Journal of Business Research and Statistics | *ISSN 1694-4356*
Published by AIR JOURNALS | *https://airjournal.org/jbrs*
16/18 Avenue des Longaniers, Quatre Bornes, Mauritius
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RESEARCH ARTICLE

Effect of Mandatory International Reporting Standards on Stock Prices of Manufacturing Firms Listed on the Nigerian Stock Market

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Accepted: April 22nd, 2020	Published: April 30th, 2020

Citations - APA

Chukwuani, V. N. (2020). Effect of Mandatory International Reporting Standards on Stock Prices of Manufacturing Firms Listed on the Nigerian Stock Market. *Journal of Business Research and Statistics, 2(1),11-18.*

ABSTRACT

This study examined the effect of mandatory adoption of IFRS on stock prices of manufacturing firms listed on the Nigerian stock market, and to determine whether there is a significant difference in stock prices given the mandatory adoption of IFRS by firms in 2012. Findings from the study, therefore, imply that the mandatory adoption of IFRS has a positive and significant effect on stock prices of manufacturing firms listed on the Nigerian Stock Exchange and that there is a significant difference in stock prices of manufacturing firms given the mandatory adoption of IFRS in 2012.

Keywords: *Mandatory International Reporting Standards; Adoption of IFRS; Stock Prices; Manufacturing Firms*

Introduction

The capital market occupies the central position for capital mobilization in the Nigerian economy and fundamentally requires investors' confidence and trust to promote the understanding of the purpose or investment prospects. Publicly available information is reflected in the financial position of a company; the stock market is described as semi-strong in pricing efficiency while the inclusion of private information makes the market pricing strongly efficient (Banerjee, 2008). Better investment decisions are facilitated by stock price informativeness. Atlen (1993), stock pricing depends on the formulation or the firm, the will industry and the market, which is driven by the amelioration in financial reporting and improvement in information flow (Ferrena and Laux, 2007). This means comparability will be enhanced with greater information efficiency that is driven by transparency and disclosure in financial reports. In recent times, a number of Nigerian companies have raised capital from international capital markets, and others have established a significant presence in other jurisdictions. Also, a good number of Nigerian entities hold the securities of non-Nigerian issuers. Thus, for a better understanding and appreciation of the risks and consequently, making decisions about the flow of global economic capital, it makes sense that financial statements prepared in Nigeria use global financial reporting standards.

Reform in Nigeria, like other emerging markets, extended to accounting as a consequence of development in financial markets and economic growth (Jahun, 2012). For example, the financial Repaving council of Nigeria Act (FRC) requires all companies to prepare their financial statements in accordance with the international financial Reporting Standard (IFRS). The adoption of IFRS has in recent times gained momentum across the world, starting first in the western world and subsequently in developing countries. Moreover, the increasing globalization of the world wade had many companies that were hitherto relying on their local capital markets for funds to now seriously increase their search for debt and equity capital inside and outside their shores. Proponents of IFRS have advocated several merits of a single set of global accounting standards. One of the main advantages of a single set of global accounting standards as advocated by its supporters is that it enables international investors to compare different financial statements across several companies and countries.

The argument is that it should increase companies' access to global capital thereby reducing cost, for developing countries, the emergence of uniform standards enhanced comparability of financial statements prepaid internationally by companies in developed economies with that prepaid locally. Despite the myriads of benefits or IFRS, it was the announcement made by the European Commission in June 2000 that it was going to require all listed companies in the European Union (EU) to use the International Accounting Standard (IAS) that brought about the real possibility of having global standards. Aian addition, there was an implicit political and economic pressure on countries to converge their accounting standards obviously this came about as a result of the 2007-2010 financial crisis, (Ernest & Young, 2014).

The new theory on the stock price informativeness noted by Beuselinck (2008) describes how the adoption of new Financial Reporting Standards (FRS) decreases stock returns synchronicity and subsequently rising following analysis educating activities. In Nigeria, the experience of trading on the floor of the Nigeria stock exchange supports that stock price informativeness attracts sophisticated investors' confidence in becoming more informed about their firm. But, the degree of IFRS in compliance with NASB and its co-movement with idiosyncratic volatilities are yet to be studied. The effect of stock price informativeness on investors' confidence, conceptually reviews the degree of adoption and implementation of NASA standards as an indicator of the preparedness for the adoption of IFRS and the extent of improving the investment climate in Nigeria. The objectives of this study, therefore, are to ascertain the effect of the mandatory adoption of IFRS on stock prices of manufacturing firms listed on the Nigerian stock market and to determine whether there is a significant difference in stock prices given the mandatory adoption of IFRS by firms in 2012. Following this introduction, the rest of the paper is structured into four parts. While section four presents the findings, section five concludes the study.

