SUSTAINABILITY DISCLOSURE AND FINANCIAL PERFORMANCE IN LISTED MANUFACTURING IN NIGERIA: DOES AUDIT FIRM SIZE MATTERS

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ABSTRACT

This study examined the Moderating effect of audit firm size on sustainability disclosure and financial performance of listed manufacturing firms in Nigeria. The period spanned for (10) years from 2012 to 2021 with a sample size of thirty-four (34) firms selected across the six sectors. Financial performance was measured using Tobin Q, GRI index was used for sustainability disclosure, Ex-post facto design was utilized, and secondary data which came from the companies' audited annual reports was used. Regression with robust fixed effects was utilized for data analysis. The results from the regression analysis showed that sustainability disclosure positively and significantly affect financial performance, Audit firms' size positively and significantly affect financial performance. However, audit firm size negatively and significantly moderates the effect of sustainability disclosure on financial performance of the listed manufacturing firms in Nigeria.

Keywords: *Sustainability disclosure, financial performance, Audit firm size, Nigeria, Robust Fixed effect regression.*

Introduction

The potential impact of sustainability Disclosure (SD) on an organization's financial performance, among other factors, has garnered substantial attention in recent years. (Li and Chen, 2018; Yoo et al., 2021). Sustainability is the ability to create and maintain conditions that create a fragile balance between the needs of enterprises and people, to improve lifestyle and well-being, and to safeguard ecosystems and natural resources (Ortiz-Martínez et al., 2023).

This concept attracted a lot of attention, particularly in the midst of the 2008 global financial crisis. It gained even more attention with the 2015 introduction of the Sustainable Development Goals (SDGs) by the UN, which aim to advance them by 2030. Among the most urgent environmental problems that businesses face on a daily basis are deforestation, water pollution, ozone layer loss, and global warming (Adomako & Tran, 2022). Reports from businesses on their environmental protection efforts are now mandated. Sustainability disclosure also addresses social issues like managing social systems like equitable compensation, working conditions, social security, women's empowerment, etc., even though it goes beyond disclosures on traditional financial measures to assist investors in making their investment decision. The long-term viability of an organization is impacted by all of these.

Financial performance in the business world can be measured using a variety of financial metrics that represent different firm views. For instance, Tobin's-Q ratio can be used to assess financial performance and represent the market's perspective (Naushad and Malik, 2015). Understanding the causal relationship between financial performance and sustainability is crucial (Aras et al., 2010). Stakeholder theory and the vast majority of studies both assert that sustainability is what boosts financial performance. According to that school of thought, financial performance and stability were unrelated

(Platonova et al., 2018). Several studies have looked at the relationship between financial performance and SD; Some have shown benefits (e.g., Okafor et al., 2021; Ramzan et al., 2021), while others have identified drawbacks (e.g., Saeidi et al., 2015). To gain more insight, a fresh examination of the relationship between sustainability disclosure and financial performance (FP) is necessary in the light of these conflicting findings.

In addition, previous studies (Saini et al., 2022; Mohammed and Wasiuzman, 2021; Awesh et al., 2020; Hongming et al., 2020) favored focusing on the direct relationship between sustainability disclosure and Financial performance (FP), but ignored potential moderating mechanisms. More specifically, they failed to take into account how certain corporate governance processes affected the company's financial results (Rodriguez-Fernandez, 2016; Achour and Bukataya, 2021). According to that perspective, a specific governance mechanism, such as audit quality, can improve the capacity of strategic decisions and guarantee the effective implementation of new strategies, such as corporate social responsibility (CSR) (Xiao et al., 2004). According to Watkins et al. (2004), audit quality is considered a critical governance tool for addressing agency issues. Information asymmetry between managers and stakeholders in an agency context results in agency expenses. Thus, companies will look for independent audits to stop opportunistic behavior (Imen and Anis, 2021; Buchanan et al., 2021).

