

Effect of Financial Statements on Investment Decision: Evidence from Nigerian Stock Exchange.

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Abstract

The study investigates the effect of financial statements on shareholders' investment decisions making in Nigerian stock market. The main type of data used in this study is secondary; sourced from the Nigerian Stock Exchange Fact Book for a period of 17 years (from 1998-2014). The regression analysis of the least square is the estimation technique employed in this study. The findings revealed that return on investment (ROI), dividend per share (DPS) earnings per share (EPS), leverage and liquidity had significant positive effect on investment decision. The study recommends that shareholders are to make proper investigation about the financial status of the company of their choice before making investment decisions. They should consult financial analysts so as to be properly guided when making investment decision.

Keywords: *Financial Statements, Investments, Shareholders, Nigeria.*

1.0 Introduction

Both large and small organizations in addition to satisfying the legislating requirements tend to retain existing investors and to attract potential ones through the publication of their financial statements where the capital stock of a corporation is widely held and its affairs are of interest to general public relations (Amedu, 2012). When financial statements are disclosed, they can have large impacts on the business and on the investors of the company. This is because many investors look at the financial statements when making investment decisions. Therefore, it is important for companies to ensure that the information disclosed in a financial statement is better or worse than expected; it can send the stock price up or down (Osuala, Ugwumba and Osuji, 2012).

The purpose of consolidated statements is to present, primarily for the benefit of stakeholders and any interested party about the progress or otherwise of the organization, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions (Maidoki, 2013). There is presumption that consolidated statements are more meaningful than separate statements (Thomas, 2008). The financial statement is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. Quoted

companies use financial statement as one of the major medium of communication with their equity shareholders and public at large (Hribar and Collins, 2002; Cheng and Yang, 2003; Sloan, 1996).

Ugwumba (2010) points out that some authors have argued that in developing economics, shareholders of quoted companies do not seem to pay particular attention to financial statements in their investment decisions but rather on other extraneous variables. Such as the frequency and regularity of dividend payment and market price per share. Shareholders focus on the regularity of their dividend payment and therefore, would usually react if there is an announcement of dividend cut or an outright omission of dividend payment (Osuala et al, 2012). According to them, companies whose focus is to maximize shareholders wealth see the knowledge of how dividend change relates to the value of the company as a very important issue.

The general objective of this study is to investigate the effect of financial statements on investment decision making of shareholders of quoted companies in Nigeria. Specifically, the study seeks to determine the effect of:

1. Profitability using return on equity (ROE) and return on investment (ROI) on investment decision.
2. Dividend per share on investment decision.
3. Earnings per share on investment decision.
4. Leverage on investment decision.
5. Liquidity on investment decision.

The study is therefore, designed to provide answers to the following research questions:

1. How does profitability affect investment decision?
2. Is there any effect of dividend per share on investment decision?
3. Do earnings per share affect investment decision?
4. How does leverage affect investment decisions?
5. Is there any effect of liquidity on investment decision?

Based on the research objectives and questions, the following hypotheses stated in their null forms have been formulated in order to empirically investigate the influence of the financial statement on shareholders' investment decision:

1. Profitability measured by return on equity (ROE) and return on investment (ROI) does not have significant effect on investment decision.
2. Dividend per share (DPS) does not have significant effect on investment decision.
3. Earnings per share (EPS) do not have significant effect on investment decision.
4. Leverage does not have significant effect on investment decision.
5. Liquidity does not have significant effect on investment decision.

The study will be of immense benefit to both the existing and potential shareholders. This is because the study intends to help these stockholders/shareholders in investment decision making. The proper investigation of financial statements of quoted companies would effectively and efficiently enhance investment decisions of shareholders.

2.0 Review of Related Literature

Financial statements have been defined as "the main source of information for major investment decisions including whether to lend money to a firm by investing in its bonds, to acquire an ownership stake in a firm by buying its preferred and common stock" (Faboyede and Mukoro, 2012). They are documents prepared on financial activities of a business (Amedu, 2012). The main objective of financial statement is to provide high-quality financial information concerning economic entities, primarily

financial in nature, useful for economic decision making (International Accounting Standards Board, 2008). It is important to provide high-quality financial information because it will positively influence capital providers and other stakeholders in making investment, credit and similar resources allocation decision which enhance overall market efficiency (IASB, 2008).