Literature Review

Financial statement apart from stating the financial position of an organization. Provides other information such as the value-added, charges in equity if any and cash flows of the enterprise within a defined period of time to which it is related (Iyoha & Faboyede, 2011). This information is useful to a wide range of users making informed economic decisions. The quality of financial reporting is indispensable to the users who require them for investment and other decision-making purpose. Financial reports can only be regarded as useful if it represents the “economic substance” of an organization in terms of relevance, reliability, comparability and aids interpretation simplicity (Penman, 1984).

Ahmed (2003), stated that useful accounting information derived from qualitative financial reports helps in the efficient allocation of resources by reducing the dissemination of information asymmetry and improving the pricing of securities. To prepare and audit financial statements, some accounting conventions and principles known as standards have been put in place by appropriate bodies set up for the purpose to encourage uniformity and reliability (Stainbank & Peeles, 2006). The implementation of IFRS would reduce information irregularity and strengthens the communication link between all stakeholder Bushman & Smith (2001). It also reduces the cost of preparing a different version of financial statements when an organization is multi-national (Healy & Palcu, 2001). Accounting standard ensures that important matters regarding the preparation and presentation of financial statements as well as auditing same are not left to the whim of the preparers and auditors. Before the IFRS adoption era, most countries had their standards with local bodies responsible for development and issuance.

The adoption of the international financing Reporting Standard (IFRS) has serious implications for regulatory authorities. The adoption entails the extensive use of judgements and assumptions that regulatory agencies must put into consideration. Stock exchanges possess enforcement powers in that they can refuse to list the shares of companies listed in the Exchange, (Akhidime.2010). Daske, Hail, Leuz and Verdi (2007) studied 3.100 companies in 26 countries under the mandate to adopt IFRS in “Mandatory IFRS Reporting around the world: Early Evidence on the economic Consequences “. The objective of the study is to examine the economic effects of the IFRS creating unassailable economic gains in the country with uncompromising regulation over financial reporting. These benefits include an enhancement in the stock market value, an increase in the market liquidity and a lower cost of capital. Companies with foremost departures between GAAP and IFRS standards sow the benefits when endorsed by a strong regulatory environment. The research also investigates possible contributory factors not related to IFRS acceptance that may have engendered these economic benefits: self-selection comes out to be a principal explanation, companies voluntarily changing to IFRS had factors unconnected to the accounting standard change that imparted them with economic benefits.

Armstrong, Barth, Jagolinzer and Riedi (2008) did a study titled ‘Market Reduction to Events surrounding the Adoption of IFRS in Europe’, with the object of unravelling European stock market reaction to events associated with IFRS adoption will outweigh the expected costs. The study left it to further research to determine whether the expectations are fulfilled. The increased trading on the stock market could have affected the volatility of the stock market. However, investors have recently been worried about the falling stock price of the Nigerian stock market (Olowe, 2009). Also, the Nigeria stock market is a developing and inefficient one characterized by the time lag between information availability about a stock and its full reflection in the price of the stock, poor infrastructural facilities in the country which makes it virtually impossible for the information to now freely and speedily to actual and potential investors, activities of corporate insiders and insider abuses. The understanding of volatility and stock price prediction in Nigeria's stock market will be imperative as it helps in predicting the path of its economy’s growth and determines the efficiency of the stock market which will serve as an indicator of economic growth and development in Nigeria and turn attract foreign portfolio investment. The scope of this study is limited to the Nigerian capital market with special reference to the stock prices of selected manufacturing companies. However, it is necessary to assess the error of adoption or IFRS on the stock market price of manufacturing companies with a view to determine whether investors' expectation is satisfactory.

