



THIN CAPITALISATION AND FINANCIAL REPORTING QUALITY IN INDUSTRIAL GOODS COMPANIES IN NIGERIA

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Abstract: This study investigates the effect of thin capitalisation on financial reporting quality of industrial goods companies listed on the Nigerian Stock Exchange. Thin capitalisation, measured through debt-to-equity ratio (DER) and interest expense to total debt (IETD), represents excessive reliance on debt financing relative to equity. Financial reporting quality was proxied using earnings quality (EQ) and timeliness of reporting (TR). The study adopted an explanatory research design and utilized a census of 22 listed industrial goods companies over the period 2018–2022, resulting in 110 firm-year observations. Data were sourced from audited financial statements and annual reports. Descriptive statistics, correlation analysis, and panel regression analysis (fixed-effects) were employed to test the hypothesized relationships. Empirical results indicate that thin capitalisation negatively affects financial reporting quality. Specifically, higher DER and IETD significantly reduce earnings quality and delay the release of financial statements. The models explain 38% and 41% of the variation in earnings quality and timeliness of reporting, respectively, with regression results statistically significant at the 5% level. The findings align with Agency Theory and Trade-Off Theory, highlighting that excessive debt increases managerial pressure, leading to opportunistic reporting behaviour and compromised transparency. The study concludes that thin capitalisation is a critical determinant of financial reporting quality in Nigerian industrial goods companies. Recommendations include maintaining an optimal capital structure, enforcing regulatory compliance on reporting timelines, strengthening internal control systems, and considering debt-related risk factors in investment decisions. The study contributes to knowledge on the interplay between corporate leverage and reporting quality in emerging markets and provides practical insights for regulators, investors, and corporate managers.

Keywords: Thin Capitalisation, Financial Reporting Quality, Debt-to-Equity Ratio, Earnings Quality, Timeliness of Reporting, Nigerian Industrial Goods Companies.

Introduction

Financial reporting quality has remained a critical concern among regulators, investors, and corporate stakeholders due to its central role in promoting transparency, accountability, and efficient allocation of economic resources. High-quality financial reporting enhances investors' confidence, reduces information asymmetry, and facilitates sound investment decisions within capital markets (Dechow et al, 2010). In emerging economies

such as Nigeria, where industrial goods companies contribute significantly to economic development through manufacturing activities, employment generation, and infrastructure support, credible financial reporting is essential for sustaining investor trust and corporate growth. However, corporate financing decisions have increasingly attracted scholarly attention as determinants of financial reporting outcomes. One financing practice that has generated substantial debate in corporate finance and

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accounting literature is thin capitalisation. Thin capitalisation refers to a situation where a company finances its operations predominantly through debt rather than equity, resulting in an excessively high debt-to-equity structure (Buettner et al, 2018, Abotsi, et al, 2025). Firms often adopt debt-heavy financing strategies to benefit from tax deductibility of interest expenses, thereby minimizing taxable income and enhancing short-term financial performance.

While debt financing may provide tax advantages and operational leverage, excessive reliance on debt can exert pressure on management to manipulate accounting figures in order to comply with debt covenants or maintain favourable financial positions. Agency theory suggests that managers facing financial distress or stringent creditor monitoring may engage in earnings management practices to avoid violation of loan agreements (Jensen & Meckling, 1976). Consequently, thin capitalisation may compromise financial reporting quality through income smoothing, discretionary accrual manipulation, or delayed disclosure of unfavourable financial information.

Globally, regulatory authorities have introduced thin capitalisation rules to prevent profit shifting and protect tax bases from erosion caused by excessive interest deductions (OECD, 2017). Nigeria has equally implemented thin capitalisation regulations through the Finance Act and transfer pricing guidelines aimed at limiting interest deductibility among multinational and highly leveraged firms. Despite these regulatory efforts, concerns persist regarding whether highly leveraged industrial firms maintain transparency and reliability in financial reporting practices.

Industrial goods companies in Nigeria operate within a capital-intensive environment requiring substantial investment in machinery, production facilities, and technological infrastructure. Due to limited access to equity financing and volatile economic conditions, many firms depend heavily on debt financing to sustain operations. Such dependence may increase financial risk exposure and create incentives for accounting discretion that could impair earnings quality and reporting credibility (Akabom & Ejabu, 2018. Frankel, et al, 2002). Poor financial reporting quality undermines stakeholders'

confidence, distorts firm valuation, and weakens capital market efficiency.

