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Effects of International Financial Reporting Standards (IFRS) on Foreign Direct Investment: A Study of Nigerian Commercial Banks

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Abstract

The study examined the effect of adopting International Financial Reporting standards (IFRS) on Foreign Direct Investment (FDI) inflow into Nigeria. The objective of the study was to assess whether the adoption of IFRS has significant impact on Foreign Direct Investment (FDI) inflow into Nigeria. Three null hypothesis were stated thus: Non-current assets disclosed by banks adopting IFRS has no significant effect on value of FDI inflow; Profit after tax of Nigerian banks adopting IFRS has no significant effect on value of FDI inflow; Total assets disclosed by banks adopting IFRS has no significant effect on value of FDI. Secondary data were collected from published financial statements of three commercial banks under study. The regression analysis based on ordinary least (OLS) was used to test our null hypotheses. The findings of the study revealed that contrary to general expectation, the value of FDI inflow into the sector did not significantly increase after the adoption of IFRS. On the basis of the findings, we recommend amongst others that the addition to encouraging IFRS adoption, Nigeria government should create enabling environment to attract foreign direct Investment into the economy.

Introduction

Background to the Study

The first recognized attempt towards standard convergence was the proposal by the professional accountancy bodies in Canada, United Kingdom, and the United States to create the Accountants International Study Group (AISG) in 1966. The primary aim of its formation was to develop studies of accounting and auditing practices in the three regions.

Meanwhile, at the 40th World Congress of Accountants in Sydney held in 1972, Sir Henry Benson put forward the proposal for the setting up of the International Accounting Standards Committee (IASC). After due deliberations by the three AISG countries and other representatives of the professional accountancy bodies present, IASC was established in

1973, with Sir Henry Benson and Paul Rosenfield as its first Chairman and Secretary respectively. The main objective of IASC formation was to develop a single set of high standard quality International Accounting Standards (IASs). All listed companies in Europe were mandated by the European Commission to adopt IASs or the IFRS from 2005(Odia & Ogiedu 2013)

It is worthy to note that financial statements which these standards are set to guide not only state the financial position of an organization, but provides other information such as the value added changes in equity and cash flows of a business entity in a specified period (Iyoha and Faboyede, 2011). Such statements provide information that is useful to the wide range of users as they help to make informed economic decisions. Financial reports can be useful if it represents the 'economic substance' of an organization in terms of relevance, reliability, comparability and aids interpretation (Penman, 1984). Similarly, Ahmed (2003), stated that useful accounting information derived from qualitative financial reports help in efficient allocation of resources by reducing dissemination of information, lop-sidedness and improving pricing of securities.

To achieve such a high quality financial report some accounting standards have to be put in place so as to encourage uniformity, reliability and comparability. It is the opinion of the Accounting bodies that the implementation of IFRS would reduce irregularity and strengthen the communication link between the stakeholders. Other notable advantages of IFRS implementation include the reduction in cost of preparing different version of financial statements where an organization is a multi-national entity. (Healy and Palepu, 2001).

Evidently, achieving a globalized capital market requires a unified global accounting reporting and disclosure of set of standards. In line with this, the International Accounting Standard Board adopted the IFRS framework on 1 April, 2001. The standards were adopted by over 90 countries around the world. IFRS was established and approved by the IASB. The goals of the IFRS foundation and the IASB is to develop in the public interest a single set of high quality understandable, enforceable and globally acceptable financial reporting standards based upon clearly articulated principles .

The introduction of IFRS came to the front burner in Nigeria by 28 July 2010, when the Nigeria Federal Executive Council approved 1st January 2012 as the effective date for convergence of accounting standards in Nigeria with International Financial Reporting Standards (IFRS). The Council further directed the Nigerian Accounting Standard Board (NASB), under the supervision of the Nigerian Federal Ministry of Commerce and Industry to take further necessary action to give effect to the council's approval. On 3rd September, the Nigerian Accounting Standard Board (NASB) announced a staged implementation of IFRS as follows: publicly listed entities and significant public interest entities are expected to implement IFRS by January, 1st 2012. Other public interest entities are expected to implement IFRS by January 1st 2013 while small and medium sized entities are expected to implement by January 2014. This staged implementation outlined by the NASB was approved by the Federal Executive Council (FEC) on 28 July, 2010.(Okpala,2012).