In the study of Ajao and Weinambu (2012) on volatility estimation and stock price prediction in the Nigerian stock market, the study aimed to understand the Nigerian stock market with regard to volatility and prediction. To this effect, the month-end stock prices of four major companies from the period January, 2005 to December, 2009 were used as proxy. The study made use of the Autoregressive Conditional Heteroscedasticity (ARCH) to estimate and find out the presence of volatility. According to the study, the presence of volatility in all the four stock prices, while past stock price volatility was then regressed against stock prices to determine their predictability. The results, however, revealed that out of the four companies, only two companies' stock prices were predicted by volatility in their stock prices, while past stock prices predicted current stock prices implying that the market does not follow a random walk. As a result of these, it is properly checked, to reduce the predictability of stock prices, information should be known and made public to all investors. Also, policymakers are advised to review their economic policies and should be careful in their use of the Nigerian bourse as a barometer to reflect performance in the general economy as our findings suggest that this could be misleading. Kenneth (2012) studied the adoption of IFRS and financial statement effects: the perceived implication on foreign direct investment (FDI) and the Nigerian Economy and stated that the IFRS adoption is already an issue of global relevance among various countries of the world due to the quest for uniformity, reliability and comparability of financial statements of companies. The paper however investigated the effects of IFRS adoption on foreign Direct Investment and Nigeria's economy. The population used consists of quoted companies in the Nigeria Stock Exchange and investment analysis. stratified random sampling method was adopted and primary data was used to elicit responses with 123 structured questionnaires administered. It was perceived that IFRS implementation will promote FDI inflows and economic growth. It was recommended that all stakeholders should endeavour to have a full implementation to reap the benefits of the global GAAP and principle basal standards.

Studies in the past have looked into several issues bothering on mandatory IFRS adoption and its implication for firms, investors and the overall economic performance. This study, however, contributes to the existing literature by objecting to ascertain the effect of mandatory adoption of IFRS on stock market, and to determine whether there is a significant difference in stock prices given the mandatory adoption of IFRS by firms in 2012.

Methodology

Design, Sampling, and Data Issues: The research design adopted for this study is the ex-post factor as the study relied on historic data of manufacturing companies listed on the Nigerian Stock Exchange from 2010-2015. The period from 2010-2015 includes two periods the pre-adoption period (2010-2012) and a post-adoption period (2013-2015). The study used firm-level data bothering on stock prices gathered from the Nigerian Stock Exchange. Stock price data exist in daily, weekly and monthly forms. This study adopts the monthly stock prices and using the December month as the closing price of the stock in each of the periods.

All the manufacturing firms listed on the Nigerian Stock Exchange formed the population of this study while the sample constitutes twenty-one (21) firms classified under the consumer goods industry sector of the Nigerian Stock Exchange. The period of analysis includes years for which firms quoted on the Exchange were forced by the regulatory authority to mandatorily adopt the IFRS as well as years before the mandatory IFRS adoption. All variables for the sampled firms are observed for each cross-section and each time period resulting in a total number of one hundred and twenty-six (126) observations.

The Model: The study used two models. Firstly, the study used a linear regression equation to evaluate the effect of mandatory adoption of IFRS on stock prices of selected manufacturing firms listed on the Nigerian Stock market and thus the equations are specified thus:

$StockPrices_u = IFRS*Adoption_u+U_{it}$……………………………………………………………………………………………………(1)
where the Stock prices are the observed end of year market prices of stocks of manufacturing firm at time and IFRS*Adoption represent the discretionary of mandatorily changing from IAS to IFRS in 2012 for the firm at various times While Uit the random errors. Regulatory pressure is one of the most influential factors on stock prices. This variable in this case decides the extent to which stock prices vary for different firms under standard IFRS reporting. Precisely, in year I and for I, the variables IFRS*Adoption are arrived by dichotomously assigning I to periods under mandatory adoption of IFRS (post-IFRS) and 0to pre-IFRS periods.

Secondly, this study used a model structured in a way to enhance comparisons of stock prices between the pre-IFRS and post-IFRS periods to find out whether there is any significant difference in stock prices before and after the mandatory adoption of IFRS by firms. Thus, the second model employed the parametric paired sample t-test model. This statistical tool focuses on determining significant differences in the chosen operational variables between two sample means observed at two points in time. In this version, the two samples are combined (pooled) to get a pooled variance and base the standard error of the difference in means on that single estimate; the resulting t can be compared directly to critical values from the t distribution table. The choice of this technique is that it suits the second objective of this study which is to determine if there is a significant difference in stock prices before and after the adoption of IFRS.