Although studies have been conducted on sustainability disclosure and financial performance of Nigerian manufacturing companies, (Alhassan et al., 2020; Asoquo et al., 2018). However, the moderating effect of audit firm size in the relationship between sustainability and financial performance in Nigeria has been underexplored. therefore, the purpose of this study is to close the aforementioned gaps in the literature. For further investigation, the work is divided into six primary sections. In Section 2, the Study setting, section 3, on theoretical foundation and empirical literature on the variables are revealed; in Section 4, the methodology and research design are explained; in Section 5, the findings and their discussions are presented; and in Section 6, suggestions and directions for future research are provided.

Literature Review

Conceptual Review

Sustainability Disclosure

The Global Reporting Initiative (GRI, 2019) characterized sustainability reports as documents published by companies detailing their economic, environmental, and social impacts resulting from their operational activities. Almaqtari et al. (2023) defined sustainability reporting (SR) as a collection of a company's actions that illustrate the integration of social and environmental considerations into business operations and stakeholder engagements. This study aims to achieve sustainable development goals (Gunarsih & Ismawati, 2018).

Sustainability disclosure has arisen as a novel trend in corporate reporting by amalgamating a company's financial and non-financial performance. Scholars and industrialists present compelling reasons that corporations derive disproportionately greater advantages from integrating environmental policies into their organizational frameworks. The assessment of sustainability performance pertains to the broader domain of social accounting. This sector encompasses numerous activities: economic, social, and environmental (Natalia, 2017). The notions of sustainability disclosures stem from corporate social responsibility (CSR), corporate governance, and human resource planning, among other factors.

Sustainability disclosure entails the identification of firm-specific social performance variables, metrics, and measurement methodologies, systematically generating information pertinent to assessing the firm's social performance and disseminating this information to relevant stakeholders both internally and externally (Almaqtari, et al., 2023). Sustainability disclosure has developed as a novel trend in corporate reporting, amalgamating a company's financial and non-financial performance into a singular report.

Financial Performance

In corporate finance, financial performance is a critical concern due to the prevalence of financial scandals and varying degrees of corporate failures. In accounting literature, financial performance denotes earnings, return on assets, and economic value derived from a firm's financial activities (Emenyi & Okpokpo, 2023). Profits constitute a source of retained earnings, supplying a significant portion of the capital for expenditures in plant and equipment that enhance productive capacity. Profits are often utilized to assess the rate of return on investment and the correlation between profits and equity valuation. Profits can also be utilized to assess the impact of policy alterations on firms or profits, as well as on economic conditions (Onoh, et al, 2023). The basic objective of a company enterprise is financial performance or profitability, as survival in the long term is contingent upon it. Consequently, assessing present or historical profitability and forecasting future profitability is crucial. Profitability is the paramount indicator of a business's success, and an unprofitable enterprise cannot endure. Consequently, a firm's profitability is crucial to its structure and development, as it assesses performance, indicates accomplishment, and bolsters the firm's reputation (Gunarsih & Ismawati, 2018).

Financial performance is a summary metric of company success or failure, serving as a crucial determinant of economic performance. Thus, a highly profitable business can provide its owners with substantial returns on their investment.

The profitability of a firm refers to its capacity to produce income that surpasses costs in relation to the company's capital base (Natalia, 2017). Almaqtari et al. (2023) defined profitability as the capacity to generate profit from all organizational business activities. They further characterized it as the effective management of organizational resources to enhance corporate value.

Audit Firm Size

Audit firm size is defined as a classification based on total revenues, number of partners, number of professional personnel, and number of offices (Arens et al., 2014). Riyanto (2007) asserted that audit firm size can be viewed as large audit companies (Big 4) and small audit firms (non-big 4). Lawrence et al. (2011) assert that the Big 4 companies deliver superior audit quality due to their investment in training programs, standardisation of audit methodologies, and more opportunities for peer review by fellow partners.

Theoretical Review

Resource Dependency Theory

Resource dependency theory emphasizes the impact of environmental factors on organizations, rather than societal expectations, and seeks to elucidate the influence of environmental restrictions on organizational behavior (Pfeffer & Salancik, 2003). The idea centers on the discourse around how firms acquire essential resources for survival and growth (Chen & Roberts, 2010). The idea highlights external organizations and the negotiation of positions within environmental restrictions. Consequently, for a corporation to sustain its activities, it must possess the requisite resources. Consequently, from the viewpoint of resource dependency theory, a corporation would generate sustainability disclosures to address sustainability challenges and to preserve the essential natural resources required for its existence and growth.