Meanwhile, the implementation of IFRS was expected to engender increased inflow of Foreign Direct Investment (FDI) into Nigeria. According to World Bank (1996), FDI is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency. Such investments may take the form of either “Greenfield” investment (also called “mortar and brick” investment) or merger and acquisition (M&A), which entails the acquisition of existing interest rather than new investment (Ayanwale, 2007). The advantages of FDI range from transfer of capital and technology, economic growth, market access and employment generation. (Caves, 1996; De Gregorio, 2003). This explains why most countries and continents (especially developing ones) now see attracting FDI as an important element in their strategy for economic development. In fact, one of the pillars on which the New Partnership for Africa’s Development and National Economic Empowerment and Development Strategy (NEEDS) were launched was to increase inflow of FDI into Africa and Nigeria respectively through a combination of reforms, resource mobilization and a conducive environment for FDI inflows (Funke and Nsouli, 2003).

In line with the above, adoption of the IFRS has been seen as a veritable tool for the attraction of FDI into a country since IFRS is expected to enhance confidence of investors by presenting financial statements in one globally accepted formats understandable by investors across the globe. Thus, this study attempts to investigate the link between IFRS adoption and the inflow of FDI in Nigerian commercial banks for the period of 2011 to 2014.

Statement of the Problem

Both IFRS and FDI are important ingredients of globalization. For example, UNCTAD (2001) notes that FDI in the world rose from US$57billion in 1982 to US$1,271 billion in 2000. However, Africa share of FDI remains insignificant compared to other regions of the world. Although the UNCTAD’s World Investment Report 2004, reported that Africa’s outlook for FDI is promising, the expected increase in FDI flow to Africa is yet to be manifest based on empirical evidence. Apparently, FDI is still concentrated in only a few countries for reasons ranging from negative image of the region, to macroeconomic policy environment. Although, Nigeria is one of the few countries with the highest share of FDI in Africa, FDI remains a small percentage of the country’s gross domestic product (GDP) ranging from 2.47% in 1970, -0.81 in 1980, 6.24% in 1989 and 3.93% in 2002 (Anywale,2007). World investment report (2014) showed that inspite the inflationary trend the FDI in 2011 remains at 12.3%,, 16% in 2012 and declined again to 11% in 2013. As a result of the insignificant percentage of FDI in the country, various approaches have been adopted to improve FDI inflow especially in this era of globalization and need to diversify the economy. The adoption of the IFRS was therefore considered as a welcome development that would serve as catalyst for FDI inflow into the country.

Instant studies reviewed shows that the relationship between International Financial Reporting standards (IFRS) adoption and FDI inflow into Nigerian banks has not been clearly articulated hence the researcher is motivated to investigate if there is any significant relationship between IFRS adoption and FDI inflow into Nigeria commercial banks.

One of the aims of creating International financial reporting standards is to achieve a high quality financial report to encourage uniformity, reliability and comparability of the financial statements produced by different entities. It is then the opinion of the Accounting bodies that the implementation of IFRS would reduce irregularity and strengthen the communication link between the stakeholders. Based on the above, current and prospective investors' confidence on the financial statements of the companies will be strengthened as standardization of Accounting statements will enable investors to assess properly the economy and the performance of companies in country of interest. IFRS reduces communication barriers occasioned by differences in accounting policies. This will now facilitate decision making hence increasing FDI inflows but the question yet to be answered is determining the relationship of IFRS adoption on the inflow of foreign direct investment hence the need for this study.

Writers like Findlay, (1978); Borensztein (1998); Caves, (1996); Carkovic and Levine (2002) concentrated on the importance and rationale for attracting FDI into a country. Some other writers like Agu (2013), Okpala, (2012) and Akindele (2012) mainly focus on the relevance of IFRS and the effect of its adoption on financial statements. All together, these studies have not clearly articulated the relationship between IFRS adoption and FDI inflow into Nigeria commercial banks. Hence, the researcher decided to explore this gap.

