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EFFECT OF FINANCIAL STATEMENT RATIO ANALYSES ON SHAREHOLDERS' INVESTMENT DECISION OF QUOTED COMMERCIAL BANKS IN NIGERIA

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ABSTRACT

The aim of this study is to explore the effect of financial statement ratio analyses on shareholders' investment decision of twelve (12) commercial quoted banks in Nigeria for the period 2010 to 2018. Financial ratios which were included in this study are return on capital employed and dividend per share which also represented the independent variables. Dividend yield (a proxy for shareholders' investment decision) as seen in prior related literature is employed as the dependent variable. Ex-post facto and descriptive research design were both considered in the study methodology. Specifically, we employed Hierarchical Regression Analyses estimator to test the study hypotheses which clearly suggest that dividend per share is a very strong and significant indicator necessary to drive shareholders' investment decision. This finding is consistent with the Dividend Relevance Theory of Lintner & Gordon (1959) who argued that shareholders are most interested in current dividend payment than retained earnings. Therefore, in line with the outcomes obtained, this study recommends that managers of quoted commercial banks whose intent is to positively signal its prospective and existing investors/shareholders should prioritize dividend payout policies which will most certainly drive up per share dividend ultimately providing good signal to shareholders' investment decision.

KEYWORDS: *Hypotheses, Obtained, Hierarchical, Regression*

INTRODUCTION

In the corporate world, directors and management are responsible for preparing and publishing audited financial report for shareholders, investors and all other interested users. Investment decision involves the commitment of current funds into long term projects for future benefit, as such financial information becomes important to the success of these investment opportunities. According to Williams (2002) financial information is the results of business operations expressed in monetary terms. The notion of financial information largely implies those aspects encapsulated in the financial statements of an organisation which may be used to ascertain the financial position of such organisations for investment decision making. Financial information relating to a business organisation is important to users within and outside the organization to enhance informed investment decision making. Investment decisions are very crucial and caution must be taken because huge, scarce and hard-earned resources are involved, irreversible in nature, risky and have long term implication which no investor would want to be confronted with if negative results occurred.

Therefore, there is every need for investors to have good knowledge and understanding of the cash flow statement, value added statement, income statement, the price, earnings, value and dividend per share and other relevant financial statements to avoid irrationality in investment decision making. It must be noted that the financial information prepared by management as a responsibility has to be reviewed by independent external auditors and duly analyzed by professional financial experts prior to investment decision making. The perceived relevance of financial information is to provide reliable information about the true and actual financial position, performance (profitability), and changes in financial position of a business investment opportunity that could be useful to a wide range of prospective investors, managers, directors, financial institutions, financial analysts, government, regulatory agencies, the media, vendors and the general public in making informed or rational investment decision.

The insurgence of corporate failures, like that of Enron Corporation and World.com in the year 2002 and other accounting scandals compounded by the global energy, food and financial crisis leading to credit squeeze across the globe, has partly been attributed to impact of financial statement manipulations which portrayed some ailing company as if they were sound. In Nigeria also, corporate failures and distresses have been witnessed in the banking sector. Evidence was the huge collapse of commercial banks all due to massive accounting related frauds. This problem resulted in the establishment of Asset Management Company of Nigeria (AMCON) to prevent corporate failures particularly in the Nigeria banking sector by acquiring financially distress companies. This trend has now more than ever ensured that financial statements are sternly scrutinized.

Investors, Financial analysts and other users of accounting information tend to use their ‘third’ eye to scrutinize financial statements. This became necessary because audited financial statements, which used to provide assurance as to the healthy nature or otherwise of a firm has now, become an object of criticism due to manipulations done in these statements. According to Onyekwelu (2010), one of the most difficulties facing the auditing profession is that there is no auditing process that can provide absolute assurance in detecting all fraudulent financial reporting. Calls have been made on the accounting/auditing profession to employ investigative principles in the preparation and audit of financial statements in order to restore confidence of the investing public on the financial statements. Duru, Hassan, Song, and Zhoa, 2012)opined that contrary to the

external auditor who is basically concerned about compliance, the forensic accountant should employ investigative, law and business principles and acumen to carry out investigations on financial statement and prepare it. When managers prepare its own final account solely for internal use by the directors and management, it can draft them in any way which is most suitable. Although such accounts might have been prepared with strict adherence to accounting theory and principles but will not necessarily be published for public consumption. These separate sets of statements are then viewed by investors as creative accounting and has contributed to eroding public confidence on published financial statements. Banks have been accused of publishing paper profits hence the general belief that published financial statements have failed in its responsibility to provide credible information for investors and other users of financial statements (Duru, Hassan, Song, and Zhoa, 2012).

