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Impact Of Earnings Quality On Firm Value Of Listed Insurance Firms In Nigeria

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ABSTRACT
This study examined the effect of earnings quality on firm value of the listed insurance companies in Nigeria. Ex-post facto research was utilized in this study. A total of 10 insurance companies were selected for the length of the inquiry (2015-2023). This inquiry made use of annual reports and financial statement from Nigerian insurance firms. The obtained data was analyzed using a multiple regression model. In order to show how much diversity of Tobin's Q can be explained by the use of explanatory factors, we employed the R-squared coefficient of determination. The t-Statistic and F-Statistic were used to show how big of an effect the independent variable had on the dependent variable. Regression research indicated that Earnings quality proxies for accrual quality and earnings persistence had a statistically significant impact on Tobin's Q at a 5% level of significance. The research also recommends that the government needs to develop management mechanisms, pressuring businesses to make, present and disclose financial statements in the expression of true and fair value.
Keywords: Earnings Quality, Accrual Quality, Earnings Persistence, Tobin's Q, Insurance Firms

INTRODUCTION

In the dynamic landscape of the global financial markets, the relationship between earnings quality and firm value has emerged as a pivotal area of research, particularly within the context of listed insurance companies in Nigeria. Olatunji and Juwson (2020) disclosed that earnings quality, denoting the reliability and relevance of financial information, is a crucial determinant of an entity's overall financial health and investor confidence. As a cornerstone of economic stability and risk mitigation, the insurance sector demands a meticulous examination of how the quality of earnings influences the valuation of listed companies within this industry.

Understanding the impact of earnings quality on firm value in the context of listed insurance companies necessitates an exploration of the unique factors shaping the insurance industry in Nigeria. The insurance sector plays an indispensable role in mitigating risks and supporting economic growth, making it imperative to scrutinize the reliability of financial information provided by these companies (Latif et al., 2017). Earnings quality, encompassing transparency, accuracy, and sustainability, becomes pivotal in shaping investor perceptions and decisions. As investors increasingly seek stable and trustworthy investment opportunities, the nexus between earnings quality and firm value gains prominence in evaluating listed insurance companies.

Moreover, the regulatory environment in Nigeria significantly influences the operations of listed insurance companies and their financial reporting practices. With regulatory bodies imposing stringent standards to ensure transparency and accountability, the quality of earnings reflects a company's financial health and a measure of its compliance with regulatory requirements (Dang et al., 2018). Examining the

impact of earnings quality on firm value in the Nigerian insurance sector requires an in-depth analysis of how regulatory frameworks shape financial reporting practices, influencing investors' confidence and ultimately impacting the valuation of listed companies.

In essence, this exploration of the relationship between earnings quality and firm value in listed insurance companies in Nigeria aims to contribute valuable insights to both academic and practitioner communities. By unraveling the intricate dynamics at play, this study endeavors to enhance our understanding of the nuances that shape investor perceptions, influence market behavior and ultimately impact the financial landscape of the Nigerian insurance sector.

Statement of Problem

The investigation into the impact of earnings quality on the firm value of listed insurance companies in Nigeria stems from a recognition of the critical role these entities play in the country's economic landscape. Despite their significance, concerns persist regarding the reliability and transparency of financial information provided by these companies. The inadequacy of current studies in comprehensively assessing the intricate relationship between earnings quality and firm value in the Nigerian insurance sector underscores the need for a thorough examination. Ambiguities in financial reporting practices and the potential repercussions on investor confidence raise pertinent questions, necessitating a focused inquiry into how variations in earnings quality affect the valuation of listed insurance companies in Nigeria.

Furthermore, the unique regulatory landscape in Nigeria adds complexity to this issue. The financial reporting requirements set forth by regulatory bodies influence the manner in which insurance companies disclose their earnings, making it imperative to explore the intersection between compliance and earnings quality. Understanding the challenges and opportunities the regulatory framework presents is crucial for discerning the true impact of earnings quality on firm value in the Nigerian context. Consequently, the problem statement seeks to address the gaps in existing literature, specifically delving into the nuanced dynamics of the Nigerian insurance sector, to provide a comprehensive understanding of how earnings quality shapes the valuation of listed insurance companies in this dynamic and evolving market.