Objectives of the Study

The broad objective of the study is to assess whether the adoption of IFRS has significant impact on Foreign Direct Investment (FDI) inflow into Nigeria.

Specifically, the study will:

1. Ascertain the relationship between changes in foreign direct Investment as a result of adoption of IFRS.
2. Ascertain the relationship of foreign direct investment and bank Profit after tax (PAT) following adoption of IFRS.
3. Determine the significant difference in the value of banks Total assets due to FDI inflow before and after the adoption of IFRS.

Statement of Hypotheses

The following three null hypotheses were stated for empirical testing.

1. Non-current assets disclosed by banks adopting IFRS has no significant effect on value of FDI inflow.
2. Profit after Tax of Nigerian banks adopting IFRS has no significant effect on FDI.
3. Total assets disclosed by banks after adopting IFRs has no significant effect on value of FDI.

Review Of Related Literature

Conceptual Framework

International Financial Reporting Standards (IFRS)

International financial reporting standards (IFRS) consist of a set of international accounting principles, the adoption of which aims at establishing clear rules to draw up comparable and transparent annual reports and financial statements. The adoption represents an essential element to obtain an integrated, competitive and attractive market, which has impelled Nigeria to adopt this set of uniform accounting standards.

It is believed that adoption of IFRS will lead to greater transparency and understandability, lower cost of capital to companies and higher share prices, reduced national standard setting costs, ease of regulation of securities markets, easier comparability of financial data across borders and assessor investment opportunities, increased credibility of domestic market to foreign capital providers. Moreso that its introduction will also facilitate easier international mobility of professional staffs across national boundaries.. For the multinational companies it will help them to fulfill the disclosure requirement for stock exchange around the world (Armstrong. Barth, Jagolizer & riedl, 2007)

Inspite the expected benefits above, it should be realized that the principal impending factor in the adoption process of IFRS in Europe, America and other continents of the world are not necessarily technical but cultural issues, mental models, legal impediments, educational needs and political influences (Obazee, 2007). According to Rong-ruey duh (2006); Okon, (2013), the implementation challenges include timely interpretation of standards, continuous amendment to IFRS, accounting knowledge and expertise possessed by financial statement users, prepares, auditors and regulators.

Foreign Direct Investment (FDI)

The growing significance of FDI across the world has equally attracted large amount of studies on FDI. For example, Ayanwale, (2007) notes that FDI is an amalgamation of capital, technology, marketing and management. In defining, FDI, World Bank (1996), FDI is an investment made to acquire a lasting management interest (normally 10% of voting stock) in a business enterprise operating in a country other than that of the investor defined according to residency. In another development, Kumai (2007) sees FDI as involving building long term relationships with enterprises in foreign countries which can be made in several ways including:

- The parent enterprise injecting equity capital by purchasing shares in foreign affiliate;
- Re-investing the affiliate's earnings;
- Short or long term lending between parents and affiliates.

Furthermore, to be categorized as a multinational enterprise for inclusion in FDI data, the parent company must hold a minimum equity share of 10% in the affiliate. In his study, Caves (1996) argued persuasively that the rationale for increased efforts to attract more FDI stems from the belief that FDI has several positive effects. Among these are productivity gains, technology transfers, and the introduction of new processes, managerial skills and know-how in the domestic market, employee training, international production networks, and access to markets. Similarly, Findlay (1978) opined that FDI increases the rate of technical progress in the host country through a "contagion" effect from the more advanced technology, management practices etc used by the foreign investors. Again, Borensztein,E.T, Detaregorra, J; Lee J. (1998) sees FDI as an important vehicle for the transfer of technology, contributing to growth in larger measure than domestic investment. In the same vein, Carkovic and Lavin (2002) posits that the economic rationale for offering special incentive to attract FDI frequently is derived from the belief that foreign investments produce externalities in the form of technology transfer and spillovers.

