



Received: 18-02-2025
Accepted: 28-03-2025

ISSN: 2583-049X

The Impact of Earnings Quality on the Financial Performance of Listed Companies on the Vietnam Stock Market

Nguyen Khanh Ly

Research Project Leader, Hanoi University of Natural Resources and Environment, Vietnam

Corresponding Author: **Nguyen Khanh Ly**

Abstract

This study examines the impact of earnings quality (EQ) on the financial performance of listed companies on the Vietnamese stock market, considering the moderating effects of firm growth (Growth) and firm size (Size). Using data from non-financial firms and applying the Feasible Generalized Least Squares (FGLS) regression model, the research provides empirical evidence on how earnings quality, growth, and firm size influence financial performance, measured by return on assets (ROA). Contrary to expectations, the results indicate that earnings quality has a negative and statistically significant impact on ROA, suggesting that firms with high-quality earnings may adopt conservative accounting policies, which enhance transparency but potentially limit short-term profitability.

Meanwhile, growth and firm size positively affect financial performance, implying that high-growth firms benefit from market expansion and economies of scale, while larger firms leverage their financial capacity and governance structures to improve efficiency. These findings highlight that while growth and firm size contribute positively to financial performance, earnings quality may reflect prudent financial strategies rather than acting as a direct driver of profitability. The study offers important policy implications, recommending that firms balance earnings quality and accounting conservatism, implement sustainable growth strategies, and enhance financial transparency to optimize long-term financial performance.

Keywords: Earnings Quality, Financial Performance, Firm Growth, Firm Size, ROA

1. Introduction

In the modern economy, financial performance is one of the key factors reflecting a company's success and sustainable development potential. Investors, managers, and stakeholders often use profitability indicators and financial reports to assess a company's operational efficiency. However, the reliability of financial information can be affected by earnings quality (EQ), especially in the context where companies may engage in earnings management to manipulate financial results to meet market expectations or personal interests. Therefore, studying the impact of earnings quality on financial performance is an important topic, particularly for listed companies in the stock market, where transparency and accuracy of financial information play a crucial role.

In Vietnam, the stock market is rapidly developing, attracting interest from both domestic and international investors. However, in reality, many listed companies still face earnings management issues, making financial reports potentially inaccurate in reflecting actual business performance. This raises questions about the relationship between earnings quality and financial performance, as well as other factors such as growth rate and firm size, which may influence this relationship.

Previous studies have shown that earnings quality can significantly affect investment decisions and firm value (Dechow *et al.*, 1995; Francis *et al.*, 2004) ^[1, 2]. Some research suggests that high earnings quality provides investors with more accurate information, thereby improving financial performance (Penman & Zhang, 2002) ^[5]. However, other studies argue that companies with high earnings quality often adopt conservative accounting policies, leading to lower reported earnings, which negatively impacts financial performance in the short term (Bhattacharya *et al.*, 2003) ^[6]. This indicates that there is no consensus on the impact of earnings quality on financial performance, particularly in emerging economies like Vietnam.

Additionally, this study examines two other important factors that may affect financial performance: firm growth (Growth) and firm size (Size). Companies with high growth rates are expected to achieve better financial performance due to business expansion and economies of scale. However, rapid growth can also be accompanied by higher risks, especially when companies adopt earnings management strategies to maintain their growth rates (Rountree *et al.*, 2008)^[8]. Similarly, firm size plays a crucial role, as larger companies often have better internal control systems, easier access to capital, and stricter regulatory oversight, enabling them to achieve better financial performance (Jensen & Meckling, 1976)^[9].

Given this context, this study is conducted to further analyze the impact of earnings quality on the financial performance of listed companies on the Vietnam stock market. By integrating three factors—earnings quality, firm growth, and firm size—the research aims to provide empirical evidence, clarify the impact of each factor, and support businesses, investors, and regulators in optimizing financial strategies and ensuring transparency in financial reporting.

2. Literature review

Research on earnings quality (EQ) and its impact on firm value has garnered significant academic attention, with various approaches used to assess the role of EQ in reducing information asymmetry and enhancing market efficiency. Early studies, such as those by Dechow *et al.*, focused on developing models to detect earnings management, demonstrating that high EQ improves the accuracy of earnings forecasts and increases the reliability of financial information. Building on this approach, Francis *et al.* expanded their research by examining EQ from the perspective of its impact on the cost of capital, finding that firms with high EQ typically have lower capital costs and higher firm value. However, this study primarily focused on financial relationships without considering accounting and corporate governance factors.