Aim and Objectives

The study examined the effect of earnings quality on the firm value of listed insurance companies in Nigeria. Specifically, the study achieved the following:

1) To determine the effect of accrual quality on Tobin's Q of listed insurance companies in Nigeria.
2) To determine the effect of earnings persistence on Tobin's Q of listed insurance companies in Nigeria.

Research Questions

The following research questions were formulated to guide the study:

1) What is the relationship between accrual quality and Tobin's Q of listed insurance companies in Nigeria?
2) What is the relationship between earnings persistence and Tobin's Q of listed insurance companies in Nigeria?

Hypotheses

The following hypotheses were formulated and tested at a 0.05 level of significance:

H01: There is no significant relationship between accrual quality and Tobin's Q of listed insurance companies in Nigeria.

H02: There is no significant relationship between earnings persistence and Tobin's Q of listed insurance companies in Nigeria.

LITERATURE REVIEW

Conceptual Review

Earnings Quality

Earnings quality is a multifaceted concept that serves as a key indicator of the reliability and relevance of financial information presented by a company. At its core, earnings quality encompasses the degree to

which reported earnings accurately reflect the underlying economic reality of a firm's operation (Succahi, 2016). High earnings quality implies that reported figures are a faithful representation of the company's financial health, providing stakeholders with trustworthy information for decision-making. This includes aspects such as transparency, accuracy, and sustainability of earnings, all of which contribute to the overall credibility of a company's financial reporting.

An essential component of earnings quality is the ability of reported earnings to persist over time. Sustainable earnings are indicative of a company's capacity to generate consistent profits, reducing the likelihood of financial manipulations or short-term fluctuations that might mislead investors. Moreover, earnings quality is closely linked to adherence to accounting standards and ethical financial practices, reflecting a company's commitment to transparency and integrity.

Accrual Quality

Within the broader context of earnings quality, accruals quality refers to the degree to which a company's reported accruals accurately capture economic events and reflect the underlying financial reality of its operations. Nguyen et al., (2019) reported that accruals represent the accounting adjustments made to recognize revenue or expenses before the associated cash transactions occur, and their quality is crucial in evaluating the reliability of financial statements. High accruals quality suggests that the reported figures align closely with the economic substance of transactions, providing a more accurate depiction of a company's financial performance. On the contrary, low accruals quality may signal potential manipulation or aggressive accounting practices, raising concerns about the credibility of the reported earnings.

Assessing accruals quality involves scrutinizing how accruals effectively capture economic events and are free from bias or managerial discretion. A focus on the precision and conservatism of accrual estimates is essential, as conservative accounting practices tend to lead to higher accrual quality by minimizing the potential for overstatement of earnings. Accrual quality is integral to understanding the transparency and reliability of a company's financial reporting. It is a valuable metric in gauging the overall quality of earnings and aiding stakeholders in making well-informed decisions about a company's economic health and prospects.

Earnings Persistence

Earnings persistence, within the conceptual realm of earnings quality, refers to the ability of a company's reported earnings to continue over subsequent periods. It is a crucial metric in assessing the sustainability and reliability of a firm's financial performance. A company with high earnings persistence demonstrates consistency in its profitability, indicating that reported earnings are not merely a result of short-term fluctuations or one-time events (Kodongo et al. 2015). Persistent earnings are reflective of a company's underlying operational strength, providing stakeholders with confidence in the long-term viability and financial health of the organization. On the contrary, low earnings persistence may signal volatility in earnings, potentially stemming from irregularities or non-recurring factors, diminishing the quality of reported financial information.

Earnings persistence is closely tied to accruals and the recognition of revenue and expenses in financial statements. Companies with transparent and reliable accounting practices tend to exhibit higher earnings persistence, as their reported figures accurately capture the economic substance of transactions over time. Investors and analysts often consider earnings persistence as a critical factor in assessing the quality of earnings, as it offers insights into the sustainability of a company's financial success and its ability to weather changing economic conditions (Dang et al, 2019). In essence, earnings persistence is a critical measure within the broader construct of earnings quality, influencing perceptions about a company's stability and the reliability of its reported financial results.