Empirical Review

Akindele (2012) in his study stated that the adoption of International Financial Reporting Standard (IFRS) has changed the way and manner in which financial statements are prepared, reported or presented. He pointed out that due to increase in globalization of capital market, it then requires a unified global accounting reporting and disclosure set of standards. The writer concluded that adopting IFRS is a very big move for the firms accounting regulatory body and the government in Nigeria because the benefits outweigh the cost.

Okpala (2012) in his work, adoption of IFRS and financial statement effects anchored on the efficiency theory. He employed the use of t-test statistics in testing the hypothesis to determine the effect of IFRS on financial statements components of selected companies. He concluded by stating that though Nigerian companies have been mandated to adopt the new trend, many of them are yet to fully adopt the new standard in the presentation of their financial statements. He moreso stated that the impact of IFRS on the financial statement components is not yet significant.

In another study, Agu (2013) in his own study on relevance of IFRS adoption also stated that its adoption is really relevant to the Nigerian industries. He used simple percentage responses to conclude that the stakeholders believe that it is relevant to adopt the IFRS.Furthermore, Adetula, Nwobu & Owolabi (2014) utilized secondary data to investigate whether IFRS adoption translated to enhanced FDI flow to Nigeria. Based on result of the OLI regression for their study, the authors argued that the longer a country uses IFRS, the higher the FDI flow to the country. Similarly, Oduware, (2012), argued that with the adoption of IFRS in Nigeria, a lot stands to be gained from the seemingly distressed global economy especially in terms of receiving a boost on FDIs.

Owolabi, Onwere & Dada (2013), argued that IFRS came on board to make international comparisons easy but this has remained difficult because each country has its own set of rules. Again, issues in IFRS are highly technical and would require great skill and man-power development to understand and implement.

In their study, Okoye & Ezejiofor (2014), concentrated on the effect of IFRS on stock market performance of banks with a view to measure whether investors’ expectation is satisfactory. Using a sample of fourteen banks quoted in Nigerian Stock Exchange, findings of the study revealed that most of the banks could not generate sufficient interest earnings to cover their interest obligations thereby unable to satisfy investor’s expectation.

Theoretical Framework

The relevant theory in this work is Keynesian theory of growth. This is more specific hence the study is anchored on it. This theory was first introduced by British economist John Maynard Keynes in his book. The general Theory of employment, interest and Money, which is published in 1936 during the great depression.

Keynesian theorists believe that aggregate demand is influenced by a series of factors and responds unexpectedly. Shifts in aggregate demand impact production and employment, and inflation in the economy. Other key features of the theory states that:

- Unemployment is the result of structural inadequacies within the economic system. It is not a product of Laziness as believed previously.
- During a recession the economy may not return naturally to full employment. The government must step in and utilize government spending to stimulate economic growth.
- A lack of investment in goods and service causes the economy to operate below its potential output and growth rate.

- Overcoming an economic depression required economic stimulus which could be achieved by cutting interest rates and increasing the level of government investment.

From the foregoing the researcher believed there is a relationship between the IFRS adoption as a stimulus to attract foreign direct investment. Hence the theory is considerd suitable for the study.

Discussion Of Strategies To Achieve Objectives

Discussion of Strategies for Data Collection

In line with the objectives of the study, the researcher relied on secondary data collected from financial statements of selected banks. Secondary data are data already collected and documented by another party and is not original to the researcher. The study adopted the Ex-*post facto* research design. Thus, the study depended on secondary data extracted from the financial statements of the selected banks. This includes: the annual value of non-current assets of each of the banks; the value of Profit after Tax (PAT) of each of the banks and the value of the total assets for the period 2011 to 2014 which represents two years before the adoption of the IFRS and two years after the adoption of the IFRS. Figure for foreign direct investment (FDI) inflow into the country for the same period was obtained from the banks. The reason for selecting 2011 to 2014 as our study period was to ensure that we have equal number of years before adoption of IFRS and after adoption of IFRS so as to enable statistical comparison.