To address this limitation, Sloan delved into the accounting structure, highlighting that discrepancies between cash flows and accounting earnings can distort information about a firm's true value. This study is particularly important in clarifying how accounting earnings are influenced by management decisions, which, in turn, affect investor behavior. Following this approach, Penman and Zhang emphasized the role of accounting policies in EQ, arguing that conservatism in accounting helps sustain earnings quality, thereby increasing investor confidence in financial statements. However, their study did not examine the impact of corporate governance factors on EQ, an aspect later addressed by Richardson *et al.* by analyzing the role of financial transparency and accountability. Richardson *et al.* found that firms with strong governance mechanisms tend to have higher EQ, reducing the negative effects of earnings management and increasing firm value.

Research on earnings quality (EQ) and firm value in the context of Vietnam has also attracted academic interest, with several notable studies shedding light on the relationship between EQ and financial performance. A study by Nguyen Thi Ngoc Trang and Bui Kim Phuong (2018)^[11] applied the accrual quality model of Dechow and Dichev (2002) to measure EQ among firms listed on the Ho Chi Minh City and Hanoi Stock Exchanges from 2010 to 2015. This study examined factors affecting EQ, including operational

efficiency, growth, firm size, maturity level, financial leverage, and capital intensity. The results showed that firm age, financial leverage, and capital intensity positively influenced EQ, whereas revenue growth had an inverse effect. However, the study found no significant impact of operational efficiency and firm size on EQ.

In another study, Dao Nam Giang (2017) analyzed the earnings quality of Vietnamese firms using a multidimensional approach, including earnings persistence, predictability, and transparency in financial reporting. This study provided a highly applicable model for measuring EQ, identifying influencing factors, and assessing the impact of EQ on firm value. The findings indicated that high EQ enhances investor confidence and increases firm value. However, the study also pointed out that Vietnam's accounting system and corporate governance framework still have limitations, affecting the quality of financial information.

Additionally, Nguyen Thi Phuong Hong (2017)^[13] proposed 11 models for detecting earnings management practices, with the modified Jones model by DeFond and Jiambalvo (1994) being the most commonly used. This study focused on applying models to detect and measure EQ while examining the impact of factors such as operational efficiency, growth, firm size, financial leverage, and capital intensity on EQ. The results indicated that these factors significantly influenced corporate EQ. However, the study also emphasized that since the listing history of Vietnamese companies is relatively short, applying these models requires adjustments to fit the specific market context.

Although there is consensus on the critical role of EQ, variations in measurement methods and research scope remain. While some studies focus on financial aspects such as capital costs and stock performance, others emphasize accounting and governance factors. This suggests that EQ is a multidimensional concept influenced by various factors. Therefore, in the context of an emerging market like Vietnam, where the accounting system and governance framework are still developing, research on EQ and its impact on firm value will provide a more comprehensive perspective, contributing to improved financial transparency and sustainable capital market development.

3. Theory and Hypotheses

3.1 Theory

Asymmetric Information Theory

The asymmetric information theory suggests that corporate managers have an advantage in accessing internal information that external investors do not possess, creating a discrepancy in evaluating the financial status of a company. When earnings quality (EQ) is high, financial statements accurately reflect business performance, reducing risks for investors and enhancing financial efficiency. Conversely, when EQ is low, financial information may be distorted due to earnings management practices, making it difficult for investors to assess the true value of a company, increasing capital costs, and negatively affecting financial performance. In this scenario, firms with high EQ tend to have an advantage in financial performance by minimizing information costs and increasing shareholder confidence. Accordingly, high EQ ensures transparency in financial information, reduces information risk for investors, and enhances the efficiency of asset utilization within the company. When earnings are accurately reported, businesses

can optimize investment decisions and improve return on assets.

Agency Theory

The agency theory, developed by Jensen & Meckling (1976) [9], describes the conflict of interest between managers (agents) and shareholders (principals). When managers do not own the entire company, they have incentives to maximize their personal benefits rather than those of the shareholders, which may lead to earnings management practices to increase personal income or create an illusion of financial performance. Low earnings quality is often associated with a high degree of earnings management, reducing the actual financial efficiency of a company. Conversely, high earnings quality helps mitigate agency problems by ensuring financial transparency, thereby improving financial performance. Additionally, firm size and growth rate may also impact financial performance, as larger firms tend to have better monitoring mechanisms, while rapidly growing firms may face pressure to manipulate earnings.

3.2 Hypotheses

Based on the aforementioned analysis, the author formulates the following research hypotheses:

- H1:** High earnings quality exerts a positive influence on financial performance, as measured by return on assets (ROA).
- H2:** Firm growth positively affects financial performance.
- H3:** Firm size has a positive impact on financial performance.

