

# *Effect Of Earnings Quality On Book Value Of Quoted Consumer Goods Companies In Nigeria*

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**Abstract:** The study examined the effect of earnings quality on the book value of quoted consumer goods companies in Nigeria, emphasizing accrual quality, earnings persistence, predictability, and smoothness. Employing a quantitative research design, secondary data from financial statements were analyzed using regression models grounded in Signaling Theory. Findings reveal that accrual quality significantly impacts book value ( $\beta = 0.312$ ,  $p < 0.05$ ), while earnings predictability and persistence show weaker but positive correlations ( $\beta = 0.176$ ,  $p = 0.08$ ;  $\beta = 0.142$ ,  $p = 0.10$ , respectively). Earnings smoothness exhibits a negative yet insignificant relationship ( $\beta = -0.097$ ,  $p = 0.12$ ). These results suggest that firms with higher accrual quality tend to have stronger book values, reinforcing the role of financial transparency in corporate valuation.

**Keywords:** Earnings Quality, Book Value, Consumer Goods Sector, Accrual Quality, Earnings Persistence, Earnings Predictability, Earnings Smoothness, Financial Reporting, Nigerian Stock Exchange.

## 1. Introduction

The relationship between earnings quality and firm valuation has been a significant area of research in the field of financial accounting. Earnings quality refers to the degree to which a company's reported earnings reflect its true financial performance, free from distortion or manipulation. High-quality earnings are considered more reliable and provide a clearer picture of a firm's economic standing (Healy & Wahlen, 1999). In this context, Book Value (BV), which represents the net worth of a company based on its financial statements, is often used as a key measure of firm valuation. The accuracy and reliability of BV depend heavily on the quality of earnings reported, making earnings quality a critical factor in determining a company's true worth (Francis et al., 2004).

In Nigeria, the consumer goods sector represents one of the largest and most dynamic industries, with companies operating in diverse sub-sectors ranging from food and beverages to household products. The financial performance of these firms is pivotal for stakeholders, including investors, regulators, and policymakers, who rely on accurate financial data for decision-making. As such, understanding the role of earnings quality in shaping the book value of these firms is essential for providing a more accurate assessment of their financial health (Adewoye, 2017). This study aims to investigate the impact of various dimensions of earnings quality—namely, accrual quality, earnings predictability, earnings persistence, and earnings smoothness—on the book value of quoted consumer goods companies in Nigeria.

Accrual quality refers to the degree to which earnings reflect a firm's actual cash flows and economic performance. Higher accrual quality indicates that the company's earnings are a reliable reflection of its true financial performance, which in turn influences the accuracy of its book value (Dechow et al., 1995). Earnings predictability, which measures how well past earnings can forecast future earnings, is another important component of earnings quality. A high level of earnings predictability provides valuable information for stakeholders and enhances the reliability of financial statements. However, the extent to which earnings predictability affects book value remains an open question, particularly in the context of developing economies like Nigeria (Zhang, 2008).

Earnings persistence is the degree to which a company's earnings are stable and sustainable over time. Firms with more persistent earnings are generally perceived as having more predictable and stable financial outcomes, which could positively influence their book value. On the other hand, earnings smoothness refers to the extent to which a company's earnings exhibit less volatility and fluctuations over time. Firms that report smoother earnings may be seen as more stable, which could enhance investor confidence and, subsequently, their book value (Watts, 2003). Despite these theoretical considerations, empirical evidence on the relationship between earnings quality components and book value in the Nigerian context remains scarce.

This study also considers the impact of firm size on book value. Larger firms typically have more resources and greater access to capital markets, which may allow them to report higher book values. Furthermore, larger firms often face more regulatory scrutiny, which could lead to higher levels of financial transparency and, consequently, improved earnings quality. The relationship between firm size and book value has been explored in prior research, with mixed findings (Chen et al., 2013). However, it remains unclear whether firm size plays a significant role in influencing the relationship between earnings quality and book value in Nigeria's consumer goods sector.

By examining the effect of earnings quality on the book value of quoted consumer goods companies in Nigeria, this study seeks to contribute to the existing literature on financial reporting quality. It will provide empirical evidence on how various aspects of earnings quality influence firm valuation, offering valuable insights for investors, regulators, and corporate managers. Given the complexities of the Nigerian market, characterized by economic volatility and regulatory challenges, understanding the dynamics of earnings quality and its impact on book value is crucial for making informed decisions and promoting financial transparency in the consumer goods sector (Akinlo, 2015).

## Research Questions

- i. What is the effect of accrual quality on book value of quoted consumer goods companies in Nigeria?
- ii. How does earnings persistence affect book value of consumer goods companies in Nigeria?
- iii. To what extent does earnings predictability affect book value of consumer goods companies in Nigeria?
- iv. What is the effect of earnings smoothness on book value of quoted consumer goods companies in Nigeria?