Research Design

As articulated by Asika (2006), *Ex-post facto* research design is a systematic empirical inquiry of events that have taken place in which the researcher does not experiment, control or manipulate the independent variable(s) but starts with the observation of a dependent variable and studies the independent variable in retrospect for its possible relationship to and effects on the dependent variable (Kerlinger, 1977; Asika, 2006; Ofo, 1999).

Discussion of Strategies for Data Analysis

In analyzing data for the study, we adopted regression analysis based Ordinary Least Square (OLS) method to estimate parameters contained in hypotheses one, two and three. Thus, econometric models were formulated to establish the relationship between FDI and other variables contained in the hypotheses like the non-current assets, profit after tax (PAT) and Total assets of the selected banks. In line with this, linear regression equations were formed and regression analyses performed based on the following popular regression function.

$Y = a + bx$

This is modified in line with our hypotheses as shown in our model specification below.

Model Specification

(a) Our model I is specified in line with hypothesis one as follows:

$FDI = f(BNCA)$……………………………….. (1)

Equation 1 was transformed to equation 2 below in order to enable us estimate our parameters using regression analysis

$FDI_t = \beta_0 + \beta_1 BNCA_t + \varepsilon_t$……………………….(2)

Where,

$BNCA_t$ = Banks Non-current Assets

FDI_t = Foreign Direct Investment into the Banks

β_0 = constant
β_1 = coefficient of the independent variable
ε_t = error term

(b) Model II is specified in line with hypothesis two as follows
FDI = f(BPAT) ………………………… (3)
Equation 3 was transformed to equation 4 below in order to enable us estimate our parameters using regression analysis

$FDI_t = \beta_0 + \beta_1 BPAT_t + \varepsilon_t$……………………….(4)

Where,
$BPAT_t$ = Banks Profit After Tax
FDI_t = Foreign Direct Investment into the Banks
β_0 = constant
β_1 = coefficient of the independent variable
ε_t = error term
(c) Model III is specified in line with hypothesis three as follows
FDI = f(BTA) ………………………… (5)
Equation 5 was transformed to equation 6 below in order to enable us estimate our parameters using regression analysis

$FDI_t = \beta_0 + \beta_1 BTA_t + \varepsilon_t$……………………….(6)

Where,
BTA_t = Banks Total Assets
FDI_t = Foreign Direct Investment into the Banks
β_0 = constant
β_1 = coefficient of the independent variable
ε_t = error term

Data Presentation And Analysis.

Estimation of Model for Hypothesis One

In order to estimate model for the first hypothesis, the Augmented Dickey-Fuller (ADF) unit root test was performed to check whether the variables are stationary. This is because regressing non-stationary time series on another non-stationary series may generate spurious regression. Result of the ADF unit root test as contained in table 3.1 indicated that the variables are stationary. Again, the explanatory variable and the dependent variable are not integrated in the same order; therefore we do not suspect co-integration or long-term relationship. The next term was to estimate our model using the OLS regression. The result of our OLS regression is contained in table 3.2

The table indicates that only 4% of the changes in dependent variable (FDI) is explained by the explanatory variable (Banks Total Non-current Assets) as indicated by the Adjusted R-squared value of -0.043. Furthermore, the estimate coefficient of the model (B = .44) shows that a unit change in the explanatory variable brings about 44% change in the dependent variable (FDI). This is however not statistically significant since $p > 0.05$. Again, the Durbin-Watson statistics of 0.86 indicates the presence of autocorrelation in our series. This means that the result should be taken with caution.

The implication of this result is that IFRS measured by Banks Total Non-current Assets has no significant impact on FDI inflow. Based on this, we accept our null hypothesis.

Estimation of Model for Hypothesis Two

In order to estimate model for the second hypothesis, the augmented Dickey-Fuller unit root test was performed to check whether the variables are stationary. Result of the ADFunit root test as contained in table 3.3 indicated that the variables are integrated in the same order 1(1). Since the variables are integrated in order one, we therefore suspect co-integration or long-term relationship among the variables. Consequently we test the variables for co-integration using Johansen and Juselius (1990). The result of the co-integration tests indicates that there is no long run relationship among the variables. Since, our cointegration test indicates that there is no long-term relationship between the variables; we therefore proceed to estimate the OLS regression equation.