4. Data and methodology

4.1 Data

Research subject: The impact of earning quality on corporate performance in non-financial enterprises.

Research scope: Data is sourced from Fiiin Group JSC.

In terms of geography: non-financial companies listed on the Vietnamese stock market are identified, excluding financial companies such as insurance, securities, and banks. These entities are considered to have their own corporate governance rules and financial reporting standards, which may affect the research results (Davidson, Goodwin-Stewart, & Kent, 2005) [10].

The linear regression model is employed to examine the impact of earnings quality on the dependent variables. A general model can be expressed as follows:

$$Y = \beta_0 + \beta_1EQ_{it} + \beta_2Size_{it} + \beta_3Growth_{it} + \epsilon_{it}$$

Y: The dependent variable, representing financial performance, measured by return on assets (ROA).

EQ: The independent variable, representing earnings quality, measured using accrual-based earnings quality.

Size: Firm size, measured as the natural logarithm of total assets.

Growth: Revenue growth, indicating the expansion rate of a firm's sales over time.

5. Results and discussion

5.1 Examining the research model

Statistical data on the factors in the research model are as follows:

Table 1: Descriptive statistics of variables

Variable	Obs	Mean	Std. dev.	Min	Max
stt	45	3	1.430194	1	5
nam	3,779	2019.001	2.581852	2015	2023
roa	3,779	.0578953	.0783663	-.6246	.7219
roe	3,779	.113948	.1867082	-3.2938	5.2319
eq	3,779	.4248369	.2573825	0	1.294471
size	3,779	10.77916	3.867933	0	14.76148
growth	3,779	.2058817	2.718804	-116.4356	55.05934
mack_num	3,779	210.4559	121.2447	1	420
san_num	3,779	1.733263	.4423124	1	2
linhvuc_num	3,779	10.14528	4.577584	1	17

The correlation between variables is shown in Table 2. This table shows that the correlation coefficient between the independent variables in the model has no pair greater than 0.5. Therefore, there is little possibility of multicollinearity among the independent variables in the model.

Table 2: Correlation coefficient matrix

	roa	eq	size	growth
roa	1.0000			
eq	-0.1031	1.0000		
size	0.2394	0.6234	1.0000	
growth	0.0410	0.0192	0.0249	1.0000

The study examines the multicollinearity of variables in the research model based on the acceptable threshold of the variable (Tolerance) and the VIF coefficient. The results of the regression analysis show that the variance exaggeration factor VIF is less than 5, so it is possible to reject the hypothesis that the model has multicollinearity (Table 4).

Table 3: Multicollinearity test result

Variable	VIF	1/VIF
size	1.64	0.611205
eq	1.64	0.611359
growth	1.00	0.999357
Mean VIF	1.42	

The study tests to choose an appropriate regression model between OLS and FEM by employing the F test and the Hausman test before analyzing factors affecting the

truthfulness of financial reporting. As a result, the FEM model was selected for further tests. The results are shown in Table 5.

Tables 4: F test and Hausman test results

Overall model	Inspection results	Conclusion
Step 1: Comparison between OLS and FEM	F(5, 146) = 5.54 Prob > F = 0.0001	OLS model selection
Step 2: Comparison between OLS and REM	chibar2(01) = 8.93 Prob > chibar2 = 0.0014	REM model selection

Table 5: Results of testing the autocorrelation and variance of variance

Overall model	Inspection results	Conclusion
Verification of variance	chi2 (420) = 4.4e+05 Prob>chi2 = 0.0000	There is a phenomenon that the variance of the error changes
Test for the phenomenon of series correlation	F(1, 419) = 47.220 Prob > F = 0.0000	There is a phenomenon of series correlation

The selected REM model appears to have defects of the research model, such as the variance of the error change and series correlation. Thus, the study uses the feasible general least squares method – (FGLS) to solve the above defects to ensure the obtained estimate is stable and efficient.

5.2. Testing hypotheses

The researcher performed feasible generalized least squares (FGLS) for the overall model, with the results shown in Table 6.

Table 6

Estimated covariances =	420	Number of obs =	3,778		
Estimated autocorrelations =	1	Number of groups =	420		
Estimated coefficients =	4	Obs per group:			
		min =	8		
		avg =	8.995238		
		max =	9		
		Wald chi2(3) =	2759.44		
		Prob > chi2 =	0.0000		
roa	Coefficient	Std. err.	z	P> z	[95% conf. interval]
eq	-.0794772	.0033976	-23.39	0.000	-.0861363 -.0728181
size	.0079718	.0001844	43.22	0.000	.0076103 .0083332
growth	.0014535	.0002238	6.49	0.000	.0010149 .0018922
_cons	-.0024327	.0012149	-2.00	0.045	-.0048139 -.0000516

As can be seen in Table 7, The hypotheses H1, H3, are accepted, while hypotheses H2 are rejected. The results of the testing hypotheses are summarized in Table 9.

