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IFRS Adoption and Foreign Direct Investment: The Nigerian Experience

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ABSTRACT

This research work examined the impact of IFRS adoption on Foreign direct investment. Using a sample of 12 years, subdivided into pre-adoption and post-adoption period. The observational findings from the charts shows that FDI generally grew consistently in the pre-adoption period while the post-adoption period witnessed a lot of inconsistent rise and fall. We employed a two-sample t-test in testing if there is a significant difference in FDI since the adoption of FDI. Findings revealed there is no significant difference. This contradicts the signaling effect of IFRS adoption on investors. However, chart 3 shows that FDI since the adoption of IFRS has been underperforming.

Keywords: *IFRS Adoption; Foreign Direct Investment; Economic Growth; Financial Statement*

1. Introduction

Economic growth remains one of the most important goals of nations' economic policies. Since globalization, foreign direct investment (FDI) has been a recognized means of achieving economic growth (Ojewumi & Akinlo, 2017; Iamsiraroj, 2016; Thampanishvong & Kannika, 2015). Cooper (1999) opines that increasing the volume of financial capital flows is one of the outstanding developments that can affect world economic growth over the past three decades (Akisik, 2014). There is no quantity of financial capital flow that is enough for an economy as all economies of the world seek to improve per time. Foreign Direct Investment is an essential contributor to economic growth (Feeny, Iamsiraroj & McGillivray 2014). This explains why countries modify their economies to be seen as business-friendly.

Over the years, FDI has faced one major challenge among countries – different accounting standards. Before the introduction of IFRS, there have been difficulties in accounting foreign capital between economies or multinationals. Foreign investors have a preference for markets with quality information as this provides them with low-cost assessing investment prospects (Castillo-merino, Menéndez-plans & Orgaz 2014)

Asides from all the benefits of foreign direct investment for national economies, Akisik (2014) identifies ineffective corporate governance and lack of proper financial reporting standards as explanations for the inadequacy of foreign direct investment. Thus, IFRS (International Financial Reporting Standard) and strong corporate governance could proffer a solution to this inadequacy.

IFRS adoption hurls the comparability and reliability of financial statements across the globe. This in turn facilitates international trade which improves countries' economic growth (Zaidi & Heurta, 2014).

The adoption of IFRS can influence the financial decisions of investors by reducing the cost of processing information, especially for foreign investors who are conversant with IFRS and facilitate the flow of capital among nations (Naranjo, Saavedra & Verdi 2013). The effects of IFRS on accounting information quality cannot be overemphasized, more so, previous studies (Zaidi & Paz, 2015; Lourenço & Branco, 2015; Ahmed, Neel & Wang, 2013) observed that the adoption of IFRS enhances transparency in preparation and presentation of financial statements.

Integration of world economies amplified the participation of foreigners in national economies. Consequently, the need for consistent, standard, and comparable quality financial information to ensure well-informed financial decisions by foreign investors. More than 100 countries are better positioned to attract FDI after adopting IFRS (FASB, 2013; Poria, 2009; UNCTAD, 2007) while a host of others have developed schemes to move from GAAP to IFRS. Lack of credibility of financial statements is among the topmost barrier to enticing foreign direct investment. This barrier is precisely prevalent in transition economies, because of the lack of an advanced financial reporting system.

The adoption of IFRS is seen as means to eradicate this problem. Developing nations who have adopted IFRS enjoy the credibility it provides in their financial reports as well as its enhancement of transparency and uniformity that attracts investors (Ikpefan & Akande, 2012; Tsakumis, Campbell, & Doupnik, 2009). IFRS has been widely accepted as a universal standard for quality accounting reporting for investment decisions (Saidu & Umar, 2014).

This work will be analyzing the significant difference in FDI, pre-IFRS, and post-IFRS eras. Graphical comparisons will be used also.

2. Literature Review

Recently, the adoption of IFRS in different is an issue that has drawn the interest of researchers, professional accountants, and economists. Past studies identified the adoption of IFRS to be among the most important factors contributing to the increasing economic growth of countries (Zaidi & Huerta, 2014; Larson & Kenny, 1995). Additional studies (Lourenço & Branco, 2015; Christensen, Glover & Wood, 2012; Lambert, Leuz & Verrecchia, 2007) submit that the adoption of IFRS enhances transparency which leads to reduced information uncertainty, information asymmetry, cost of equity capital and leads to better risk estimations. Transparency in financial reporting also leads to enhanced comparability, higher level of accuracy, higher information quality and market liquidity, and higher efficiency in capital market activities (Aliabadi & Shahri, 2016; Ball, 2016).