In Nigeria, the financial statement of quoted companies are regulated by the requirements of the Nigerian Accounting Standards Board (NASB) now known as the International Accounting Standards Board (IASB) through its pronouncements referred to as Statement of Accounting Standards (SAS) or International Accounting Standards (IAS). SAS and IAS/IFRS (International Financial Reporting Standards) define the way accounting information was presented in financial statements. Financial statements provide valuable information for different stakeholders. Stakeholders such as investors, managers, suppliers, customers, lenders, employees, government and the general public have vested interest in the financial statements (Lewis and Pendrill, 2000; Sutton, 2004; Elliot and Elliot, 2005; Glantier and underdown, 1997; Werner and Jones, 2003).

Statement of Accounting Standards (SAS) 2 provides that financial statements consist of: statement of accounting policies, balance sheet (or statement of financial position), profit and loss Account or income statement, the Note to the Accounts, Statement of sources and Application of funds, Value Added Statements and Historical Financial Summary. These elements of financial statement provide information about the resources, obligation and the performance of the company in a clear, simple and understandable manner (Osuala, Ugwumba and Osuji, 2012). Shareholders need to receive full benefit of their investment and so need clear and fairly stated information to enable them make effective and efficient investment decision. Such information is expected to be fully contained in the financial statements of the companies of interest to the shareholders (Osuala et al, 2012).

According to Amedu (2012), investment decisions are not made on a vacuum. According to Amedu, there are bedrocks to which every decision stands. Financial statement summarizes a company's assets, liabilities and shareholders equity at a specific point in time, and these three segments give investors an idea as to what the company owns and owes, as well as the amount invested by the shareholders. Frankel, Johnson & Nelson (2002) as cited in Popoola, Akinsanya, Babarinde and Farinde (2014). According to Kothari & Barone (2006) and Ekeigwe (1995), Balance sheet provides a deep understanding for stakeholders to know the company's financial position and aids stakeholder to see whether profit is realized in a company for a particular year. Stakeholders make decisions based entirely on the reported earning from the statement of income without checking the balance sheet or cash flow statements (Hung & Subramanyam, 2007 and David, 2013) as cited in Popoola et al, (2014).

As cited in Popoola, Akinsanya, Babrinde & Farinde (2014), Holthausen and Watts (2001) point out that for every investment analysis, it is essential for stakeholders to understand and be able to express the income statement analysis. Understanding income statement analysis bestows good approaches for stakeholders to know how management effectively manages income and expenses, along with the actual taxes paid (Hirshleifer, Hou, Teoh & Zhang 2004). Cash flow statement aids investors to evaluate future growth (Hirshleifer et al, 2004). It captures both the current operating results and the accompanying changes in the balance sheet; it may perhaps make available considerable information for stakeholders about what is really happening in a firm before making investment decision (Kothari & Barone, 2006; Hirshleifer et al, 2004; popoola et al; 20014).

3.0 METHODOLOGY

The main type of data used in this study is secondary; sourced from the Nigerian Stock Exchange Fact Book (1998-2014) and the annual reports of the selected companies. Financial information of six selected companies, namely Nigeria Breweries PLC, 7-up Bottling Company PLC, Uniliver PLC,

Dangote Cement PLC, UAC PLC and Dangote Sugar PLC were collected. The above companies were purposively selected based on convenience and availability of the required data. Panel data collected for the six quoted companies over a seventeen (17) years period on six(6) focus variables.