## Research Hypotheses

**H<sub>01</sub>** Accrual quality has no significant effect on book value of quoted consumer goods companies in Nigeria.

**H<sub>02</sub>** Earnings persistence has no significant effect on book value of quoted consumer goods companies in Nigeria.

**H<sub>03</sub>** Earnings predictability has no significant effect on book value of quoted consumer goods companies in Nigeria.

**H<sub>04</sub>** Earnings Smoothness has no significant effect on book value of quoted consumer goods companies in Nigeria.

## 2. Theoretical Framework

### Signaling Theory

Signaling Theory served as the foundational framework for this study, providing a theoretical basis for understanding how the quality of reported earnings influences the book value of publicly listed consumer goods companies in Nigeria. The theory, first introduced by Spence (1973), suggests that firms use financial reports to signal their true economic value to investors and other stakeholders. High-quality earnings serve as a positive signal, reinforcing investor confidence and enhancing firm valuation, while low-quality earnings may indicate financial instability or earnings manipulation, potentially diminishing book value.

In the context of this study, Signaling Theory explains the relationship between earnings quality attributes—accrual quality, earnings smoothness, earnings predictability, and earnings persistence—and firm valuation. Investors and financial analysts rely on reported earnings to assess a company's financial health and future performance. Firms with high accrual quality, for instance, provide more reliable financial statements, signaling transparency and credibility, which can positively impact their book value. Conversely, inconsistencies in earnings predictability or weak earnings persistence may send negative signals, raising concerns about the firm's financial stability.

Earnings smoothness, another key variable in this study, plays a crucial role in signaling financial stability to investors. Firms that exhibit smoother earnings over time are often perceived as having well-managed financial operations, reducing investor uncertainty. However, excessive smoothing can also raise concerns about earnings management and potential manipulation, which could undermine investor trust. By applying Signaling Theory, this study examined how the market interprets these earnings quality indicators and how they collectively shape firm valuation.

Furthermore, the theory suggests that firms with superior earnings quality are likely to attract more investors, as they are perceived as less risky and more financially stable. This, in turn, can enhance their book value by increasing investor confidence and demand for the company's shares. Firms with poor earnings quality, on the other hand, may struggle to maintain investor trust, leading to lower valuation and potential capital constraints. The ability of firms to consistently report high-quality earnings, therefore, serves as a crucial signal in determining their market position and long-term financial success.

Overall, Signaling Theory provided a relevant theoretical framework for analyzing the effect of earnings quality on the book value of consumer goods firms in Nigeria. The theory highlighted the role of financial reporting in shaping investor perceptions and firm valuation. By evaluating key earnings quality attributes through the lens of Signaling Theory, this study aimed to provide insights into how firms can enhance transparency and credibility, ultimately influencing their financial standing in the market..

### 3. Materials and Methods

The study relied on secondary data, as the research was grounded in quantitative analysis. The primary focus of the model was to explore how various reported earnings quality attributes influenced the book value of publicly listed consumer goods firms in Nigeria. The predictor variables for this analysis included accrual quality, earnings smoothness, earnings predictability, and earnings persistence. The theoretical framework guiding this investigation was Signaling Theory, which posited that the reported earnings quality directly impacted a company's book value. The specific models utilized in this study were outlined below, in accordance with the work of Anaekenwa and Rafiu (2018).

$$BV_{it} = b_0 + \beta_1 ACQ_{it} + \beta_2 ESM_{2it} + \beta_3 EPR_{it} + \beta_4 EPE_{it} + \epsilon_{it} \dots \dots \dots (i)$$

Where;

BV= Book Value

ACQ= Accrual Quality

ESM= Earnings Smoothness

EPR= Earnings Predictability

EPE= Earnings Persistence

FSIZE = Logarithms of total Asset as a control Variable

$b_0$  = intercept (constant)

$i$ = cross-sectional time

$t$ =time series

$\epsilon$  = Error term

### Measurement of Variables

### 4. Results

#### Descriptive Statistics

Variable	Min.	Max.	Mean	Std. Dev.	Skewness	Kurtosis
BV	0.0100	0.4300	0.0933	0.1045	2.0710	6.2337
ACQ	7.0000	23.0000	12.8258	3.5941	0.8776	2.1837
EPR	0.0100	0.9400	0.496	0.2956	-0.1124	1.4909
EPE	0.1600	0.7500	0.3542	0.0917	2.0363	8.5019
ESM	0.1200	0.6600	0.1443	0.04988	6.2023	54.2148
FSIZE	6.5100	9.7000	7.9853	0.6678	0.7348	3.1112

Source: STATA Output Result 2023

The descriptive statistics provided in Table 4.1 offer key insights into the effect of earnings quality on the Book Value of quoted consumer goods companies in Nigeria. The Book Value has a minimum value of 0.01 and a maximum value of 0.43, with an average of 0.0933. A standard deviation of 0.1045 indicates a 10% deviation from the mean, suggesting moderate variability in Book Value across these companies. The skewness value of 2.0710 and kurtosis of 6.2337 reveal a positively skewed distribution with potential outliers. This suggests that while most companies exhibit relatively low Book Value, a few companies stand out with much higher values.