Stakeholder theory

Stakeholder theory stated that companies should consider the interests of all stakeholders, including employees, customers, suppliers, investors, communities, and the environment (Freeman, 1984).

Stakeholder consensus states that in order to appease stakeholders, companies should disclose information about their environmental, social, and governance (ESG) policies on sustainability disclosure issues (Clarkson, 1995). The size of the audit firm plays an important moderating role in the relationship between financial performance and sustainability disclosure/. Larger audit firms are better equipped to assess how firms deliver on sustainability issues because they have greater resources and experience (KPMG, 2017). Thus, larger auditing firms can increase the reliability and trustworthiness of sustainability disclosures, which in turn can have a positive impact on economic performance (De Villiers & Marques, 2017). However, smaller banks may not have the same resources and expertise to assess the quality of their sustainability disclosures, which could negatively impact their financial success. This may lead to a decline in investment and sales because stakeholders may not trust the sustainability information provided by subsidiaries audited by small accounting firms (Cho, Laine, & Roberts, 2015). To meet stakeholder demands, companies should prioritize sustainability disclosure, according to stakeholder perspectives. Large audit firms can also contribute significantly to the legitimacy and reliability of sustainability disclosures, which can have a positive impact on financial performance.

Empirical Review

Sustainability disclosure and Financial Performance

A few recent empirical studies have looked at the relationship between financial performance and sustainability disclosure. There is evidence of a complex and context-dependent relationship between financial performance and sustainability. In this comprehensive study, Coelho et al. (2023) used 53 empirical papers published between 1984 and 2021 to examine the relationship between CSR and business financial success. According to most studies, CSR directly affects a company’s bottom line.

This effect is more pronounced the higher the firm’s ESG score. Meta-findings analysis by Khan (2022) shows that there is a significant positive relationship between corporate performance and ESG disclosure. The study also shows that the strength of the association depends on ESG disclosure, type of performance metric, and industry conditions.

The study by Saini et al. (2022) examines the relationship between ESG disclosure and corporate financial performance (CFP), focusing on the existence of sustainable value chains. To overcome endogeneity issues, the study uses panel data consisting of 1,170 firm-level observations from 2012 to 2020. Method of moments (GMM) approaches have been applied, both general and systematic. The study highlights ESG as an indicator of a sustainable manufacturing strategy by demonstrating a positive relationship between ESG and CFP. Muhammad and Wasiuzman (2021) examined the impact of competitive advantage on the relationship between a company's performance and its ESG disclosures. 3,966 firm-year observations of 661 businesses listed on Bursa Malaysia from 2012 to 2017 constituted the sample data used. To further the robustness of the findings, the study employs clustering techniques in regression analysis. The results show that, even after adjusting for competitive advantage, ESG disclosure improves business performance. However, it is important to note that the study is limited to publicly traded companies in Malaysia and may not be applicable to other situations.

Zhang and Lucey (2022) looked at the moderating role of financial mechanisms associated with environmental sustainability as well as the relationship between company profitability and ESG performance. The study examines data from 215,110 firm-year observations of globally listed companies between 2016 and 2020. According to the study, company performance as determined by ROA and ROS is significantly and favorably affected by ESG performance. Additionally, the study showed that increasing ESG performance can increase a company's ability to raise external financing, including long- and short-term debt, and reduce financing constraints. Overall, according to the study's findings, businesses that emphasize ESG performance can improve their financial results and reduce their financial constraints. Pham et al.'s (2021) research shows that return on equity, earnings yield, assets, and capital employed all reflect the relationship between FP and organization sustainability.