The regression indicates that only 14% of the changes in dependent variable (FDI) is explained by the explanatory variables Bank profit after tax as indicated by the adjusted R-squared value of .14 furthermore, the estimate coefficient of the model B =.14 shows that a unit change in the explanatory variable results in only 14% change in the dependent variable (FDI). This are however not statistically significant since $p>0.05$. Again, the Durbin Watson statistics of 0.62 indicates the presence of autocorrelation in our series. This means that the result should be taken with caution.

The implication of this result is that IFRS measured by Banks' Profit after Tax (PAT) has no significant impact on FDI inflow. Based on this, we accept our null hypothesis.

Estimation of Model for Hypothesis Three

In order to estimate model for the third hypothesis, the augmented Dickey-Fuller unit root test was also performed. The process repeated as in hypothesis two above. The regression indicates that only 2% of the changes in dependent variable (FDI) is explained by the explanatory variables Bank total assets as indicated by the adjusted R-squared value of -0.2. furthermore, the estimate coefficient of the model B =-0.02 shows that a unit change in the explanatory variable results in only 2% change in the dependent variable (FDI). This are however not statistically significant since $p>0.05$. Again, the Durbin Watson statistics of 1.23 respectively indicates the presence of autocorrelation in our series. This means that the result should be taken with caution.

The implication of these results is that IFRS measured by Bank's Total asset has no significant impact on FDI inflow. Based on this, we accept our null hypothesis.

Summary and Conclusion

This study set out to examine the effect of adopting the International Financial Reporting Standards (IFRS) in Nigeria on Foreign Direct Investment (FDI) inflow into Nigeria. Accordingly, the broad objective of the study is to assess whether the adoption of IFRS has significant impact of Foreign Direct Investment (FDI) inflow into Nigeria banks.

Specifically, the study:

1. Determined Non-current assets disclosed by banks adopting IFRS has significant effect on value of FDI inflows.
2. Examined whether the Profit after tax of Nigerian banks adopting IFRS has significant impact on FDI inflows.
3. Ascertained whether the Total Assets disclosed by banks adopting IFRS has significant effect on FDI.

To achieve our set objectives, we embarked on review of relevant literature. Based on our conceptual and empirical review, we observed that the relationship between adopting the

International Financial Reporting Standards (IFRS) in Nigeria and Foreign Direct Investment (FDI) inflow into Nigeria have not been given adequate attention in extant literature. This formed the gap in literature which this study attempted to fill.
In line with the above, we anchored our analysis on the Keynesian theory as postulated by John Maynard Keynes. Secondary data were collected from financial statements of three commercial banks selected based on record of early adoption of IFRS while the data on FDI inflow into Nigeria for the period under investigation were also obtained. The t-test statistical analysis was adopted to test the three hypotheses stated in the study.
The study found that contrary to general expectation, the value of non-current assets of the three commercial banks selected for the study did not witness significant increase except that of UBA. Again, despite the adoption of IFRS in Nigeria, the volume of FDI inflow into the country did not significantly increase after the adoption of IFRS. Finally, our study also revealed that non-current assets; Profit after tax and Total assets of the three selected commercial banks did not significantly increase after the adoption of IFRS. Based on these findings we upheld our three null hypotheses and concluded that there is no significant relationship between IFRS adoption and FDI inflow into Nigeria.

Recommendations
Based on the findings of our study, we put forward the following recommendations:
1. In addition to encouraging IFRS adoption, Nigerian government should create enabling environment for attracting FDI into the economy.
2. Accounting bodies should continue to ensure that international best standards are adopted by Nigerian banks in presentation of their financial statements so as to make them attractive to foreign investors across the world.
3. Nigerian banks should strive to remain competitive and focus more on lending to the real sectors of the economy which can add to the banks PAT.

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