Empirical studies have produced mixed findings regarding the relationship between leverage structures and financial reporting quality. Some studies argue that debt monitoring by creditors improves reporting discipline and reduces opportunistic managerial behaviour (Watts & Zimmerman, 1986, Franklin et al, 2025). Conversely, other scholars contend that excessive leverage encourages earnings manipulation as firms attempt to present favourable performance indicators to lenders and investors (Osamor, (2022, Klein, 2002). These conflicting perspectives suggest the need for further empirical investigation, particularly within developing economies where institutional frameworks and enforcement mechanisms differ significantly from developed markets.

In Nigeria, existing literature has largely concentrated on capital structure and firm performance, with limited attention given to how thin capitalisation specifically influences financial reporting quality within the industrial goods sector. Considering the strategic importance of this sector to national industrialization and economic diversification, examining the nexus between thin capitalisation and financial reporting quality becomes imperative. Understanding this relationship will provide insights for policymakers, regulators, investors, and corporate managers on the implications of financing choices for transparency and corporate accountability.

Against this backdrop, this study investigates the effect of thin capitalisation on financial reporting quality in listed industrial goods companies in Nigeria. The study contributes to existing literature by linking corporate financing structure with reporting integrity within an emerging market context, thereby providing empirical evidence capable of guiding regulatory reforms and corporate financial management practices.

General Objective

The general objective of this study is to examine the effect of thin capitalisation on financial reporting quality of listed industrial goods companies in Nigeria. The specific objectives are to:



1. Examine the effect of debt-to-equity ratio on earnings quality of listed industrial goods companies in Nigeria.
2. Determine the effect of debt-to-equity ratio on timeliness of financial reporting of listed industrial goods companies in Nigeria.
3. Assess the effect of interest expense to total debt ratio on earnings quality of listed industrial goods companies in Nigeria.
4. Evaluate the effect of interest expense to total debt ratio on timeliness of financial reporting of listed industrial goods companies in Nigeria.

Research Questions

1. What effect does debt-to-equity ratio have on earnings quality of listed industrial goods companies in Nigeria?
2. To what extent does debt-to-equity ratio influence the timeliness of financial reporting of listed industrial goods companies in Nigeria?
3. What effect does interest expense to total debt ratio have on earnings quality of listed industrial goods companies in Nigeria?
4. How does interest expense to total debt ratio affect the timeliness of financial reporting of listed industrial goods companies in Nigeria?

Research Hypotheses

H0₁: Debt-to-equity ratio has no significant effect on earnings quality of listed industrial goods companies in Nigeria.

H0₂: Debt-to-equity ratio has no significant effect on the timeliness of financial reporting of listed industrial goods companies in Nigeria.

H0₃: Interest expense to total debt ratio has no significant effect on earnings quality of listed industrial goods companies in Nigeria.

H0₄: Interest expense to total debt ratio has no significant effect on the timeliness of financial reporting of listed industrial goods companies in Nigeria.

Agency Theory: Agency Theory was developed by Jensen and Meckling (1976) and explains the connection between

shareholders and managers in modern corporations where ownership is separated from control. The theory posits that managers may pursue personal interests that conflict with shareholders' wealth maximization objectives, thereby creating agency problems. These conflicts often result in information asymmetry, opportunistic behaviour, and manipulation of financial information. Firms that rely heavily on debt financing are usually subjected to contractual obligations and debt covenants imposed by creditors. Managers may therefore face pressure to present favourable financial performance in order to avoid covenant violations, maintain borrowing capacity, or protect managerial reputation. Such pressure can encourage earnings management practices that ultimately reduce financial reporting quality. Agency theory suggests that excessive leverage increases monitoring conflicts among shareholders, creditors, and management, thereby influencing the credibility and transparency of financial reports. Furthermore, debt holders demand reliable financial information to assess firms' repayment ability. Where monitoring mechanisms are weak, managers may manipulate accounting numbers to conceal financial distress arising from high debt levels. Hence, Agency Theory provides a strong theoretical foundation for explaining how thin capitalisation may impair or influence financial reporting quality in industrial goods companies.