The achievement of better transparency in the accounting reporting system is the reason many countries opt to adopting IFRS (Joshi, Yapa & Kraal, 2016; Zaidi & Paz, 2015; Chen et al., 2014). Thus, the need to emphasize the economic consequences of the adoption of IFRS by different countries and consequently influence international trade positively. There are many studies that examined the economic consequences of adopting IFRS (Utama, Farahmita & Anggraita, 2016; Lourenço & Branco, 2015; Ismail & Kamarudin, 2013; Brüggemann, Hitz & Sellhorn, 2013; Elbannan, 2011; Zeghal & Mhedhbi, 2006). Some of these studies reported that IFRS adoption is negatively associated with the cost of equity capital. This implies that if higher quality information is made available to investors, this could reduce the volume of risk in their investment, and thus, they could accept lower investment returns.

However, there have been very limited studies on the relationship between IFRS adoption and FDI inflows. Akisik (2014) examined the relationship between Foreign Direct Investment and changes in the financial reporting system in 12 Latin American countries from 1997 to 2010. Empirical results revealed that accounting standards had positive effects on Foreign Direct Investment. DeFond, Hu, Hung, and Li (2011) explored FDI changes between European Union firms after mandatory adoption of IFRS from 2003 to 2007. Supporting Akisik (2014)'s findings, DeFond et al. (2011) concluded that FDI increases after mandatory IFRS adoption because of enhancement comparability of financial statements. Chen, Ding, and Xu (2014) examined if convergence from domestic standards to IFRS leads to increased FDI. The study covered 30 OECD countries from 2000 to 2005. Their findings revealed that a positive association between IFRS and FDI exists due to reduced costs of processing information for foreign investors. Gordon et al. (2012) explored the effect of IFRS adoption on FDI inflows. They took sample data from 124 countries from 1996 to 2009. Their finding supports a positive association between IFRS adoption and increasing FDI inflows. Beneish, Miller and Yohn (2015) examined if the mandatory IFRS adoption is associated with increased foreign investment for 51 countries in 2005. The study found that IFRS adoption was positively related to increasing FDI. Lungu et al. (2017) also examined the effect of IFRS adoption on FDI between 26 emerging countries from 1996 to 2014. The findings revealed that countries that adopted IFRS have a higher likelihood of benefiting from increased FDI inflows.

Notwithstanding the above evidence supporting positive associations between the adoption of IFRS and FDI, the findings of Nnadi & Soobaroyen (2015) differ. Nnadi and Soobaroyen (2015) revealed that the adoption of IFRS has negative associations with FDI with sample data drawn from 34 African countries over 20 years. Owusu et al. (2017) also examined the relationship between IFRS adoption and FDI using a sample data of 116 developing countries covering from 1996 to 2013. Their study revealed that the adoption of IFRS does not have any significant effect on FDI inflows. Some Evidences supporting the association or relationship between the adoption of IFRS and Foreign direct investment are inadequate, particularly in Nigeria. Hence the need to represent Nigeria's observational and experimented findings of the relationship between the adoption of IFRS and FDI.

Based on the viewpoint of Gordon et al. (2012) that countries adopt IFRS because of the strong signal it sends to foreign investors that their firms prepare standard acceptable financial statements which could be used globally, the adoption of IFRS should be positively associated with FDI in Nigeria. On this premises of signaling theory, we hypothesize that 'the adoption of IFRS has not significantly improved foreign direct investment in Nigeria'.

