FINANCIAL STATEMENTS CONTENT AND INVESTMENT DECISIONS – A STUDY OF SELECTED FIRMS

A.E. Osuala, E. C. Ugwumba and J.I. Osuji
College of Agribusiness and Financial Management
Michael Okpara University of Agriculture, Umudike, Nigeria
E-mail: osuala.alex@mouau.edu.ng +234-803-0606-878

Abstract

This work empirically investigates the effect of information content of financial statements on shareholders’ investment decisions. The study is vital as it portrays the extent to which shareholders of firms listed on the Nigerian Stock Exchanged (NSE) are influenced by the contents of published accounts in their investment decisions. In order to determine the relationship between information contents of financial statements and shareholders’ investment decisions, some of the key contents of financial statement were used to derive the proxy variables used in the study, namely profitability, dividend per share, earnings per share, leverage, and liquidity; while shareholders’ investment decisions is represented by change in number of shares. Data for the study were obtained from the published annual financial report of the selected firms. Regression model was employed to establish the relationship between the variables. The findings generally indicate that shareholders in the Nigerian capital market do not rely much on financial statements as a major determining factor for their investment decisions. It was observed that other factors or variables outside firms’ annual reports such as regularity of dividend payment and market price of shares are vital to shareholder’s investment decisions. The study recommends proper awareness creation by the appropriate agencies to enhance shareholders’ understanding of the relevance of published accounts to enable them to know the financial states of the companies of their interest before making investment decisions. Besides, shareholders should seek the advice of financial analysts so as to be properly guided in their investment decisions.

Keywords: Financial statements, shareholders, investments, published accounts

Introduction.

The purpose of financial statement is to provide reliable information about the financial position, performance, and relevant changes in financial position of a company or business. Listed companies use financial statements as one of the major medium of communication with their equity shareholders and public at large (Cheng and Yang, 2003; Sloan, 1996; Hribar and Collins, 2002).

When these financial statements are released, they can have large impacts on the business and on the investors of the company. Therefore, it is critical for the companies to ensure that the information the statements present is correct.

Financial statements can have a drastic effect on the stock price of a company. Many investors look at the financial statements when making investment decisions. If information is presented in a financial statement that is better or worse than expected, it can send the stock price up or down. Investors often use financial ratios based on information from the financial statements to make assumptions. Because of this, the financial statements can have a serious effect on the investors of a business.

Financial statements can also have an impact on how easy it is for a business to get financing. If a company is trying to take out a business loan, the lender will typically want to look at the financial statements of that company. If the information on the financial statements is not flattering, it may negatively impact the ability of the company to borrow money. Lenders usually only want to invest in companies that have good financial numbers.
Financial statements also have impact on new investors. When a company issues new shares of stock, it will most likely distribute financial statements to potential investors. The potential investors will examine the financial statements to determine if they want to put money into the company. Low earnings numbers could negatively impact the number of investors willing to put money into the company.

In some cases, financial statements can even affect other businesses. For example, a leading company in a particular industry releasing financial statements can influence that industry as a whole. Bad numbers by a leading company can sometimes lead to a negative outlook on other companies. This may drive down the stock prices on other companies in the same industry or sector of the market.

Statement of Accounting Standards (SAS)2 provides that financial statements consist of: Balance Sheet, Profit and Loss Account or Income Statement, the Notes 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.

Shareholders of a company, both existing and potential, will want to know how effectively the directors are performing their stewardship function. They will use the financial statement as a base for decisions to dispose of some or all of their shares, or to buy some. Investment decisions depend on expectations of the benefits of the investment, which in turn depend on expectations of future growth and product demand. Expectations of future growth are based on information that includes earnings per share, dividends per share, leverage, and liquidity. Thus, the financial statements are considered very important to shareholders.

Some authors have however argued that in developing economies, shareholders of corporate firms 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 (ugwunba, 2010).

Shareholders are said to be quite keen with respect to the regularity of their (cash) dividend and, therefore, would usually react if there is an outright omission of dividend payment, or an announcement of dividend cut. To this effect, 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 objective of this study is to investigate the effect of the relevant contents of financial statements on the investment decision making of shareholders of firms listed on the Nigerian Stock Exchange. Specifically, the study seeks to determine:

1. To what extent shareholders base their investment decisions on the financial statements of the companies of their interest.
2. To what extent dividend payout affects shareholders’ investment decisions.

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. In order to empirically investigate the influence of the information contents of financial statements on shareholders’ investment decision, the following hypotheses stated in their null form have been formulated:

H01: Profitability does not have any significant impact on shareholders’ investment decisions.

H02: There is no significant positive relationship between declared dividend per share and shareholders’ investment decisions.

H03: Earnings per Share does not have any significant impact on shareholders’ investment decisions.

H04: Leverage has no significant impact on shareholders’ investment decisions.

H05: Corporate firms’ Liquidity does not significantly influence shareholders’ investment decisions.

This study is significant to the shareholders and to the investing public because proper investigation of
the information contents of financial statements of companies would undoubtedly enhance efficient and effective investment decisions. The study is beneficial both to existing shareholders and potential ones because it reveals what actually should form the basis of shareholders’ investment decisions—that is, whether the information contents of financial statements, or other factors like market price of shares.