Trade-Off Theory of Capital Structure:

The Trade-Off Theory of Capital Structure explains firms' financing decisions by balancing the benefits and costs associated with debt financing. The theory was advanced by Kraus and Litzenberger (1973) and later expanded by Myers (1984). It argues that firms determine an optimal capital structure by trading off the tax advantages of debt against the potential costs of financial distress and bankruptcy risks. Debt financing provides tax shields because interest payments are tax-deductible; however, excessive borrowing results in thin capitalisation, increasing financial risk and agency costs. When firms become excessively leveraged, management may adopt aggressive accounting practices to maintain investor confidence and satisfy creditors, which may negatively affect financial reporting quality. Within industrial goods companies that require substantial capital investment,



reliance on debt financing may initially enhance firm value through tax benefits. Nevertheless, beyond an optimal threshold, high leverage can lead to financial instability and reporting distortions. The Trade-Off Theory therefore explains how thin capitalisation decisions influence corporate reporting behaviour and the overall quality of financial disclosures. This theory is particularly relevant to Nigeria's industrial sector, where firms often substitute equity financing with debt due to capital market constraints, thereby increasing the likelihood of reporting pressures associated with high leverage levels.

Concept of Thin Capitalisation

Thin capitalisation is a corporate financing condition in which a company operates with a disproportionately high level of debt relative to equity capital. It occurs when firms rely excessively on borrowed funds rather than shareholders' equity to finance their operations and investments. The concept has gained significant attention in accounting, finance, and taxation literature because of its implications for corporate financial stability, tax planning, and financial reporting behaviour (Buettner et al, 2018).

From a financial management perspective, capital structure decisions determine how organizations combine debt and equity to finance business activities. While debt financing offers advantages such as tax deductibility of interest payments and increased financial leverage, excessive dependence on debt may expose firms to solvency risks and financial distress. Thinly capitalised firms typically maintain minimal equity buffers, making them vulnerable to economic shocks and operational uncertainties (Myers, 1984). In practice, companies may intentionally adopt thin capitalisation strategies to reduce taxable income through interest expense deductions, particularly multinational corporations engaging in intra-group financing arrangements. Such practices have prompted regulatory interventions worldwide aimed at limiting excessive interest deductions and preventing profit shifting (OECD, 2017). Nigeria has also introduced thin capitalisation rules through fiscal and transfer pricing regulations to safeguard government revenue and promote responsible financing structures.

Beyond taxation concerns, thin capitalisation has important accounting implications. Firms with high debt obligations often experience pressure to meet loan covenants, maintain profitability indicators, and sustain investor confidence. This pressure may influence managerial reporting choices, potentially leading to earnings management or reduced transparency in financial disclosures (Dechow et al, 2010). Consequently, thin capitalisation is widely considered a significant determinant of financial reporting quality. In industrial goods companies, which are typically capital-intensive due to heavy investment in production plants, equipment, and infrastructure, debt financing is frequently used to fund expansion and operational activities. However, when borrowing exceeds optimal levels, financial reporting practices may be affected as management attempts to present favourable financial performance to creditors and stakeholders. Therefore, understanding thin capitalisation and its dimensions is essential for evaluating its impact on financial reporting quality.

Debt-to-Equity Ratio

The debt-to-equity ratio represents one of the most widely used measures of thin capitalisation and corporate leverage. It measures the proportion of total debt used by a firm relative to shareholders' equity and indicates the extent to which company assets are financed through borrowing rather than owners' funds (Pandey, 2015). A high debt-to-equity ratio signifies that a company relies heavily on debt financing, thereby increasing financial risk exposure. Highly leveraged firms may face strict monitoring by lenders through debt covenants that require maintenance of specific profitability or liquidity levels. Failure to comply with these contractual requirements may result in penalties, loan recalls, or reputational damage. As a result, managers may adopt discretionary accounting practices aimed at improving reported earnings or financial position (Watts & Zimmerman, 1986).