3. Methodology and Data Analyses

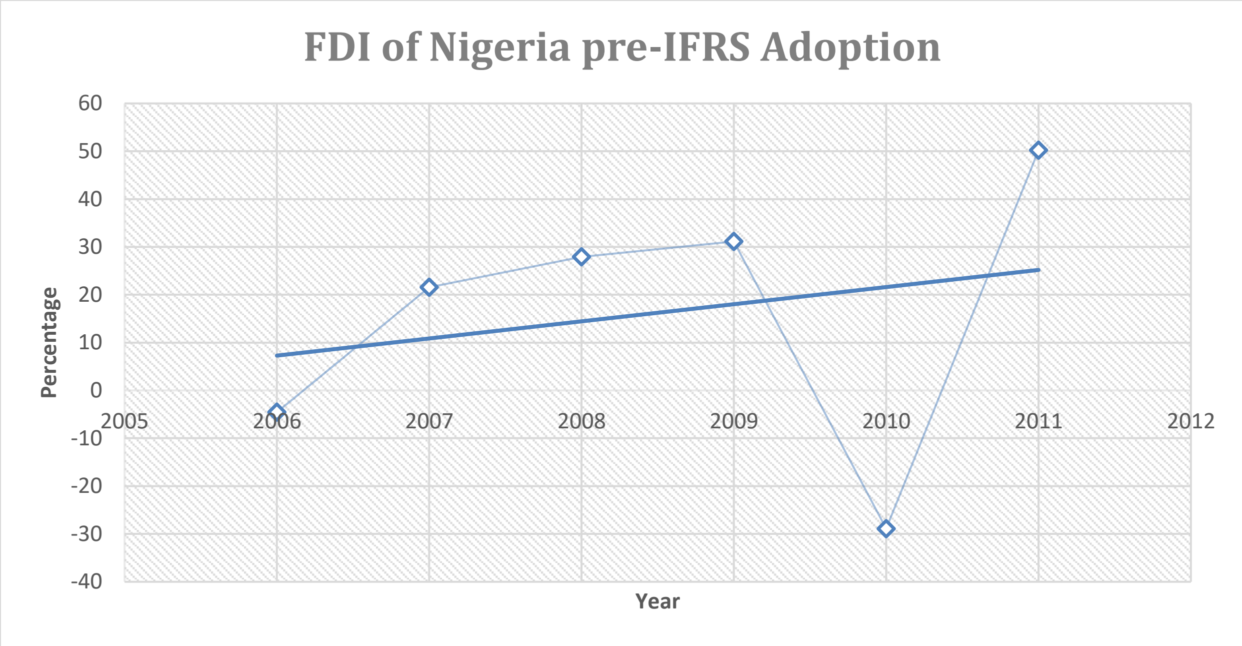
We adopt descriptive research in presenting variables. A descriptive research design seeks to describe a population, phenomenon, or situation accurately and systematically. It provides answers to where, when, what, and how questions, but not why questions. Descriptive research designs can widely use varieties of qualitative and quantitative methods to examine one or more variables. Dissimilar to experimental research, there is no control or manipulation of the variables, the researcher can only observe and measure variables. Data for this study was obtained from the Central Bank of Nigeria (CBN) Yearly Statistical Bulletin, 2018.

To enable us to test our hypothesis that the adoption of IFRS has not significantly improved since FDI in Nigeria, we adopt two-sample test statistics using Stata 15.1. This method of analysis was chosen to enable us to test the statistical difference in FDI before and after the introduction of FDI in 2012, a sample data from 2006 to 2018 was used. The data was split into two groups: pre-IFRS adoption and post-IFRS adoption.