Firm Value

Firm value, a fundamental concept in finance, represents the total worth of a company in the eyes of its investors and stakeholders. Also referred to as market capitalization, it is determined by multiplying the company's stock price by the total number of outstanding shares. Firm value encapsulates the aggregate expectations and assessments of the market regarding a company's future profitability, growth prospects, and risk factors (Dang et al, 2019). It is a dynamic and multifaceted metric influenced by various internal

and external factors, including financial performance, management efficiency, industry trends, and broader economic conditions. Understanding firm value is paramount for investors and analysts as it provides a snapshot of the market's perception of a company's intrinsic worth and future potential.

The concept of firm value extends beyond the stock market and is integral to corporate finance decisions. Managers strive to maximize firm value by making strategic choices that enhance profitability, efficiency, and competitiveness (Nguyen et al., 2019). This involves optimizing the capital structure, making prudent investment decisions, and effectively managing operational aspects to align with shareholder interests. Firm value is a measure of a company's current standing and reflects its expected future cash flows and risk profile. Thus, comprehending the determinants of firm value is essential for investors seeking optimal returns and corporate decision-makers aiming to enhance the overall wealth of their organizations.

Tobin's Q

Tobin's Q is a widely-used financial metric that measures firm value and is named after economist James Tobin. This metric compares the market value of a company's assets to their replacement cost (Nguyen et al., 2019). Tobin's Q is calculated by dividing the market value of a company (the market capitalization of its outstanding shares) by the replacement cost of its assets, which is the cost of acquiring or reproducing those assets. A Q value greater than 1 suggests that the market values the company's assets more than their replacement cost, indicating that the firm has created value. Conversely, a Q value less than 1 implies that the market values the company's assets less than their replacement cost, suggesting potential undervaluation or inefficiency.

Tobin's Q is particularly insightful regarding investment and capital allocation decisions. When Q is high, it may signal that the firm's investments and assets generate substantial value, encouraging potential investors and indicating that the company is using its resources efficiently. Conversely, a low Q may suggest that the market questions the value generated by the firm's investments, prompting further investigation into the company's strategies and operations. This metric provides investors, analysts, and corporate decision-makers a valuable tool. It offers insights into the market's perception of a company's asset utilization and its potential impact on overall firm value.

Theoretical Review

Agency Theory

Agency theory offers a valuable lens through which to understand the impact of earnings quality on the firm value of listed insurance companies in Nigeria. In the agency relationship between shareholders and management, the quality of earnings becomes a critical mechanism for aligning the interests of these two parties. High earnings quality signals transparent and reliable financial reporting, reducing information asymmetry between shareholders and managers. In the context of Nigerian insurance companies, where agency conflicts may arise due to complex operational structures and diverse stakeholder interests, earnings quality becomes pivotal. Shareholders rely on reported earnings to assess the company's financial health and make informed investment decisions. If earnings quality is high, it fosters trust and confidence among shareholders, potentially mitigating agency conflicts and positively influencing the firm value.

Furthermore, agency theory suggests that managers may have incentives to engage in opportunistic behavior or earnings management to meet certain targets or personal objectives. In the case of listed insurance companies in Nigeria, where regulatory oversight and adherence to industry standards are paramount, the quality of earnings serves as a safeguard against managerial opportunism. Transparent and reliable financial reporting, indicative of high earnings quality, enhances the credibility of managers' actions, fostering a more effective alignment of interests between shareholders and executives. As a result, agency theory provides a conceptual framework for understanding how earnings quality acts as a tool for mitigating agency conflicts, influencing the valuation of listed insurance companies, and shaping the overall corporate governance landscape in the Nigerian insurance sector.

Stewardship Theory

Stewardship theory provides a unique perspective on the impact of earnings quality on the firm value of listed insurance companies in Nigeria by emphasizing the role of management as responsible stewards of shareholder resources. In the context of stewardship, high earnings quality becomes a crucial indicator of the managerial commitment to transparency, accountability, and the prudent use of company resources. Quality earnings, characterized by accurate financial reporting and a faithful representation of the company's economic performance, serve as a testament to the stewardship qualities of the management. For listed insurance companies in Nigeria, where the industry's stability and public trust are paramount, a stewardship approach underscores the importance of earnings quality in ensuring that management acts in the best interests of shareholders and the broader stakeholder community.