Using a sample of Spanish companies, Ormazabal and Roman (2021) investigates the effects of stakeholder involvement and sustainability reporting (SR) on company value. Findings indicate that SR increases firm value, particularly when combined with stakeholder engagement initiatives that promote communication and understanding between the company and its stakeholders. Giron, et al. (2021) study found that return on equity (ROE) and return on assets (ROA) show a positive relationship with company financial performance. Specifically, the authors find that monetarily, businesses that report on sustainability do better than those that do not. Hongming et al. (2020) analyzed the data of 50 non-financial public limited companies registered on the Pakistan Stock Exchange between 2013 and 2017.

Employing a sustainability reporting index consisting of 42 parameters, they discovered that company performance was positively affected by environmental, health and safety, and social indicators. Over a period of five years (2012–2016), Asuguo et al. (2018) looked at the relationship between corporate performance and SR for three Nigerian brewing companies. The study discovered that the return on assets of the selected Nigerian brewing companies was not significantly affected by economic, environmental, or social performance disclosures. This means that, at least when considering these specific companies and the time period under investigation, there may not be a direct relationship between SR and financial performance. It is important to remember that this study only looks at a limited sample of manufacturing companies in a specific industry. Over a ten-year period, Alhassan et al. (2021) looks into how SR affects the FP of listed industrial goods companies in Nigeria. The results showed that sustainability reporting positively and significantly affects ROE, EPS and ROA.

Moderating effect of Audit firm size

Dakhil (2022) research provides valuable insights into the possible moderating effect that audit quality could have in the association between FP and CSR. The author indicates that CSR has a beneficial effect on the financial success of the company as measured by ROE, ROA and Tobin's Q. This conclusion is based on an 11-year timeframe utilizing a panel dataset of 200 French enterprises. This suggests that companies who participate in social projects can see an improvement in their financial performance. The moderating influence of audit quality in the relationship between corporate FP and ESG issues was examined by Zahid et al. (2022) in Western European nations. They also discovered that companies audited by Big 4 auditors had a greater benefit from CSR's favorable effect on financial performance. The authors' sample comprised 620 firms with headquarters located in Western Europe between 2010 and 2019. This evidence supports the trade-off hypothesis, which claims that an organization's financial performance as measured by ROA is severely harmed by ESG. Furthermore, companies that have obtained accreditation from the Big Four accounting firms exhibit a particularly pronounced negative impact of ESG on CFP.

Bacha et al. (2021) looked at the effect of CSR on loan costs for non-financial French firms from 2005 to 2016. The authors used panel data regressions to find a negative correlation between the cost of loan and CSR performance, suggesting that financial institutions are likely to charge socially conscientious enterprises less. The study contended that financial institutions ought to understand that CSR can reduce firm risk and enhance its standing, both of which will reduce the cost of borrowing for companies that prioritize social responsibility. The impact of audit quality on the relationship between debt costs and corporate social responsibility is also examined in this study. The authors find that when calculating debt price, banks take perceived audit quality and CSR performance into account. The study claims that the incremental audit quality that comes from audits carried out by the Big 4 audit firms lowers the cost of funding for CSR enterprises.

Methodology

The study examines the moderating effect of audit firm size on the link between financial performance and sustainability disclosure using an ex post facto research approach. A sample of 34 manufacturing companies listed on the Nigeria Exchange Group Limited was chosen for the study using a purposive sampling technique. The sample was selected from all 56 manufacturing enterprises in Nigeria. This was selected based on availability of sustainability reports for the years 2012 to 2021. The chosen firms' annual reports and sustainability reports for the years 2012 and 2021 will be the source of secondary data collection. The market value of all assets divided by the book value of all assets is known as Tobin Q, which is used to measure financial performance. The Global Reporting Initiative (GRI) disclosure index will be used to measure sustainability disclosure. 91 GRL items including the social (47), environmental (34), and economic aspects were content-analyzed.

Reputable, large audit firms assess the quality of audits (BIG4) the brand name (BIG4/NonBIG4) was used to denote audit quality in earlier research (Kalbuana et al., 2020; Rigen et al., 2021). Deloitte, Ernst & Young, KPMG, and Price Waterhouse Coopers are the four biggest auditing firms globally.