Table 7: The impact direction of factors

S. No	Variables	Expected	Results
1	EQ	+	-
2	Size	+	+
3	Growth	+	+

Based on the FGLS regression results, this study provides deeper insights into the impact of earnings quality (EQ), firm growth (Growth), and firm size (Size) on financial performance, measured by return on assets (ROA). According to Hypothesis H1, EQ was expected to have a positive impact on financial performance. However, the regression coefficient for EQ is -0.0795 with a p-value of 0.000, indicating a statistically significant negative effect.

This finding suggests that firms with high earnings quality may adopt conservative accounting policies, which could limit short-term profit optimization and consequently negatively impact ROA.

Regarding Hypothesis H2, the regression coefficient for Growth is 0.0015 with a p-value of 0.000, confirming a positive and statistically significant impact on ROA. This result aligns with expectations, as high-growth firms typically have greater opportunities to increase profitability and optimize financial performance.

Finally, Hypothesis H3 on the effect of firm size (Size) is also supported, with a regression coefficient of 0.00797 and a p-value of 0.000, indicating that larger firms benefit from superior financial resources and better access to capital, thereby achieving higher financial performance.

These findings underscore that while growth and firm size can enhance financial performance, earnings quality may reflect a more conservative accounting strategy rather than serving as a direct driver of ROA.

6. Conclusion and policy implication

6.1 Conclusion

The research findings provide significant insights into the relationship between earnings quality, firm growth, firm size, and financial performance. One of the key findings is that earnings quality negatively affects financial performance, contrary to initial expectations. The negative and statistically significant regression coefficient suggests that firms with high earnings quality often adopt conservative accounting policies, ensuring financial transparency but potentially reducing short-term profitability. This indicates that earnings quality is not necessarily a direct driver of ROA but may instead reflect risk management strategies and the financial transparency of a firm.

In contrast, firm growth positively influences financial performance, suggesting that companies with higher growth rates tend to achieve better financial outcomes. This may be attributed to the ability of high-growth firms to leverage economies of scale, expand their market presence, and increase revenue, thereby improving operational efficiency. However, the study also highlights that excessive growth may be associated with earnings management risks, necessitating a balance between growth and financial sustainability.

Furthermore, firm size exhibits a positive impact on ROA, aligning with theoretical expectations. Larger firms typically possess stronger financial capacity, easier access to capital, and more effective internal control mechanisms, which contribute to enhanced financial performance. These findings underscore the critical role of firm size in ensuring long-term financial efficiency.

6.2 Policy Implications

Based on the research findings, several key policy implications can be proposed to enhance corporate financial performance and ensure sustainable development:

First, improving earnings quality while maintaining a balanced accounting strategy. Although high earnings quality enhances transparency and mitigates financial risks, firms must ensure that accounting policies are not excessively conservative to the extent that they hinder capital mobilization and value creation from earnings. Regulatory bodies should establish more flexible accounting

standards that encourage financial transparency while still fostering corporate growth.

Second, promoting sustainable growth strategies. Since firm growth has a positive impact on financial performance, businesses should focus on well-planned expansion strategies, leveraging market opportunities without pursuing excessive growth. In particular, firms should implement financial risk management systems and earnings management controls to ensure that growth does not lead to financial statement manipulation.

Third, leveraging the advantages of firm size. Large firms should continue to capitalize on their financial resources, capital mobilization capabilities, and professional management expertise to enhance financial performance. For small and medium-sized enterprises (SMEs), government policies and financial institutions should provide greater support to facilitate access to capital, improve corporate governance systems, and enhance market competitiveness.

Fourth, strengthening financial oversight and transparency mechanisms. Regulatory agencies and investors should reinforce financial reporting controls and corporate governance monitoring, particularly for high-growth firms. The adoption of International Financial Reporting Standards (IFRS) and stricter independent audit practices can help minimize the negative effects of earnings management while improving investor confidence in the market.

7. Acknowledgments

This paper was conducted with the research support of the project "The Impact of Earnings Quality on the Financial Performance of Listed Companies on the Vietnam Stock Market" project code 2025.TĐHHN.06.12, led by Hanoi University of Natural Resources and Environment.

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