**Research methodology**

**Data collection procedures**

This section focuses on the procedures and methods employed in collecting data used for the study. In the study, secondary data were collected. The data were sourced from the Nigeria Stock Exchange Fact Book (1999-2008) and the annual reports of the selected firms. Financial information of five selected companies, namely, Nigerian Breweries Plc, PZ Industrial Plc, 7UP Bottling Company Plc, Vitafoam Nigerian Plc, and University Press Plc were collected. The above mentioned firms were selected based on convenience and availability of the required data. Panel data collected for the five listed firms over a ten year period on six focus variables resulted in 300 data points used for the study.

**Model specification and operationalization of variables**

For the purpose of testing the hypotheses formulated for the study, some variables, namely, Investment Decision, Dividend per Share, Earnings per share, leverage and liquidity were selected and expressed as follows:

**Hypothesis 1:** \( ID = f (PRO) \)

where: \( ID = \) Change in Investment Decision proxied by the logarithm of change in number of shares outstanding (i.e. \( \log NS_{t} - DS_{t-1} \))

\( PRO = \) Profitability measured by \( \frac{Profit\ after\ tax}{Total\ assets} \),

\( f = \) Denotation that \( ID \) is a function of \( PRO \).

The variables include Change in Number of Shares, represented by the logarithm of change in number of shares. This stands as the dependent variable (\( ID \)). Other variables (independent variables) include Profitability (\( PRO \)), Dividend per Share (\( DPS \)), Earnings per Share (\( EPS \)), Leverage (\( LEV \)), and Liquidity (\( LIQ \)).

**Hypothesis 2:** \( ID = f (DPS) \)

\( DPS = \) Dividend per Share (as presented in the annual reports of the selected firms).

**Hypothesis 3:** \( ID = f (EPS) \)

\( EPS = \) Earnings per Share (as presented in the annual reports of the selected firms).

**Hypothesis 4:** \( ID = f (LEV) \)

\( LEV = \) Leverage (measured as \( \frac{Total\ liabilities}{Total\ assets} \)).

**Hypothesis 5:** \( ID = f (LIQ) \)

\( LIQ = \) Liquidity, captured as \( \frac{Current\ assets}{Current\ liabilities} \).

Multiple regression analysis was employed for analyzing the data set. Regression analysis is concerned with the study of the dependence of one variable, the dependent variable, on one or more other variables called the explanatory (or independent) variable(s), with the view of estimating and/or predicting the population from the former in terms of known or fixed values of the latter (Damodar 1995:16). The explicit form of the regression model for the study is expressed thus:

\[
ID = \beta_0 + \beta_1PRO + \beta_2DPS + \beta_3EPS + \beta_4LEV + \beta_5LIQ + \mu
\]

where: \( ID \) = Dependent Variable \( PRO, DPS, EPS, LEV, LIQ \) = Explanatory (Independent Variables)

\( \beta_0 = \) Intercept.

\( \beta_1, \beta_2, \beta_3, \beta_4, \beta_5 \) = Parameters. \(( \beta_1, \beta_2, \beta_3, \beta_4, \beta_5 > 0 )\)

\( \mu = \) Stochastic Term.

**Analysis of data and interpretation of results**

For the purpose of testing the hypotheses formulated for this study, the data for the analysis were run using Eviews econometric software, version 7.1 and the results are presented in Table 1.
Table 1
Result of the multiple regression

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Std.Error</th>
<th>t-Statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRO</td>
<td>2.266213</td>
<td>1.297180</td>
<td>1.747030**</td>
</tr>
<tr>
<td>DPS</td>
<td>0.338613</td>
<td>0.256646</td>
<td>1.319378</td>
</tr>
<tr>
<td>EPS</td>
<td>0.076034</td>
<td>0.233507</td>
<td>0.325616</td>
</tr>
<tr>
<td>LEV</td>
<td>1.604735</td>
<td>0.567044</td>
<td>2.830001**</td>
</tr>
<tr>
<td>LIQ</td>
<td>0.044016</td>
<td>0.251766</td>
<td>0.174829</td>
</tr>
<tr>
<td>C</td>
<td>3.838977</td>
<td>0.666928</td>
<td>5.756210**</td>
</tr>
</tbody>
</table>

R-square 0.248239  Adjusted R-square 0.162812 F-statistic 2.905852
Durbin-Waston stat 2.160559 Prob (F-statistic) 0.023688

** Indicates significant at 5% level.

Testing for hypotheses

$H_0$: Profitability has no significant impact on shareholders’ investment decision:

The result of the analysis indicates that Profitability is positively related with Change in Number of Shares, implying that companies with higher profitability attract more shareholders. This observation is in tandem with a priori expectation. For instance, Attaullar and Tahir (2004) in their work, “The Determinants of Capital Structure of Stock Exchange-listed Non-Financial Firms in Pakistan” noted that large firms are more profitable and hence attract more investors than less profitable ones. Hence, we reject our null hypothesis the alternate hypothesis ($H_1$) that profitability has no significant impact on shareholders’ investment decisions.