These are big, well-known audit organizations. The fact that BIG4 audit companies are linked to a more respectable brand name and are expected to uphold that reputation adds even more incentive to deliver better audit services (Watkins et al., 2004; De Angelo, 1981). Two control variables firm age based on the year of listing and firm size as determined by the natural logarithm of total asset are introduced in the study.

The study uses multiple regression analysis to test the moderating effect of audit firm size on the relationship between sustainability disclosure and financial performance. The model includes three variables: sustainability disclosure, audit firm size, and their interaction and two control variables (firm size and firm age). Tobin Q will be used as the dependent variable, while sustainability disclosure, audit firm size, and their interaction will be. The model is.

$FP\ (Tobinq) = \beta 0 + \beta 1SDit\ þ\ \beta 2BIG4it\ þ\ \beta SD{*}BIG4it + \beta 4FSit + \beta 5FAGit + \varepsilon i$

Where:

SD, means sustainability disclosure,

BIG4 present the big 4 audit firms

*FS*is firm size and

FAG is firm age

Result and Discussion

Table 1: Descriptive Analyses

Variables	Obs	Mean	Std.Dev	Min	Max
Tobinsq	340	1.785	1.604	0.417	11.757
SD	340	0.192	0.116	0.037	0.828
BIG4	340	0.706	0.456	0	1
FS	340	24.01	1.890	19.38	28.50
FAG	340	47.27	19.51	7	98

Note: *SD*, means sustainability disclosure, *BIG4* present the big 4 audit firms means 1 and 0, *FS*is firm size and *FAG* is firm age.

Table 1 shows that tobinsq has a mean of 1.785, a standard deviation of 1.604, a minimum value of .417, and a maximum value of 11.757. The mean value suggest that majority of the firms are overvalued as thee mean is more than. Table 1 also showed that the mean score for sustainability disclosure to be 0.186 which indicated that the disclosure level is low for manufacturing firms in Nigeria. The standard deviation of .12, a minimum value of .03, and a maximum value of .828. The table also showed that 71% of the manufacturing firms are audited by the big4 audit firms. On firm size (fs) the mean value shows a natural log value of 24. 123 firm age showed an average value of 47.27.

Table 2: Diagnostic tests

Test	$\chi2$	P-Value
Normality test (Jacque Bera)	.00	0.000
Breusch-Pagan / Cook-Weisberg test for heteroskedasticity	30.50	0.000
Hausman specification test	58.44	0.000

Stata output, 2023

Jacque bera test was used to examine the normality of the residual variable. The chi-square value was significant ($\chi2(2) = 0.0000$, $p < .05$) indicating a departure from normality. Further, a Breusch-Pagan/Cook-Weisberg test was conducted to examine heteroskedasticity in the fitted values of tobinsq. The null hypothesis that assumes constant variance was tested. The results showed that the chi-square test statistic was significant ($\chi2(1) = 30.50$, p-value is .000), indicating the presence of heteroskedasticity.

To decide which model the fixed-effects or random-effects model—was more appropriate, a Hausman test was performed. The findings demonstrated a significant chi-square value ($\chi2(5) = 58.44$, p-value = 0.000), suggesting the existence of a fixed effect. As a result, it was decided that the fixed-effects model would fit the existing data better. Based on deviation from normality and presence of heteroskedasticity, a robust fixed effect regression is used.

Table 3 Robust Fixed effect Regression

Variables	Coeff	Std error	T-value	P-Value
SD	4.707	1.04	4.54	0.001***
BIG4	0.603	0.188	3.21	0.011**
SD*BIG4	-5.397	0.971	-5.56	0.000***
FS	-0.490	0.093	-5.24	0.001***
FAG	-0.094	0.021	-4.55	0.001***
Constant	17.47	2.00	8.94	0.000***
R2 square	25.6			
F-stat	32.30			
No of Obs	340			

Note: significant level, *** p<0.01, ** p<0.05, * p<0.1

The results of an econometric technique known as fixed-effects regression with Driscoll-Kraay standard errors, which is used to investigate the association between a dependent variable (tobinsq) and multiple independent variables are displayed in Table 3. The inside R-squared value of the data suggests that the independent variables account for 25.6% of the variation in "tobinsq".