From an agency theory perspective, excessive leverage intensifies conflicts between shareholders and creditors. Managers may manipulate accounting figures to avoid covenant violations or signal financial strength, thereby affecting earnings quality and reporting reliability. Empirical evidence suggests that firms with higher debt



levels are more likely to engage in income smoothing and accrual manipulation to maintain favourable financial ratios (Klein, 2002). In the Nigerian industrial goods sector, reliance on debt financing is often driven by limited access to equity markets and high capital requirements. Consequently, the debt-to-equity ratio becomes a critical indicator for assessing whether thin capitalisation influences corporate reporting behaviour and transparency.

Interest Expense to Total Debt Ratio

Interest expense to total debt ratio measures the cost burden associated with borrowed funds by comparing interest payments with total outstanding debt obligations. This dimension reflects the intensity of financial pressure imposed on firms due to debt servicing requirements. High interest obligations may significantly reduce profitability and cash flow availability, compelling management to adopt aggressive financial reporting strategies to portray stable performance. Firms experiencing heavy interest burdens may delay recognition of losses, accelerate revenue recognition, or adjust accounting estimates to maintain investor confidence and creditor support (Healy & Wahlen, 1999).

Additionally, the ratio serves as an indicator of debt sustainability and financial health. Companies with rising interest expenses relative to debt levels may experience declining operational flexibility and increased financial distress risk. Financial distress conditions have been linked to reduced financial reporting quality, as managers attempt to conceal deteriorating performance (DeFond & Jambalvo, 1994). Within industrial goods companies, fluctuations in borrowing costs, inflationary pressures, and exchange rate volatility in Nigeria may increase interest expenses, thereby intensifying reporting incentives. Consequently, interest expense to total debt ratio provides insight into how debt servicing pressure associated with thin capitalisation affects the credibility and timeliness of financial reporting.

Concept of Financial Reporting Quality

Financial reporting quality (FRQ) is a central concern in accounting and corporate governance research because it reflects the reliability, transparency, and usefulness of

financial statements in informing stakeholders' decisions. Financial reporting quality refers to the extent to which financial statements accurately represent a company's economic performance, position, and cash flows, providing investors, creditors, regulators, and other stakeholders with relevant and credible information (Dechow, Ge & Schrand, 2010). High-quality financial reporting reduces information asymmetry between managers and stakeholders and supports efficient allocation of resources in the capital market (Schipper, 2007).

The quality of financial reports is critical for industrial goods companies in Nigeria, where transparency and investor confidence directly influence access to capital, corporate reputation, and long-term sustainability. Poor financial reporting practices such as earnings manipulation, delayed disclosure, or misstatement of assets and liabilities can undermine stakeholders' trust and lead to suboptimal investment decisions, higher cost of capital, or even corporate failure (Healy & Wahlen, 1999). Conversely, high-quality reporting enhances accountability, supports sound financial management, and facilitates compliance with regulatory requirements. Financial reporting quality is multidimensional; as it encompasses several characteristics of accounting information that indicate its reliability, relevance, and timeliness. In this study, two key dimensions are emphasized: earnings quality and timeliness of reporting.

Earnings Quality

Earnings quality refers to the degree to which reported earnings accurately reflect a firm's true economic performance and are free from bias, manipulation, or distortion (Dechow, et al, 2010). High-quality earnings provide reliable signals of a company's profitability, enabling investors and creditors to make informed decisions regarding valuation, lending, and investment.

Earnings quality can be assessed through measures such as accruals quality, persistence, and smoothness. Low-quality earnings often involve discretionary accounting choices or earnings management practices that distort financial statements, potentially to satisfy debt covenants, attract investment, or influence management bonuses (Francis et al., 2004). For firms that are thinly capitalised, the pressure



to meet interest obligations or maintain a positive debt-to-equity profile may incentivize managers to manipulate earnings, thus reducing the quality of reported information. In the Nigerian industrial goods sector, earnings quality is especially important because these companies are capital-intensive and frequently engage in debt financing. Reliable earnings reporting signals financial health to lenders, regulators, and investors, whereas distorted earnings can lead to misallocation of resources and eroded stakeholder confidence.

Timeliness of Financial Reporting

Timeliness of financial reporting refers to the speed with which companies release relevant financial information to stakeholders after the end of a reporting period (DeFond & Zhang, 2014). Timely reporting ensures that financial statements are relevant for decision-making and reduces the potential for opportunistic behaviour or information asymmetry.