Stewardship theory posits that managers, acting as stewards, are motivated to maximize the firm's long-term value, aligning their interests with those of shareholders. In the Nigerian insurance sector, where regulatory compliance and ethical business practices are vital, high earnings quality reinforces the notion of effective stewardship. Reliable financial reporting builds investor confidence, enhances the company's reputation, and contributes to the overall stewardship narrative. Consequently, stewardship theory provides a conceptual framework for understanding how management's commitment to quality earnings can positively impact the firm value of listed insurance companies in Nigeria, fostering a sense of trust and confidence among stakeholders and contributing to the sustainable growth of the insurance industry.

Empirical Review

Fajuyagbe (2023) examined the effect of earnings quality on the firm value of Nigerian firms that manufacture consumer products using static and dynamic models. Earnings quality was proxied by an accrual-based score, and firm value was proxied by the ratio of share price to book value. From 2012 to 2021, data from the annual reports of a selection of consumer goods manufacturers listed on the Nigerian Group of Exchanges was used as a secondary source of information. This investigation uses panel data regression and panel vector autoregressive as estimation methods. According to the static model, earnings quality has a positive but insignificant effect on the value of a company. In addition, the results of the Granger causality test demonstrated that earnings quality cannot be used to predict future firm value and that earnings quality has a negative and insignificant influence on firm value in the short term. Thus, it was determined that earnings quality does not affect the firm's long-term or short-term value. The study concluded that earnings quality does not significantly affect the firm value of Nigerian companies that manufacture consumer products. In light of this, the study recommends that the management of companies that manufacture consumer products use an accrual-based score as a measure of earnings quality for informative earnings management, which will increase firm value.

Latif, et al., (2017) investigated the impact of earnings quality on Pakistani firm value. Using panel data of 214 non-financial listed firms in Pakistan from 2003 to 2014 and a one-way random effect estimator for the SUR system, it was determined that corporate governance effectively improves the earnings quality and firm value, which validates the monitoring role. The conclusion is that corporate governance not only increases the firm's value directly, but also indirectly through the earnings quality channel. Olatunji and Juwon (2020) examined the relationship between accrual-based earnings, real-based earnings management, and the firm value of Nigerian manufacturing firms that are publicly traded. The study utilized descriptive, panel least square regression techniques, such as pooled, fixed, and random effect, in conjunction with a number of diagnostic evaluation techniques. The result indicated that accrual-based earnings management, as measured by abnormal discretionary accrual earnings (ADA), was positively associated with the firm's value reflected by the return on equity (ROE) of the publicly traded manufacturing companies and increased it by 38.31%. Individually selected publicly traded manufacturing companies revealed accrual-based earnings management documented by the study, which concluded that earnings management is advantageous to the manipulator of accounts. It can be emphasized that the simplicity of detecting accrual earnings management can help investors determine whether a company is a good investment.

METHODOLOGY

Ex-post facto research design was used in the study's conduct. Observers cannot directly influence independent variables in ex-post facto studies because their manifestations have already happened or they are fundamentally unmodifiable. Due to the nature of this research, there is no manipulation of factors. Twenty-nine (29) of Nigeria's listed insurance firms are included in this study's population. The probability sampling approach was chosen since it does not leave the researcher with any choice. The sample size was determined using a random sampling method. Due to a lack of data, the research only looks at ten (10) insurance providers. AIICO Insurance Nigeria Plc, Consolidated Hallmark Insurance, Custodian & Allied insurance company Nigeria, Gold Link Assurance Company Plc, Intercontinental Wapic Insurance Nigeria, Niger Insurance Company Plc, Universal Insurance Company, and Lasaco Assurance Company are some of the companies that fall under this category. The research was based on panel data from insurance firms' public financial statements from 2015 through 2020.

With the help of E-View version 9, Pearson correlation and simple regression were used to examine the connection between the variables in this study's data.

Model of Specification

FV = f (EQ)

$TBQit = \beta_0 + \beta_1 AQ_{it} + \beta_2 EP_{it} + \varepsilon t$

Where:

FV = Firm Value,

EQ = Earnings Quality

TBQ= Tobin's Q = Net Income/Average Asset

Accrual Quality= The absolute value of the residuals from the equation, multiplied by (-1): $ACCit = \alpha + \beta 1(REVit - ARit) + \beta 2PPEit + \varepsilon it$

Earning Persistence= The level of explanation R2 of the equation: $EARNit = \alpha + \beta EARNit\text{-}1 + \varepsilon it$

i = company,

t = time (year),

ε = error term

Statistical analysis that was used for the research. Both descriptive and regression analysis was utilized in the study. Descriptive statistics was computed using E-views which amongst other things help show the pattern, distribution, deviation and nature of the data.