LITERATURE REVIEW

Financial Statement Analyses

Financial Statements have been widely defined in the extant literature by scholars and experts. According to the Companies and Allied Matters Act 1990 (CAMA), financial statements consist of the basic statement of accounts used to convey quantitative information of the financial statusof a business to shareholders, creditors and others interested in the reports of company's financial condition, result of operation uses and sources of funds. Ekwe (2013) also defines financial statements as reliable financial information about the economic resource and obligations of a business enterprise. Meigs & Meigs (1998) posit that financial statement is a logical point to begin the study of accounting. However, financial analysis is the selection, evaluation and interpretation of financial data along with other pertinent information to assist in investment and financial decision making. Financial analyses may be employed internally to evaluate issues such as employees' performance the efficiency of operations and credit policies and externally to evaluate potential investments and the credit worthiness of borrowers among others. Four critical ratios have been so far identified in literature; Liquidity Ratio, Profitability & Activity Ratios, Leverage Ratios and Shareholders' Ratios. However, in this paper we consider profitability and shareholders' ratios due to their relevance and popular and usage.

Return on Capital Employed

The return on capital employed (ROCE) ratio (profitability ratio) compares a firm's earnings from its primary operations with the capital invested in the company and can serve as a reliable measure of corporate performance (McClure, 2010). ROCE provides a means of measure to determine how well a company invests funds in its basic business operation (Eilon, 1992). Capital employed is the total amount of share capital and debt that a company has and uses (Scarlett, 2006); it refers to the amount of assets that contribute to a company's ability to generate revenue. This financial ratio employed to express ROCE uses operating income as the numerator and capital employed as the denominator (Bodie, Kane & Marcus, 2004). Essentially, ROCE is the operating profit per unit of capital employed. Earnings before interest and taxes (EBIT) is a measure of a firm's profitability that excludes interest and income tax expenses (Bodie, Kane & Marcus, 2004). EBIT indicates the level of operating income the firm is generating.

Dividend Per Share

Dividend per Share (DPS) is the sum of dividends declared by a company divided by the number of outstanding ordinary shares issued. According to Zameer, Rasool, Igbaland Ashad (2013), there

are varied reasons why companies pay dividends. It may either be a way to reduce the rise in agency cost between managers and shareholders or to reduce the uncertainty of the investors of the company. It could be a goal of the investor to receive returns on continuous basis, so will prefer to invest in firms paying dividends. Studies concludes that firms paying more dividends have an easy access to the capital markets and dividends payment also effect stock valuation. Dividends are mostly paid out by companies that are in a better cash position and whose earnings can be said to best able and sound (Kania & Bacon, 2005). According to Denis and Osobov (2008), large, mature and more profitable firms are thought to be highly probable to pay dividends as they can even source for such funds to pay out dividends from cheap external debt sources at their disposal.

Shareholders' Investment Decision

The wisdom behind the use of financial ratios is to guide users to make good and effective decision which is expected under normal circumstances in order to have a multiplier effect on the economy at large (Maidoki, 2013). The objective of financial statements is to convey information about the true financial performance or position as well as the capability of an entity (Piotroski, 2000). There are different users of accounting information; each of the categories have their unique demand in terms of their information need. For instance, potential shareholders are interested in ascertaining the earnings that will emanate from the financial resources they will commit to finance their organizations. Employees, on the other hand, are strongly interested in being adequately compensated for the services they rendered. Governments are interested in the reports to ensure that a just and fair resources allocation is achieved and for tax purposes. Moreover, members of the public are in need of information to understand the operational performance of the businesses located in their domain, particularly their responsibilities to stakeholders (Dandago& Hassan, 2013). In other words, the public are solely interested in information from financial ratios which will guide them in appreciating the economic and social impact of the firm's activities.