MODEL SPECIFICATION

The model which specifies that investment decision is significantly influenced by the financial statements indices (Profitability, dividend per share, earnings per share, leverage and liquidity) are formulated as follows:

$$ID = f(\text{PRO, DPS, EPS, LEV, LIQ}) \dots \dots \dots (I)$$

Where,

ID= Investment Decision

PRO=Profitability [Proxy by Return on Equity (ROE) and Return on Investment (ROI)]

DPS= Dividend per share

EPS= Earnings per share

LEV= Leverage

LIQ=Liquidity

TABLE 1: VARIABLES MEASUREMENT

Variable(s)	measurements
Investment Decision	Capital expenditure
Return on Equity	Profit after tax/Total equity
Return on Investment	Profit after tax/ Total assets
Dividend per share	as presented in the annual reports of the selected companies
Earnings per share	as presented in the annual reports of the selected companies
Leverage	Total debt/Total equity
Liquidity	Current Assets-stock/current liability

The regression equation based on the above functional relational model is stated below:

$$ID = \beta_0 + \beta_1 \text{ROE} + \beta_2 \text{ROI} + \beta_3 \text{DPS} + \beta_4 \text{EPS} + \beta_5 \text{LEV} + \beta_6 \text{LIQ} + \mu \dots (II)$$

Where,

β = Constant

$\beta_1 - \beta_6$ = Estimated regression coefficients of equation.

μ = Error term

4.0 RESULTS AND DISCUSSION

Table 2 in the appendix shows the summary of regression analysis, profitability (measured by ROE and ROI) has significant effect on investment decision as shown by the substantial size of the multiple regression coefficient ($R = 0.897$), the squared regression coefficient ($R^2 = 0.804$), the $F(2/14) = 158.622$ and its corresponding P -Value = 0.000. ROE and ROI contributes 80.4% to investment decision as indicated by the squared regression coefficient ($R^2 = 0.804$). However, in terms of unique contribution of each, as shown by the standardized regression coefficients (β), only return on investment (ROI) had significant positive effect on investment decision as shown by the standardized coefficients ($\beta = 1.992$) and its t -value = 3.298, $p = 0.005$; compared to return on equity (ROE) which made a smaller positive contribution ($\beta = 0.307$, t -value = 1.598 and p -value = 0.132) to investment decision. It was therefore decided that profitability as measured by ROI had large positive effect while ROE had modest positive effect on investment decision.

In the appendix, data in table 3 displays the summary of simple regression analysis using dividend per share (DPS) as predictor of investment decision. The table shows that the regression coefficient is $R = 0.873$, the squared regression coefficient R^2 is 0.762, the $F(2/14) = 48.024$ and its corresponding P -value = 0.000. These information shows that DPS made huge (76.2%) contribution to the prediction model. This was also demonstrated by the size of the standardized coefficients ($\beta = 0.873$) and its t -value = 6.930, $p = 0.000$. Therefore, it was decided that DPS had significant positive effect on investment decision as such the null hypothesis was rejected.

As shown in table 4 in the appendix, the summary of simple regression analysis using earnings per share (EPS) as predictor of investment decision shows that the regression coefficient was $R = 0.849$, the squared regression coefficient R^2 was 0.720, the $F(2/14) = 38.584$ and its corresponding P -value = 0.000. These information shows that EPS had significant effect on investment decision. This was also demonstrated by the size of the standardized coefficient ($\beta = 0.849$) and its t -value = 6.211, $P = 0.000$. It was decided that EPS had significant effect on investment decision, thus null hypothesis was rejected.

The data in table 5 in the appendix shows that the R (regression coefficient) for the model fitted is 0.672, the R^2 (squared regression coefficient) is 0.452, the $F(2/14) = 12.357$ and its corresponding P -value = 0.003. This indicates that leverage explained 45.2% of the variance in investment decision; and therefore made moderate contribution to the model. The standardized better weight ($\beta = 0.672$) show that company's leverage made positive contribution to investment decision. It was decided that leverage had moderate positive effect on investment decision; the null hypothesis was thus rejected.