For the regression analysis, Ordinary Least Square (OLS) Regression using E-view Software Package was used to analyze the test the hypotheses.

RESULTS AND ANALYSIS

Table 4.1.1: Descriptive statistics of focused variable

	TBQ	AQ	EP
Mean	4748.654	0.207549	0.355364
Median	19.80135	0.150888	0.274364
Maximum	198976.0	0.522794	0.854730
Minimum	18.63510	0.010750	0.096356
Std. Dev.	30462.65	0.169566	0.256483
Skewness	1.246979	0.763445	0.826862
Kurtosis	2.02488	2.350436	2.259361
Jarque-Bera	5344.292	9.636638	11.49173
Probability	0.000000	0.008080	0.003196
Sum	398886.9	17.43408	29.85060
Sum Sq. Dev.	7.70E+10	2.386481	5.460013
Observations	84	84	84

Source: E-View Output (2024)

Table 4.1.1 illustrates vividly the descriptive statistics of the primary variables in the study. It shows the total number of observations, mean, median, maximum, minimum, standard deviation, kurtosis, and skewness. The dependent variable firm value had mean value of 4748.654 and the standard deviation value of 30462.65. It was revealed also, that all the variables have positive average values (means). The Accrual quality (AQ) and Earning Persistence (EP) had mean values of 0.207549 and 0.355 respectively. The independent variables also show signs of positive skewness.

4.2 Results of Diagnostic Statistics

4.2.1 Test for Normality

The normality of the distribution of the data series is shown by the coefficients of Skewness and Kurtosis coefficients. The skewness coefficients which is less than or around figure one in all the variables under study. The kurtosis coefficient also provides a second level of confirmation that all the explanatory variables are normally distributed with a Kurtosis coefficient that is less than or around three.

4.3 Correlation Matrix

Table 2: Correlation Matrix of the focal variables

	TBQ	AQ	EP
TBQ	1		
AQ	0.19875	1	
EP	0.00220	0.02606	1

E-views Output (2024)

The correlation matrix is to check for multi-collinearity and to explore the association between each explanatory variable and the dependent variable. The table shows that TBQ has positive association with AQ and EP. In checking for multi-collinearity, the study observed that no three explanatory variables were perfectly correlated.

4.4 TestingHypotheses

H01: There is no significant relationship between accrual quality and Tobin's Q of listed insurance companies in Nigeria.

Table 3: Regression Analysis on accrual quality and Tobin's Q of listed insurance companies in Nigeria

Dependent Variable: TBQ
Method: Panel Least Squares
Date: 02/12/24 Time: 21:37
Sample: 2015 2023
Periods included: 9
Cross-sections included: 10
Total panel (unbalanced) observations: 84

Variable	Coefficient	Std. Error	t-Statistic
AQ	27977.56	12202.70	2.292735

R-squared	0.364303	Mean dependent var	
Adjusted R-squared	0.036433	S.D. dependent var	
S.E. of regression	29902.58	Akaike info criterion	
Sum squared resid	7.42E+10	Schwarz criterion	
Log likelihood	-984.3667	Hannan-Quinn criter.	
Durbin-Watson stat	1.819359		

Source: E-Views Output (2024)

The result of the regression analysis shown in Table 3 revealed that Accrual Quality had a positive effect on of Tobin's Q listed insurance companies in Nigeria. This is indicated by the signs of the coefficients, that is β_1, which is 27977.56. The coefficient of the independent variable is positive that is, a unit increase

in AQ by 1% would cause 27977.56 increase in TBQ when all other factors are kept constant. The overall coefficient of determination of Adjusted R-squared which is the explanatory power of the model is 0.364303; this implies that within the model context AQ is responsible for 36.4% variation in TBQ. The tables also revealed that the p-values for AQ is 0.002 which is less than 0.05 hence $H0_1$, is rejected. Therefore, there is a significant relationship between accrual quality and Tobin's Q of listed insurance companies in Nigeria.