Accrual Quality (ACQ) ranges from 7 to 23, with an average of 12.83 and a standard deviation of 3.59. A higher accrual quality reflects that earnings more accurately represent the firm's true performance. The skewness of 0.8776 shows a mild positive skew, and the kurtosis of 2.1837 suggests that the distribution is approximately normal but slightly clustered around the mean.

Earnings Predictability (EPR) spans from 0.01 to 0.94, with an average of 0.496 and a standard deviation of 0.2956. The negative skewness of -0.1124 indicates a slight leftward skew, and the kurtosis value of 1.4909 suggests a relatively flat distribution. This shows that, on average, around half of the consumer goods companies in the sample show independent earnings, although the degree of independence varies substantially across firms.

Earnings Persistence (EPE) has a range from 0.16 to 0.75, with a mean of 0.3542 and a standard deviation of 0.0917, pointing to low variability around the mean. The skewness value of 2.0363 and kurtosis of 8.5019 indicate a distribution that is highly positively skewed and sharply peaked. This implies that while some firms show a relatively high level of earnings persistence, most firms have lower levels of this quality.

Earnings Smoothness (ESM), which reflects a firm's ability to present consistent financial performance and lower perceived risk for investors, has a range from 0.12 to 0.66, with an average value of 0.1443. The standard deviation of 0.04988 indicates low variation, suggesting that most firms in the sample have relatively stable earnings, though still with some variability.

Lastly, Firm Size (FSIZE), measured by the logarithm of total assets, ranges from 6.51 to 9.70, with an average of 7.9853 and a standard deviation of 0.6678. The skewness of 0.7348 shows a mild positive skew, and the kurtosis of 3.1112 indicates a moderately peaked distribution. This suggests that while there is some variation in firm size, the majority of firms tend to have a size closer to the mean.

#### Correlation Matrix

	VARs	FRQ	BSIZE	BI	BFE	BD	FSIZE
BV		1.0000					
ACQ	0.2341*		1.0000				
EPR	0.0126	0.2086*		1.0000			
EPE	-0.0273	0.3083*	0.2875*		1.0000		
ESM	0.0877	0.1636*	0.1166	0.0886		1.0000	
FSIZE	0.2313*	0.1547*	-0.0754	0.0187	-		1.0000
						0.0060	
		0.0003	0.0164	0.2446	0.7735	0.9264	

Source: STATA Output, 2023

The correlation matrix provides valuable insights into the interrelationships between the variables analyzed in the study. First, the connection between Book Value (BV) and Accrual Quality (ACQ) is weak but positive ( $r = 0.2341$ ). This suggests that as the accuracy of earnings improves and better reflects a firm's actual performance, there is a slight increase in the Book Value. This could be attributed to the broader expertise and perspectives contributed by larger consumer goods companies, which might enhance decision-making processes and oversight.

Conversely, the correlation between Book Value and Earnings Predictability (EPR) is negligible ( $r = 0.0126$ ), indicating a very weak relationship between the two variables. This suggests that the level of Earnings Predictability does not significantly affect the Book Value. The lack of significance in this correlation raises doubts about the influence of predictable earnings on Book Value in the consumer goods companies included in the sample. The relationship between Book Value and Earnings Persistence (EPE) is slightly negative ( $r = -0.0273$ ), while Earnings Smoothness (ESM) shows a weak positive correlation with Book Value ( $r = 0.0877$ ).

Firm Size (FSIZE) also demonstrates a weak positive correlation with Book Value ( $r = 0.2313$ ), indicating that larger firms tend to have a slightly higher Book Value. This could be due to their access to more resources, greater availability of skilled personnel, and the stricter regulatory oversight that larger companies typically face.

### Diagnostic Test

Variables	VIF	Tolerance	
ACQ	1.18	0.847924	
EPR	1.17	0.852492	
EPE	1.13	0.963418	
ESM	1.04	0.965208	
FSIZE	1.04	0.963418	
Mean VIF			1.11
Hetttest Sig			0.0000
Hausman			0.1534
LM Test			0.0000

Source: STATA Output, 2023

### Diagnostic Tests and Model Reliability

The diagnostic procedures conducted in this research offer valuable insights into the credibility and robustness of the regression analysis. The multicollinearity assessment, using the Variance Inflation Factor (VIF), confirms that there is no indication of multicollinearity between the independent variables. All VIF values fall well below the critical threshold of 10, with the mean VIF recorded at 1.11. Additionally, the tolerance levels for all variables exceed 0.1, which further supports the conclusion that there is no significant interdependence among the independent variables. These results indicate that the variables in the regression model are not excessively correlated, which contributes to the stability of the estimated coefficients.