Finally, table 6 in the appendix shows that the regression coefficient for the simple regression model with liquidity as predictor of investment decision is $R = 0.858$, the squared regression coefficient R^2 is 0.735, the $F(2/14) = 41.670$ and its corresponding P -value = 0.000. These show that companies' liquidity had significant effect on investment decision. This was also demonstrated by the size of the standardized coefficients ($\beta = 0.854$) and its t -value = 6.455, $p = 0.000$. Therefore, it was decided that companies' liquidity had significant positive effect on investment decision, the null hypothesis was rejected.

5.0 CONCLUSION

The aim of this work was to examine the effects of financial statements on shareholders' investment decision making in Nigerian stock market. Taking this in consideration, a sample of five Nigerian listed firms - Nigeria Breweries PLC, 7-up Bottling Company PLC, Uniliver PLC, Dangote Cement PLC, UAC PLC and Dangote Sugar PLC were purposively selected to conduct a study with panel data. The results of the study show that:

- Shareholders are after their own return on their investment in the company and thus, more shareholders are attracted by the companies with higher profitability.

- The extent which companies' divided per share affects shareholders' investment decision is very high. This is because the shareholders are after the companies' divided per share when making their investment decision in the Nigeria Stock Market.
- EPS made positive contribution to investment decision as such; it had high positive effect on investment decision.
- To ensure that they are not left with nothing in case of liquidation, shareholders tend to be sensitive about the stock leverage of the company of their interest.
- Companies with high liquidity attract more shareholders in the sense that the regression beta weight ($\beta=0.858$) is an indication that companies' liquidity had positive contribution.

RECOMMENDATIONS

Based on the above findings, the study made the following recommendations:

- ❖ Before making investment decisions, shareholders are advised to make proper investigation about the financial status of the company of their choice.
- ❖ Shareholders' wealth maximization objective should be maintained by the companies.
- ❖ Companies should ensure that the information the financial statements disclose is correct because it will negatively affect the confidence of the shareholders if there is evidence of the presence of manipulation in their financial statements.
- ❖ In their investment decisions making, shareholders are advised to consult financial analyst so as to be properly guided.
- ❖ Appropriate agencies should create awareness to enhance shareholders' understanding of the relevance of financial statements in their investment decision making.

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APPENDIX

Table 2 significance of multiple regression analysis predicting investment decision using return on equity (ROE) and return on investment (ROI) as predictors

Variables(s) entered as predictor(s)	B	SE B	B	t	p-value
<i>Constant</i>	325589.175	526103.500		.619	.546
Return on equity (ROE)	1350742.446	845520.846	.307	1.598	.132
Return on investment (ROI)	7210875.057	2186184.711	1.992	3.298	.005
R	.897				
R ²	.804				
F	28.731				.000

Table 3: significance of simple regression analysis predicting investment decision using divided per share (DPS) as predictor

Variables(s) entered as predictor (s)	B	SE B	B	T	p-value
<i>Constant</i>	-859976.015	669538.474		-1.284	.218
Divided per share (DPS)	5459340.336	787792.903	.873	6.930	.000
R	.873				
R ²	.762				
F	48.024				.000

Table 4: Significance of simple regression analysis predicting investment decision using earning per share (EPS) as predictor

Variables(s) entered as predictor (s)	B	SE B	B	T	p-value
<i>Constant</i>	-1052993.921	773852.711		-1.361	.194
Earning per share (EPS)	4279474.462	688965.493	.849	6.211	.000
R	.849				
R ²	.720				
F	38.584				.000

Table 5: Significance of simple regression analysis predicting investment decision using Leverage as predictor

Variables(s) entered as predictor (s)	B	SE B	B	t	p-value
<i>Constant</i>	- 1023916.964	1332358.031		-0.768	.454
Leverage	3681442.679	1047271.319	.672	3.515	-0.003
R	.672				
R ²	.452				
F	12.357				.003

Table 6: Significance of simple regression analysis predicting investment decision using liquidity as predictor

Variables(s) entered as predictor (s)	B	SE B	B	t	p-value
<i>Constant</i>	- 4615125.180	1279700.828		-3.606	.003
Liquidity	4915830.472	761528.808	.858	6.455	.000
R	.858				
R ²	.735				
F	41.670				.000