H02: There is no significant relationship between earnings persistence and Tobin's Q of listed insurance companies in Nigeria.

Table 4: Regression Analysis on earnings persistence and Tobin's Q of listed insurance companies in Nigeria

Dependent Variable: TBQ
Method: Panel Least Squares
Date: 02/12/24 Time: 21:38
Sample: 2015 2023
Periods included: 9
Cross-sections included: 10
Total panel (unbalanced) observations: 85

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EP	8662.851	7479.559	2.58203	0.0001

R-squared	0.519800	Mean dependent var	4693.007
Adjusted R-squared	0.819800	S.D. dependent var	30285.13
S.E. of regression	30409.02	Akaike info criterion	23.49456
Sum squared resid	7.77E+10	Schwarz criterion	23.52330
Log likelihood	-997.5189	Hannan-Quinn criter.	23.50612
Durbin-Watson stat	1.771721		

Source: E-Views Output (2024)

The result of the regression analysis shown in Table 4 revealed that earnings persistence had a positive effect on of Tobin's Q listed insurance companies in Nigeria. This is indicated by the signs of the coefficients, that is β_1, which is 8662.851. The coefficient of the independent variable is positive that is, a unit increase in EP by 1% would cause 8662.851 increase in TBQ when all other factors are kept constant. The overall coefficient of determination of Adjusted R-squared which is the explanatory power of the model is 0.519800; this implies that within the model context EP is responsible for 51.9% variation in TBQ. The tables also revealed that the p-values for EP is 0.0001 which is less than 0.05 hence $H0_2$, is rejected. Therefore, there is a significant relationship between earnings persistence and Tobin's Q of listed insurance companies in Nigeria.

DISCUSSION OF FINDINGS

The effect of accrual quality on Tobin's Q of listed insurance companies in Nigeria

The study revealed that a unit increase in AQ by 1% would cause 27977.56 increase in TBQ when all other factors are kept constant. The revealed that within the model context AQ is responsible for 36.8% variation in TBQ. Also, the result revealed that there is a significant relationship between accrual quality and Tobin's Q of listed insurance companies in Nigeria. This supports Latif, et al., (2017) who investigated the impact of earnings quality on Pakistani firm value and reported that improved earnings quality had a significant impact on firm value. Also, the study supports Fajuyagbe (2023)whoexamined the effect of earnings quality on the firm value of Nigerian firms that manufacture consumer products using static and dynamic models and reported that accrual quality does not affect the firm's long-term or short-term value.

The effect of earnings persistence on Tobin's Q of listed insurance companies in Nigeria

The study revealed that a unit increase in EP by 1% would cause 8662.851 increase in TBQ when all other factors are kept constant. The revealed that within the model context AQ is responsible for 51.9% variation in TBQ. Also, the result revealed that there is a significant relationship between **earnings persistence** and Tobin's Q of listed insurance companies in Nigeria. This supports Olatunji and Juwon (2020) who examined the relationship between accrual-based earnings, real-based earnings management, and the firm value of Nigerian manufacturing firms that are publicly traded. And reported that abnormal discretionary accrual earnings (ADA), was positively associated with the firm's value reflected by the return on equity (ROE) of the publicly traded manufacturing companies and increased it by 38.31%.

CONCLUSION

Understanding the impact of earnings quality on firm value in the context of listed insurance companies necessitates an exploration of the unique factors shaping the insurance industry in Nigeria. The insurance sector plays an indispensable role in mitigating risks and supporting economic growth, making it imperative to scrutinize the reliability of financial information provided by these companies. The study has established that there is a significant relationship between earnings quality (measured as accrual quality and earnings persistence) and Tobin's Q of listed insurance companies in Nigeria.

RECOMMENDATIONS

Based on the findings and conclusion drawn, the following recommendations were made:

i. The government needs to develop management mechanisms, pressuring businesses to make, present and disclose financial statements in the expression of true and fair value. The processes should be strictly controlled, have sanctions against firms that violate and protect the rights of investors.

ii. Firms should be aware of the importance of having their financial statements by preparing, issuing reliable financial statements. By doing this will help investors be aware of which firms develop well through the aspects of EQ to firm value, there will be appropriate investment direction to avoid risks and firms will reduce the cost of capital.

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