Sustainability disclosure and financial performance

Table 3 shows that a one-unit increase in sustainability disclosure is associated with a 4.71 increase in "tobinsq", on average ($p < 0.01$). This revealed that increase. This implies that sustainability disclosure has positive effect on FP of listed manufacturing firms in Nigeria. This could result from the fact that by disclosing sustainability information, firms can signal to stakeholders that they are committed to social and environmental responsibility. This can enhance the firm's reputation and brand image, which can translate into increased customer loyalty, stakeholder trust, and ultimately, financial performance.

Further manufacturing firms that disclose sustainability information may be more attractive to these investors. This can result in increased investment and access to capital, which can positively impact a firm's financial performance. this is in line with stakeholders' theory and prior studies by Ulrich et al. (2023), Saini et al. (2022), Mohammad and Wasiuzzaman (2021) and Zhang and Lucey (2022) and Ormazabal and Román (2021).

Moderating effect of audit quality on Sustainability disclosure and financial performance

Table 3 showed the coefficient of SDBIG to be -5.40 which is significant at less than 5% as indicated by a P-value of 0.001. These means the association between sustainability disclosure and the financial performance of Nigerian listed manufacturing enterprises is moderated by the audit quality as determined by audit firm size. The interaction effect thus implies that, for firms with a low level of BIG4, the impact of sustainability disclosure on tobinsq is positive, but for firms with a high level of "BIG4", it is negative. The negative coefficient of the interaction variable (SDBIG) means that the effect of sustainability disclosure on tobinsq is negatively moderated by the level of audit firm size. In particular, for the Big 4 audited companies, the impact of sustainability disclosure on Tobinq is less noticeable than for those audited by other audit firms. This study shows that when audit organizations are larger, they generally have more complex organizational structures and more bureaucratic processes. They may find it more difficult to react quickly and effectively to ESG challenges as a result of these considerations. Additionally, as their clientele grows, large audit firms may find it difficult to maintain the quality of their audit services. If the audit company has a large client base, its distribution among them may be more concentrated. The financial performance of their clients may suffer as a result, and audit capabilities may deteriorate. The audit firm may pay less attention to and audit its clients, increasing the likelihood that errors or fraud will go unnoticed. Ultimately, this can damage the reputation of the audit company and its clients and result in financial losses for all parties. This is in line with a previous study by Zahid et al. (2022), who found that companies accredited by the Big Four accounting firms are more likely to experience negative effects of ESG on the company's financial performance. According to Bacha et al. (2021) and Dakhil (2022), there is a high correlation between firms audited by Big Four audit firms and firms audited by non-Big Four audit firms.

Conclusion

Your regression study demonstrates that, when firm age (FAG), company size (FS), and moderating with BIG4 audit firm are taken into account, sustainability disclosure (SD) has a favorable impact on financial performance (tobinsq) for businesses. Companies that reveal more information about sustainability generally have higher financial performance, according to the positive association shown between SD and FP. In contrast to companies examined by smaller audit firms, the interaction effect between audit firm size and sustainability disclosure (SDBIG) suggests that the beneficial impact of sustainability disclosure on financial performance is less pronounced for companies audited by bigger audit firms. The study comes to the conclusion that financial performance benefits from sustainability disclosure, but that this influence is tempered by the size of the audit company. Consequently, businesses might gain by sharing sustainability data, especially if bigger audit firms are doing their audits.

Recommendations

Nigerian manufacturing companies may benefit from disclosing more sustainability information as it can positively impact their financial performance. Companies should prioritize and invest resources in their sustainability reporting efforts.

Nigerian policy makers may want to consider the implementation of regulations or guidelines that encourage Nigerian manufacturing companies to disclose more sustainability information, particularly for companies audited by smaller audit firms. This could help increase the credibility and reliability of sustainability information disclosed by Nigerian manufacturing companies, which could lead to a stronger positive effect on financial performance.

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