Data Description

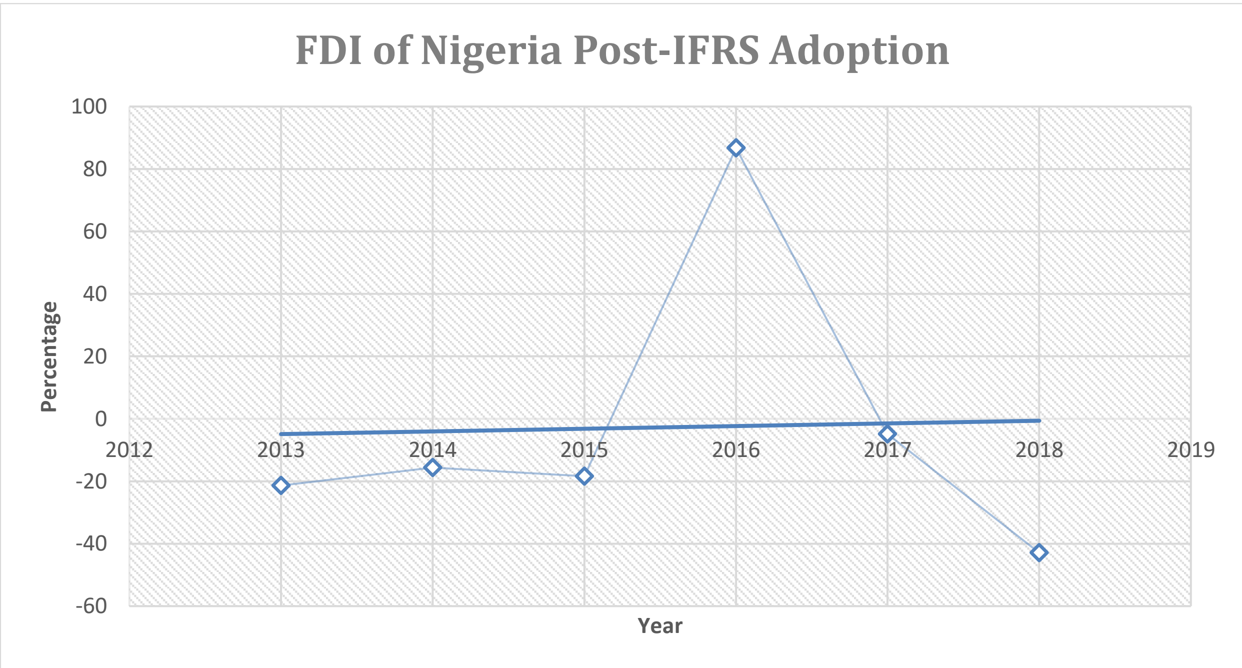
In trying to present the growth rate of FDI, pre and post-adoption period, we calculated the growth rate of FDI 6 years before the adoption and 6 years after the adoption. This will give us good observational differences between the state of FDI between these two periods (pre-adoption and post-adoption).

Chart 1: Growth Rate of FDI in the pre-adoption Period



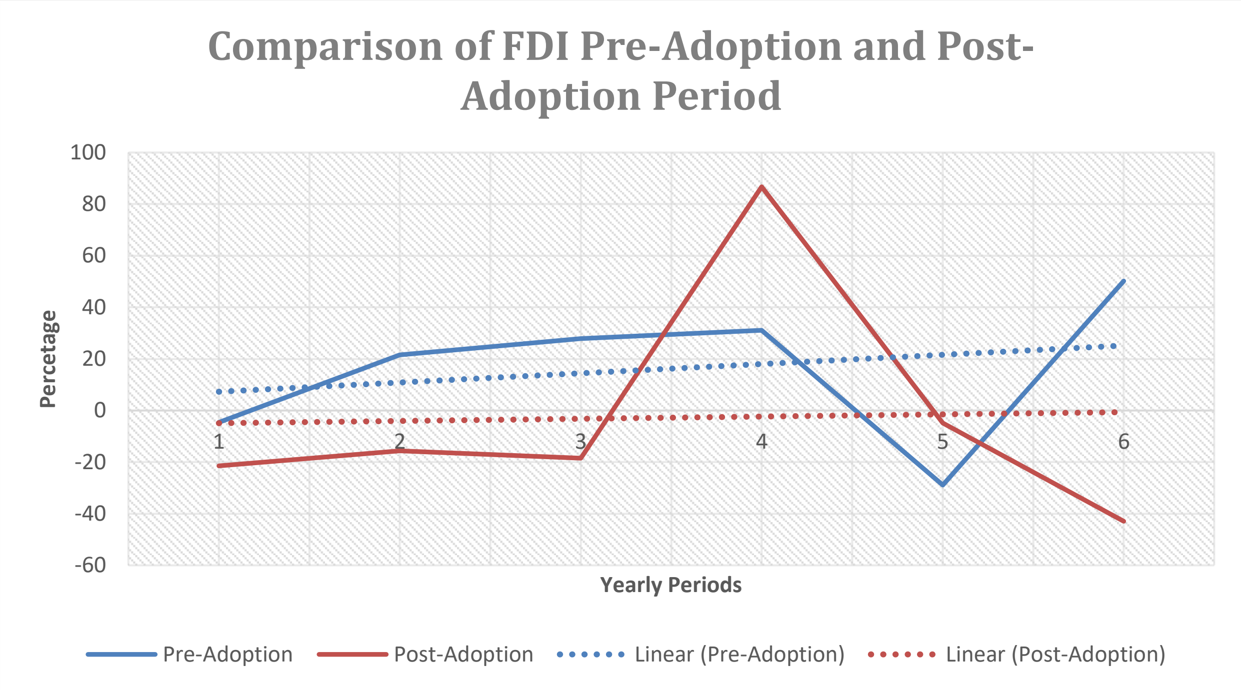
In chart 1 above, the trend line shows a slightly upward movement from left to right. This indicates a general progression of FDI between 2006 to 2011. Although FDI witnessed a sharp decline in growth in 2010 and increased by about 50 percent in 2011, thus representing an abnormality in the curve.