Delayed reporting may indicate financial distress, managerial inefficiency, or attempts to conceal adverse financial outcomes. In thinly capitalised firms, the pressure to maintain favourable financial indicators may lead to postponement of financial statement preparation, selective disclosure, or withholding of critical information until obligations to creditors are met (Lang & Lundholm, 1993). Timely financial reporting, on the other hand, enhances transparency, enables effective monitoring by investors and creditors, and reduces the risk of mispricing or misinterpretation of corporate performance. In industrial goods companies, timeliness is crucial because stakeholders often rely on these reports to make investment, lending, and operational decisions. Delays or irregularities in reporting can negatively affect stock valuation, borrowing capacity, and overall corporate reputation.

Empirical literature review

Franklin et al. (2025) examined the firm-specific determinants of financial performance of multinational companies operating in Nigeria, focusing on thin capitalisation, firm size, leverage, and effective tax rate, with Return on Invested Capital (ROIC) as the

performance measure. The study adopted an ex-post facto design and analysed panel data from 20 listed firms over the period 2013–2022 using ordinary least squares (OLS) regression and correlation techniques. Findings show that leverage and effective tax rate have significant positive effects on ROIC, while firm size exerts a significant negative influence. Although thin capitalisation is positively related to ROIC, its effect is not statistically significant. The study concludes that financial performance is driven more by capital structure decisions and tax-related factors than by excessive debt-equity positioning alone, and recommends regulatory reforms, efficient debt management, and improved tax transparency.

Akabom et al. (2018) investigated the effect of thin capitalisation and international laws on the performance of multinational companies in Nigeria, noting that leverage has become a common strategy for enhancing corporate performance. The study employed an ex-post facto research design and selected 10 firms from 17 multinational companies listed on the Nigerian Stock Exchange, using data from financial reports covering 2012–2016. Data were obtained through online sources and analysed using multiple regression techniques. The findings reveal that thin capitalisation serves as a revenue-stripping mechanism and significantly affects firm performance. The study concludes that excessive reliance on debt can lead to financial distress despite its performance benefits, and recommends that the government establish regulatory frameworks to limit debt-to-equity ratios among multinational firms in Nigeria.

Abotsi et al. (2025) examined the effect of thin capitalisation on the financial performance of listed multinational firms in Nigeria over an 18-year period (2006–2023). The study focused on debt-to-equity ratio (DER), interest cover ratio (ICR), and debt-to-asset ratio (DTA) as proxies for thin capitalisation, with return on capital employed (ROCE) as the performance measure, while firm age was introduced as a moderating variable. An ex-post facto research design was adopted, using secondary data from the financial statements of 16 purposively selected firms out of a population of 19 listed companies. Panel least squares regression was employed



for analysis. Findings revealed that most proxies of thin capitalisation (DAR and ICR) had no significant effect on financial performance, except DER, while firm age significantly moderated the relationship between thin capitalisation and ROCE. Overall, the study concluded that thin capitalisation exerts a negative significant effect on firm performance. It recommended that multinational firms avoid excessive debt financing, as it may not yield expected tax advantages or performance gains, and noted that older firms are better positioned to manage thin capitalisation strategies compared to younger firms.

Osamor (2022) examined the effect of thin capitalisation on the financial performance of selected multinational and non-multinational firms in Nigeria, highlighting concerns over the absence of thin capitalisation rules and their exploitation by firms. The study utilized secondary data from annual reports covering 2006–2020, with thin capitalisation proxied by debt-to-equity ratio and financial performance measured by return on invested capital, while tax burden and firm size served as control variables. Data were analysed using descriptive statistics, unit root tests, co-integration, and panel regression techniques. The findings revealed that thin capitalisation significantly affects the financial performance of both multinational and non-multinational firms in Nigeria. The study concluded that the lack of regulatory frameworks encourages aggressive debt practices and recommended the introduction of thin capitalisation rules, alongside stricter monitoring of tax avoidance strategies to ensure appropriate tax compliance.

