quality concerns.

2. For bank boards and stakeholders: Compensation systems should incorporate non-financial and long-term performance metrics to reduce earnings manipulation incentives. Reliance on accounting-based bonuses should be minimized to prevent short-term financial reporting distortions. Improved corporate governance mechanisms are essential to ensure alignment between executive actions and shareholder interests. Although inflation does not directly influence earnings management, it remains an important macroeconomic factor affecting financial stability. However, its limited role in this study suggests that financial reporting behavior is more institutionally driven than macroeconomically determined in Nigerian banks. Overall, the study concludes that earnings management in Nigerian commercial banks is primarily incentive-driven rather than macroeconomically driven, with executive compensation serving as the dominant explanatory factor.

Limitations of the Study

Despite the contributions of this study, several limitations should be acknowledged.

1. The study relies on secondary data and accounting-based proxies, particularly discretionary accruals derived from the Modified Jones model. While widely used, this approach may not fully capture all forms of earnings management, especially real earnings manipulation, which involves operational decisions rather than accounting adjustments. Furthermore, the Modified Jones model is primarily designed for non-financial firms; it may not fully capture banking-specific discretionary accruals, such as strategic alterations to Loan Loss Provisions (LLPs).

2. The study focuses on listed commercial banks in Nigeria, which limits the generalizability of the findings to other sectors of the economy such as insurance, manufacturing, or fintech firms. The banking sector also operates under stricter regulatory oversight, which may influence earnings management behavior differently from less regulated industries.

3. The study covers a limited time horizon (2012–2022). Although this period captures important economic fluctuations, including inflationary variations, it may not fully

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reflect long-term structural changes in executive compensation systems or regulatory reforms.

4. The study does not fully account for corporate governance quality, ownership structure, or board independence, which are important determinants of earnings management. Excluding these variables may introduce omitted variable bias.

5. While inflation is included as a macroeconomic variable, the study does not distinguish between different dimensions of inflation (core vs. headline inflation, or short-term vs. long-term inflationary trends), which may have different implications for managerial behavior.

Suggestions for Future Research Directions

Based on the limitations identified, several avenues for future research are recommended.

1. Future studies should incorporate both accrual-based and real earnings management measures to provide a more comprehensive understanding of earnings manipulation behavior in banks.

2. Researchers may extend the analysis to other sectors of the Nigerian economy, such as insurance companies, manufacturing firms, and fintech institutions, to assess whether the observed relationships hold across different institutional settings.

3. Future research should consider a longer time horizon and post-2022 data, particularly to capture the effects of recent macroeconomic shocks such as currency redesign policies, global inflationary pressures, and monetary tightening.

4. It is recommended that future studies incorporate corporate governance variables such as board independence, audit committee effectiveness, and ownership concentration, to better explain earnings management behavior alongside compensation incentives.

5. Future research may explore non-linear and threshold effects of inflation, examining whether earnings management behavior changes significantly only beyond certain inflation levels.

6. Advanced econometric techniques such as System GMM or quantile regression models are recommended to address potential endogeneity issues and to capture heterogeneous effects across different levels of earnings management intensity.

Conflicts of Interest

The author declares that there are no conflicts of interest associated with this study. The research was conducted independently, and no financial, institutional, or personal relationships influenced the design, data collection, analysis, interpretation, or reporting of the findings. All data sources are publicly available and obtained from audited financial statements of Nigerian commercial banks and official publications of the Central Bank of Nigeria (CBN) and the National Bureau of Statistics (NBS). The study does not involve any form of sponsorship or funding that could bias the outcomes or conclusions.

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