The t-test statistics are modelled thus;

$$tn_1 + n_2 = \frac{\bar{x}_1 - \bar{x}_2}{S(x_1 - x_2)} \quad \text{………………………………………………………………………………………………(2)}$$

Where;

$\bar{x}_1$ = Samples mean value of the specified variable in the pre-adoption period

$\bar{x}_2$ = Samples mean value of the specified variable in the post-adoption period

$S(x_1 - x_2)$ = the standard deviation of the difference in the pooled variance and thus calculated as:

$$S(x_1 - x_2) = \sqrt{S^2P} \quad \text{……………………………………………………………………………………… (3)}$$

$$= \sqrt{S^2x_1 - S^2x_2}$$

$$= \sqrt{(n_1 - 1)S^2 + (n_1 - 2)S^2} \quad \text{……………………………………………………………………………… (4)}$$

Where S

Findings

In the effort to determine the effect of mandatory adoption of IFRS on stock prices of manufacturing firms, a regression equation was estimated using a panel square and the result presented in the table 1 below:

Table 1: Regression Analysis Result

Dependent variable: STOCKPRICE
Method: Panel Least Squares
Date:01/15/17 Time: 13:20
Sample: 2010 2015
Periods included: 6
Cross-sections included:21
Total panel (balance) observations: 126
TABLE 2: Paired Samples Test

Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
IFRS	40.94317	14.52264	2.819264	0.0058
C	44.08794	10.26906	4.293279	0.0000

Effects Specification

Cross-Section Fixed (Dummy Variables)

R-squared	*0.787027*	*Mean dependent var*	*64.55952*
Adjusted R-squared	*0.744022*	*S.D. dependent var*	*161.1016*
S.E. of regression	*81.50814*	*Akaike info criterion*	*11.79660*
Sum squared resid	*690932.0*	*Schwarz criterion*	*12.29182*
Log Likelihood	*-721.1857*	*Hannan-Quinn criter*	*11.99779*
F-statistic	*18.30113*	*Durbin-Waston stat*	*0.681026*
Prob(F-statistic)	*0.000000*		

Source: Author's EViews 7.2

The F-statistics of 18.3011 with a probability of 0.000000<0.05 shows that our model fits and the R-squared of 0.787027 suggest that 78% of the variations in stock prices of manufacturing firms listed in Nigeria Stock Exchange are caused by the mandatory adoption of IFRS. Consequently, the t-statistics of 2.819264 with a probability of 0.0058<0.05 and thus being significant suggests a positive and significant effect. This implies that the mandatory adoption of IFRS has a positive and significant effect on stock price of manufacturing firms listed on the Nigerian Stock Exchange.

Also, this study objects to determine whether there is a significant difference in the stock prices of manufacturing firms listed on the Nigerian Stock Exchange after the mandatory adoption of IFRS. The findings from the parametric t-test in achieving this objective is as presented in table 2 below

	Paired Differences						
	Mean	Std. Dev.	Std. Err Mean	95% Confidence Interval of the Difference	t	df	Sig. (2-tailed)

				Lower	Upper			
Pair 1 preIFRS-postIFRS	28.48339	96.22236	12.22236	52.92351	4.04327	2.330	61	0.23

Looking at the t-test result above, the t= 2.330 was significant with the 2-tailed significance value of 0.023<00.05 level of significant difference in the stock prices of manufacturing firms given the mandatory adoption of IFRS in 2012.

Conclusion

The new theory on the stock price informativeness noted by Beuselinck (2008) describes how the adoption of new Financial Reporting Standards (FRS) decreases stock returns synchronicity and subsequently rises following analysis educating activities. In Nigeria, the experience of trading on the floor of the Nigeria stock exchange supports that stock price informativeness attracts sophisticated investors' confidence in becoming more informed about their firm. The effect of stock price informativeness on investors' confidence conceptually reviews the degree of adoption and implementation of NASB standards as an indicator of the preparedness for the adoption of IFRS and the extent of improving the investment climate in Nigeria. The objectives of this study therefore are to ascertain the effect of mandatory adoption of IFRS on stock prices of manufacturing firms listed on the Nigerian stock market and to determine whether there is a significant difference in stock prices given the mandatory adoption of IFRS by firms in 2012. Findings from the study, therefore, imply that the mandatory adoption of IFRS has a positive and significant effect on stock prices of manufacturing firms listed on the Nigerian Stock Exchange and that there is a significant difference in stock prices of manufacturing firms given the mandatory adoption of IFRS in 2012.

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