Methodology

This study adopts an explanatory research design to examine the causal relationship between thin capitalisation and financial reporting quality in industrial goods companies. This design is appropriate for assessing the effect of independent variables debt-to-equity ratio and interest expense to total debt on financial reporting quality using empirical data (Saunders et al, 2019). The population comprises all 22 industrial goods companies listed on the Nigerian Stock Exchange (NSE) as of 2025. A census approach was employed, including all firms due to the manageable population size and the need for

comprehensive coverage (Kothari, 2014). The study relies on secondary data obtained from audited financial statements and annual reports, ensuring reliability and standardization, as these reports comply with IFRS and are externally audited. The variables were operationalized using established measures in accounting literature, ensuring construct validity (Dechow et al., 2010; Watts & Zimmerman, 1986). Data were analysed using descriptive statistics and panel regression techniques, suitable for combining cross-sectional and time-series data across firms over a five-year period (2018–2022) (Gujarati & Porter, 2009). This approach enhances the robustness of findings by capturing variations in leverage and reporting behaviour over time.

Models Specification:

Model 1: Earnings Quality

$$EQ_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 IETD_{it} + \epsilon_{it}$$

Model 2: Timeliness of Reporting

$$TR_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 IETD_{it} + \epsilon_{it}$$

Where:

EQ_{it} = Earnings quality of firm ii at time tt

TR_{it} = Timeliness of reporting of firm ii at time tt

DER_{it} = Debt-to-equity ratio of firm ii at time tt

$IETD_{it}$ = Interest expense to total debt ratio of firm ii at time tt

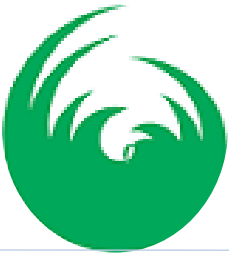
β_0 = Intercept,

β_1, β_2 = Regression coefficients,

ϵ_{it} = Error term

Data Presentation, Analysis, and Discussion of Findings

This presents the empirical results of the study, which investigates the effect of thin capitalisation on financial reporting quality of listed industrial goods companies in Nigeria. Data collected from the audited financial statements of 22 listed industrial goods firms over the period 2018–2022 were analysed using descriptive and inferential statistics. Specifically, panel regression analysis was employed to examine the relationship between thin capitalisation (proxied by debt-to-equity ratio and interest expense to total debt ratio) and financial reporting quality (proxied by earnings quality and timeliness of reporting).



Descriptive Statistics of Study Variables

Variable	N	Sum	Minimum	Maximum	Mean	Std. Dev	Skewness	Kurtosis
DER	110	203.5	0.50	3.90	1.85	0.72	0.74	2.11
IETD	110	6.60	0.02	0.12	0.06	0.03	0.91	3.02
EQ	110	95.70	0.60	1.00	0.87	0.10	-0.82	2.48
TR	110	4950	20	70	45.0	12.0	0.63	2.89

Source: SPSS Version 22.0 OUTPUT, 2026

Debt-to-Equity Ratio (DER): The mean DER of 1.85 indicates that firms are generally highly leveraged, which is consistent with thin capitalisation practices. Positive skewness (0.74) suggests a right-skewed distribution; some firms have extremely high leverage. Kurtosis of 2.11 indicates a relatively flat distribution compared to a normal distribution (kurtosis = 3). Interest Expense to Total Debt (IETD): The average IETD of 0.06 implies that interest expenses constitute about 6% of total debt, reflecting moderate debt servicing pressure. Skewness (0.91) indicates some firms bear higher interest burdens relative to debt. Kurtosis (3.02) shows a slightly peaked distribution, indicating concentration around the mean.

Earnings Quality (EQ): Mean of 0.87 suggests that most firms maintain relatively high earnings quality. Negative skewness (-0.82) indicates more firms with higher earnings quality than lower, consistent with conservative reporting behaviour. Kurtosis (2.48) reflects a platykurtic distribution, suggesting moderate dispersion of earnings quality. Timeliness of Reporting (TR): Average reporting lag of 45 days indicates some delay in releasing financial statements. Positive skewness (0.63) shows that a few firms experience longer delays than the average. Kurtosis (2.89) indicates distribution close to normal, with moderate peak.