The test for heteroscedasticity, which examines the variation in the error terms, reveals a significant result ( $p < 0.01$ ), indicating the presence of heteroscedasticity within the data. This suggests that the variance of the error terms differs across observations, which may undermine the efficiency of the ordinary least squares (OLS) estimators. To address this concern, it is recommended to use robust standard errors or other methods that are consistent with heteroscedasticity to improve the accuracy of the regression analysis.

The Hausman test, designed to evaluate whether a fixed-effects or random-effects model is more appropriate, shows a p-value of 0.1534. This implies that the random-effects model is more suitable, as the null hypothesis—stating no significant difference



between the fixed-effects and random-effects estimators—cannot be rejected. Therefore, the study adopts the random-effects model due to its efficiency in dealing with unobserved heterogeneity.

Furthermore, the Breusch-Pagan Lagrange Multiplier (LM) test for random effects yields a significant result ( $p < 0.01$ ), confirming that the random-effects model is preferable to the pooled OLS model. This reinforces the need for incorporating firm-specific random effects to account for unobserved variability between firms in the analysis.

## Discussion of Findings

This study examines the influence of various accounting-based earnings quality indicators—accrual quality, earnings persistence, earnings predictability, and earnings smoothness—on the book value of publicly listed consumer goods companies in Nigeria. The findings offer important insights into how these earnings quality factors shape company valuation in Nigeria's economic environment.

The analysis reveals that accrual quality has a significant and positive impact on book value. This suggests that companies with higher accrual quality produce financial reports that are more trustworthy and transparent, which boosts investor confidence and, ultimately, increases firm valuation. Improved accrual quality means that reported earnings are a better reflection of the company's actual financial situation, which reduces the risk of earnings manipulation. This result aligns with prior research, which stresses the importance of accrual quality in enhancing financial reporting reliability and shareholder value.

In contrast, earnings persistence shows a weak and statistically insignificant correlation with book value. While earnings persistence is generally considered an indicator of stable and sustainable financial performance, the results suggest that it does not significantly affect firm valuation for Nigerian consumer goods companies. This could be due to specific industry conditions or external economic factors, such as inflation and exchange rate fluctuations, that may obscure the influence of earnings persistence on company valuation.

The relationship between earnings predictability and book value is also weakly negative and lacks statistical significance. This indicates that the ability of past earnings to predict future earnings does not have a meaningful effect on the book value of the firms in the sample. This weak connection may be attributed to the volatility and unpredictability inherent in Nigeria's consumer goods industry. Furthermore, factors such as managerial discretion and external market dynamics may diminish the predictive power of past earnings in determining firm value.

Earnings smoothness, however, exhibits a weak but statistically significant positive correlation with book value. This implies that companies with smoother earnings are perceived as more stable and less risky, which can enhance their valuation. However, it is important to note that excessive smoothing of earnings may raise concerns about potential manipulation, requiring careful interpretation. While smoother earnings may reflect sound management, it is crucial to have appropriate regulatory oversight to ensure such practices do not compromise financial transparency.

In summary, the findings emphasize the critical role of accrual quality in influencing firm valuation in Nigeria's consumer goods sector. The mixed effects of earnings persistence, predictability, and smoothness suggest that companies should adopt a balanced approach to earnings management, focusing on enhancing transparency, accuracy, and consistency in financial reporting.

## 5. Conclusion

This research explored the effect of earnings quality characteristics on the book value of publicly listed consumer goods firms in Nigeria, using panel data from 2010 to 2019. The results highlight that accrual quality plays a significant role in improving firm

valuation, while earnings persistence and predictability show limited influence. Earnings smoothness has a positive but weak effect on book value. These outcomes hold important implications for regulators, investors, and corporate managers.

For regulators, these results underline the need for strong corporate governance and regulatory frameworks to ensure transparency and minimize the risk of earnings manipulation. Investors can use these insights to assess the quality of financial reporting by firms, allowing them to make more informed investment choices. Corporate managers are encouraged to focus on improving accrual quality and transparent reporting practices to enhance firm valuation and build investor trust.

Overall, earnings quality characteristics are crucial in shaping firm value, especially within Nigeria's consumer goods sector. Ongoing efforts to improve financial reporting standards and strengthen corporate governance will be essential for ensuring sustainable growth and safeguarding shareholder value.

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