Chart 2: Growth Rate of FDI in the post-adoption Period



The above chart shows that FDI in Nigeria's post-IFRS adoption grew slightly. Although the plots reveal the underperformance of FDI post-IFRS adoption yearly, the trend shows an overall slight increase, this could be due to the sharp unreal increase by 86% in 2016, otherwise, the trend would have been downwards.

Chart 3: Comparison of FDI Pre-IFRS Adoption and Post-IFRS Adoption Period



The above chart represents a foreign direct investment in Nigeria after the adoption of IFRS. FDI since adoption in 2012 has been underperforming. The volume of inflows into the country has not been growing significantly over the years except for the peak growth of over 80% in 2016 (4th-year post-adoption). Although FDI pre-IFRS adoption has the highest peak, it also has the lowest minimum among the two time periods. Comparing both periods, FDI pre-adoption outperforms FDI-post adoption. The former only declined once within the period while the latter witnessed all 4 declines in 6 time periods. The above chart also reveals that FDI in the pre-adoption period was more consistent as it witnessed only one sharp fall in 2010 while FDI in the post-adoption period was very inconsistent as there were majorly sharp rises and declines. Observationally, the introduction of FDI could not improve the inflow of FDI into Nigeria, ceteris paribus as against the popular signaling theory in the adoption of IFRS and FDI.

Fig 1. Two-Sample t-test with equal variances

Two-sample t test with equal variances

Variable	Obs	Mean	Std. Err.	Std. Dev.	[95% Conf.	Interval]
preIFRS	6	982.5499	117.1251	286.8968	681.4702	1283.63
postIFRS	6	836.5526	92.05685	225.4923	599.9129	1073.192
combined	12	909.5512	74.35217	257.5635	745.9032	1073.199
diff		145.9973	148.9723		-185.9337	477.9284

diff = mean(**preIFRS**) - mean(**postIFRS**)　　t = **0.9800**
Ho: diff = 0　　degrees of freedom = **10**

Ha: diff < 0	Ha: diff != 0	Ha: diff > 0
Pr(T < t) = **0.8249**	Pr(|T| > |t|) = **0.3502**	Pr(T > t) = **0.1751**

A two-sample t-test with equal variances was run on a pre-IFRS and post-IFRS FDI sample data from 2006 to 2011 and from 2013 to 2018 respectively, comparing foreign direct investment 6 years before the adoption of IFRS and 6 years after. We tried to determine if there is any significant difference in FDI since the introduction of IFRS in Nigeria or if the mean difference in FDI is significantly different from zero between both time intervals.

Having compared the two-time periods, it is evident that there is no statistical difference between the FDI pre-IFRS adoption and FDI post-IFRS adoption.

Conclusion

The adoption of IFRS in the Nigerian accounting system does not correspond to the signaling theory expected boost to the influx of Foreign direct investment, rather the reverse is the case as FDI post-IFRS adoption performed badly compared to FDI pre-adoption period. Hence, we found no evidence supporting the signaling theory discussed by Gordon et al. (2012).

Our findings align with the findings of Nnadi & Soobaroyen (2015) and Owusu et al (2017). Nnadi & Soobaroyen (2015) using a sample of 34 African countries over 20 years found IFRS adoption to be negatively associated with FDI inflows. In a wider study by Owusu et al (2017), they deployed a sample data of 116 developing countries from 1996 to 2013 of which their findings showed that the adoption of IFRS has no significant effect on FDI inflows. Hence, the conclusion that the supposed effect of the signaling theory is as it is, 'a theory' and does not possess enough power to instigate foreign investments in Nigeria. Other factors, such as political and economic stability affects the foreign investment decisions in Nigeria.

We recommend that the Government stabilize the economy so that certain economic theories and expectations could be made applicable in Nigeria.

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