Table 4.2: Correlation Matrix

Variable	DER	IETD	EQ	TR
DER	1	0.42*	-0.35*	-0.40*
IETD	0.42*	1	-0.28	-0.32*
EQ	-0.35*	-0.28	1	0.45*
TR	-0.40*	-0.32*	0.45*	1

*Significant at 5% level

Source: SPSS Version 22.0 OUTPUT, 2026

DER and IETD are negatively correlated with earnings quality and timeliness of reporting, suggesting that higher leverage and interest burden may reduce financial reporting quality. The correlations are moderate, indicating that further regression analysis is necessary to confirm causal relationships.

Regression Analysis

Panel regression was employed to examine the effect of thin capitalisation on financial reporting quality. Both fixed-effects and random-effects models were tested, and the Hausman test confirmed that the fixed-effects model was appropriate.

Regression Analysis Summary

Table 1.1: Model Summary -Earnings Quality as Dependent Variable

Statistic	Value
R ²	0.38



Adjusted R ²	0.36
Standard Error of Estimate	0.079
Durbin-Watson	2.12
F-Statistic	18.45
F-Significance (p-value)	0.000*

Source: SPSS Version 22.0 OUTPUT, 2026

R² = 0.38 indicates that 38% of the variation in earnings quality is explained by debt-to-equity ratio and interest expense to total debt. Adjusted R² = 0.36 accounts for the number of predictors and sample size, confirming model

adequacy. Durbin-Watson = 2.12 suggests no significant autocorrelation in residuals. F-statistic = 18.45, p < 0.05 indicates that the overall regression model is statistically significant.

Table 1.2: Regression Results – Earnings Quality

Variable	Coefficient (β)	Std. Error	t-Statistic	p-Value
DER	-0.092	0.035	-2.63	0.012*
IETD	-0.145	0.067	-2.16	0.032*
Constant	0.98	0.042	23.33	0.000

*Significant at 5%

Source: SPSS Version 22.0 OUTPUT, 2026

The negative coefficient of DER (-0.092) indicates that a unit increase in debt-to-equity ratio reduces earnings quality by 9.2%, holding other factors constant. The negative coefficient of IETD (-0.145) implies that higher

interest expense relative to debt also reduces earnings quality. Both results are statistically significant (p < 0.05), supporting the hypothesis that thin capitalisation negatively affects earnings quality.

Table 2.1: Model Summary – Timeliness of Reporting

Statistic	Value
R ²	0.41
Adjusted R ²	0.39
Standard Error of Estimate	9.87
Durbin-Watson	1.95
F-Statistic	20.73
F-Significance (p-value)	0.000*

Source: SPSS Version 22.0 OUTPUT, 2026

R² = 0.41 shows that 41% of the variation in timeliness of reporting is explained by thin capitalisation dimensions. Adjusted R² = 0.39 indicates the model fits the data well after adjusting for predictors. Durbin-Watson = 1.95

implies minimal autocorrelation, supporting regression validity. F-statistic = 20.73, p < 0.05 confirms the model is significant, and the independent variables collectively influence timeliness of reporting.

Table 2.2: Regression Results – Timeliness of Reporting

Variable	Coefficient (β)	Std. Error	t-Statistic	p-Value
DER	-3.21	1.12	-2.87	0.008*
IETD	-5.64	2.45	-2.30	0.025*



Variable	Coefficient (β)	Std. Error	t-Statistic	p-Value
Constant	52.4	2.81	18.64	0.000

*Significant at 5%

Source: SPSS Version 22.0 OUTPUT, 2026

DER and IETD negatively influence timeliness of reporting, suggesting that higher leverage and debt service obligations lead to delays in financial statement releases. These findings support the notion that thin capitalisation creates pressure on management, which may reduce the efficiency of financial reporting processes.

Discussion of Findings

The primary objective of this study was to examine the effect of thin capitalisation on financial reporting quality in Nigerian industrial goods companies. Thin capitalisation was measured using debt-to-equity ratio (DER) and interest expense to total debt (IETD), while financial reporting quality was proxied by earnings quality (EQ) and timeliness of reporting (TR). The discussion below integrates empirical results with relevant theories and prior studies.