$H_0$: Dividend per Share has no significant impact on shareholders’ investment decision.

Dividend per Share though has a positive relationship with Change in Number of Shares, this is however not statistically significant at 5% level. This result agrees with Gordon’s bird-in-hand argument, where he disclosed that investors prefer to avoid uncertainty and would be willing to pay higher price for the share that pays greater current dividend, all other things held constant; (Pandy 2004:385). It also supports Pandy’s criticism on the Miller and Modigliani (MM) hypothesis of dividend irrelevance, in which he disclosed that there exists a higher-payout clientele who value shares of dividend paying firms more than those which do not pay dividend. However, Dividend per Share recorded a t-statistic of 1.319378 which is less than the tabular value of 1.680 at the given degree of freedom, indicating that the positive relationship between Dividend per Share and Change in Number of Shares is not statistically significant at 5 percent significant level. Hence, we accept the null hypothesis that Dividend per Share has no significant impact on shareholders’ investment decision. This observation seems to agree with Ugwumba (2010) that shareholders are not just interested in DPS but more importantly, on the regularity of such payment.

$H_0$: Earnings per Share does not have significant impact on shareholders’ investment decisions.

Earnings per Share recorded though a positive relationship with Change in Number of Shares, this is not significant at 5% level. Therefore we accept the Null hypothesis ($H_0$) that Earnings per Share has no significant impact on shareholders’ investment decisions. This result captures Pandy’s criticism on maximization of Earnings per Share, where he reveals that maximization of Earnings per Share implies that firms should make no dividend payment so long as funds can be invested internally at any positive rate of return, however small. He stressed that such a dividend policy may not always be to the shareholders’ advantage; (Pandy 2004:9).

$H_0$: Leverage has no significant impact on shareholders’ investment decisions
The result of the analysis indicates that Leverage is positively related with Change in Number of Shares, and statistically significant at 5% level, having a coefficient of 1.604735, indicating that there is a positive relationship between Leverage and Shareholders’ investment decisions. Thus, we reject the null hypothesis (H0), that leverage has no significant impact on shareholders’ investment decisions.

\( (H_0) \): The impact of Liquidity on shareholders’ investment decisions is not significant. Liquidity recorded a coefficient of 0.044016, indicating a positive relation with Change in Number of Shares. The coefficient however, indicates that the positive relationship is weak, being not significant at 5% level. This tends to agree with Waliullah and Mohammed (2008), and Bhole (2004) who argue that shareholders are not after how management of the company settles their obligation to creditors and lenders, rather, they are after what should be their own returns on their investment in the company.

\( R^2 \) from the result is 0.248239. This implies that the included independent variables explained only about 24.82 percent of the total variation in the dependent variable. This implies that these variables (Profitability, Dividend per Share, Earnings per Share, Leverage, and Liquidity) can only explain 24.82 percent of Change in Number of Shares, leaving 75.18 percent unexplained. Although Profitability and Leverage have significant impact on shareholders’ investment decisions, this result tends to indicate that contents of financial statements have low (minimal) explanation on the investment decisions of the shareholders, indicating that there are other factors that shareholders consider in making their investment decisions order than contents of financial statement.

F-statistic of 2.905852 was observed from the analysis which is greater than the tabular value of 2.43, indicating that the estimated regression model adopted in this study is statistically significant at 5% significant level. With this, the researcher affirms the validity of the regression model adopted in this study.

Conclusions
This study empirically investigated the effect of information content of financial statements on shareholders’ investment decisions. The study is vital as it portrays the extent to which shareholders of firms listed on the Nigerian Stock Exchanged (NSE) are influenced by the contents of published accounts in their investment decisions.

The results of the study show that:
- Companies with higher profitability attract more shareholders.
- Shareholders are more attracted to companies who pay dividend than those who do not pay dividend as they are uncertain about the state of such companies.
- Shareholders show less interest in companies’ Earnings per Share while making their investment decisions in the Nigerian Stock market.
- Shareholders tend to be sensitive about the stock leverage of the company of their interest, so as to ensure that they are not left with nothing in case of liquidation.
- Shareholders are after their own return on their investment in the company, and not how the management of the company settles its obligation to creditors and lenders.
- The extent which information content of financial statement affects shareholders’ investment decision is low; implying that there are other factors that have stronger
effect on the investment decision of shareholders.

**Recommendations**

In view of the findings in this study, it is recommended that:

I. Potential shareholders should make proper investigation about the financial state of the company of their interest before making investment decisions.

II. Companies should avoid miss-stating their financial statements, as such actions have negatively affect the confidence of the shareholders on financial statements.

III. Companies should maintain the shareholders’ wealth maximization objective through regular payment of dividend so as to ensure that shareholders receive the benefits of their investment as at when due.

IV. There should be proper awareness creation by the appropriate agencies to enhance shareholders’ understanding of the relevance of published accounts to enable them to know the financial states of the companies of their interest before making investment decisions. Besides, they should seek the advice of financial analysts so as to be properly guided in their investment decisions.

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