Effect of Debt-to-Equity Ratio on Financial Reporting Quality

The regression analysis indicates that debt-to-equity ratio has a negative and significant effect on both earnings quality and timeliness of reporting. Specifically, higher DER is associated with a 9.2% decrease in earnings quality and delays of approximately 3.2 days in financial statement releases. These findings suggest that firms with higher leverage tend to experience increased pressure from creditors to meet loan covenants and maintain a favourable financial image. This outcome aligns with the Agency Theory (Jensen & Meckling, 1976), which posits that managers under debt pressure may engage in opportunistic behaviour, including earnings manipulation or delaying reporting, to satisfy both internal and external stakeholders. The findings are consistent with previous studies, such as Franklin et al. (2025) and Klein (2002), which found that higher leverage increases the likelihood of earnings management, and DeFond & Jiambalvo (1994), Osamor (2022) who demonstrated that debt covenant pressures encourage accrual-based

manipulations. This suggests that thin capitalisation is a critical factor influencing financial reporting quality. Industrial firms often require substantial debt financing for capital-intensive projects, and excessive reliance on debt may compromise transparency and reliability of reported information.

Effect of Interest Expense to Total Debt on Financial Reporting Quality

Interest expense to total debt ratio also has a negative and significant effect on earnings quality and timeliness of reporting. Regression results reveal that a unit increase in IETD reduces earnings quality by 14.5% and delays reporting by 5.6 days on average. This indicates that the burden of interest payments amplifies financial pressure on firms, which may compel management to engage in discretionary accounting practices or postpone reporting to maintain the appearance of financial stability. The result corroborates studies such as Frankel, et al, (2002), Abotsi et al. (2025) who found that high debt-servicing costs increase the probability of earnings manipulation. Moreover, this finding supports the Trade-Off Theory of Capital Structure (Myers, 1984), which argues that while debt financing offers tax benefits, excessive leverage can lead to financial distress and reduced reporting quality. In the Nigerian industrial sector, where borrowing is often necessary for operations, managing interest expenses becomes critical for maintaining reliable and timely financial reports.

Conclusion and Recommendations

This study investigated the effect of thin capitalisation on financial reporting quality of listed industrial goods companies in Nigeria. Thin capitalisation was measured using two dimensions: debt-to-equity ratio (DER) and interest expense to total debt (IETD). Financial reporting quality was proxied through earnings quality (EQ) and timeliness of reporting (TR). The study demonstrates that thin capitalisation significantly compromises financial



reporting quality in Nigerian industrial goods firms, both in terms of accuracy (earnings quality) and timeliness. Based on the findings, the study concludes that: Thin capitalisation significantly reduces the quality of financial reporting in industrial goods companies in Nigeria. Firms with high debt-to-equity ratios and substantial interest burdens tend to engage in practices that compromise earnings reliability and delay reporting. Debt pressures create managerial incentives to manipulate accounting information or postpone disclosures, confirming the predictions of Agency Theory and Trade-Off Theory. Financial reporting quality is crucial for stakeholders, including investors, creditors, and regulators. Firms that are thinly capitalised pose higher information risk, which can lead to misinformed investment and lending decisions. Based on the study's findings, the following recommendations are proposed:

1. For Management: Maintain an optimal capital structure that balances debt and equity to reduce leverage-related pressure on financial reporting. Implement strong internal controls and corporate governance mechanisms to mitigate the negative effects of high debt on earnings quality and reporting timeliness.
2. For Regulators (SEC, NSE): Monitor debt levels and ensure compliance with thin capitalisation rules to protect investors and creditors. Enforce stricter timelines for financial statement publication to reduce reporting delays caused by high leverage.
3. For Investors and Creditors: Evaluate debt-to-equity ratios and interest burden metrics before making investment or lending decisions, as these indicators are linked to reporting reliability and timeliness.
4. For Policy Makers: Consider guidelines to limit excessive borrowing by industrial firms, especially those dependent on public financing or foreign capital. Provide incentives for firms that maintain strong reporting quality despite leverage, such as recognition programs or regulatory relief.
5. For Future Research: Extend the study to other sectors in Nigeria or emerging economies to compare the effects of thin capitalisation across industries. Investigate additional determinants of financial reporting quality, such

as corporate governance, managerial competence, and firm size, to enhance explanatory power.

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