Financial Statement Ratio and Shareholders investment Decision

Most reviewed related empirical studies conducted in the area of financial statements information and shareholders 'investment decision revealed plausible association between financial statement information and investment decisions of shareholders (Nkuhi 2015; Heikal,Khaddafi& Ummah 2014; Zagger&Zagger 2006; Anaja&Onoja 2015; Ekwe 2013). These opinions were theoretically anchored on the traditional role of accounting which bothers on the provision of historical information as it relates the business performance and further usage of the past performance so detected to measure or estimate the future and form opinion about the firm's future performance. It is therefore important and proper that financial statements being crucial to investment decisions are regulated by different national bodies and globally by International Accounting Standard Board (IASB) in order to forestall uninformed decisions.

2.2 Signaling Theory

According to signaling theory, also referred to as the information content hypotheses, this is where corporate announcements are hypothesized to have information content, for example mangers use cash dividend announcement to signal changes in their expectations about the future prospect of the company when the market becomes imperfect. The investment and financing decisions of firm's are made at the management discretion. It is argued that company mangers use earnings as a tool to convey information about the prospects of the company. Like dividends, if earnings convey useful information, it will reflect on stock price changes immediately following a public announcement. An increase in equity (shares) issued by a company reduces the price of its share,

stock splits cause price increase while issuing more debt instruments leads to price increase actions. Berhardt, Douglas, and Robertson (2005) in their study noted that markets are rarely in equilibrium, the information has a cost and it does not reach all at the same time. When a firm announces its earnings or dividend it sends signals to investors and if they react to the signals as expected this will affect the share prices of the companies listed on the stock market, consequently this effects investor' decisions.

Dividend Theory Relevance

In the study of Black & Myron (1974) "Dividend Relevance is a theory relating to the impact of dividends on organizations and individual investors' decision. The theory propounded by Lintner, (1956) and Gordon, (1959), established that there is a direct relationship between dividend policy of firms and its market value. Investors respond quickly to receiving actual cash "Bird in hand theory" which is another name for dividend Relevance. According to Lintner, (1956) and Gordon, (1959), dividends received today are preferable to future dividends, which are subject to uncertainty. Higher certainty will cause investors to ascribe a higher risk premium to those payments, thereby increasing a firm cost of capital by decreasing the value of stock" Gordon & Lintner, (1956) strongly believed that stockholders prefer current dividends and that this causes a positive relationship between dividends and market value.

2.3 Empirical Review

Osuala, Ugwuma, & Osuji (2012) in their study on the effect of information content of financial statement on shareholders' investment decision on some selected firms Nigeria employed some content of financial statement; profitability, Dividend Per Share (DPS), Earnings Per Share (EPS), leverage and liquidity as proxy variables while shareholders' investment decision was represented by change in number of shares. Data for the study was obtained from published annual reports of selected firms. Regression model was employed to establish the relationship between the variables which indicated that shareholders in the Nigerian capital market do not rely heavily on financial statements as a major determinant for their investment decision. It was observed that other variables outside firms' annual reports such as regularity of dividend payment and market price of shares are critical to shareholders in their investment decision.

Sembel (2007), investigated the nature of indicators that have influence on investor's needs and motivation to invest in equity shares, using data of firms traded on the Jakarta stock exchange the findings shows that investors in emerging markets require certain metrics as tools to analyze and predict the value of shares. The metrics here are the key compositions of financial information which will be analyzed and interpreted by analysts for investors to determine the future prices of share of a particular business in other to make investment. The researcher argued that the metric provides a basis to ascertain the interrelationships among fundamentals, external risks, and value of the shares influencing the quality of fundamental investment decisions the result reveals an indirect relationship suggesting that the value of shares is determined by its price, and price in turn is a function of number of shares (NOS), as number of shares is determined by Dividend per share.

Shun &Chyan (2011) Conducted a research in Taiwan relating to the influence of information search on risky investment preferences, the study suggested that digital information search increases the individual interest in risky investment because investment might reduce their uncertainties via greater understanding of company's financial status. The study showed that due to lack of information and understanding for various risks, investors desire advice from professional advisors (financial experts). They especially desire a face-to-face contact when

choosing a complex investment. Information here also is imperative to investment decision in respect to risky investments, especially in a portfolio of stock, where dividend per share is also key in selecting stocks to combine in a portfolio of investment

Zayol, Agaregh, and Eneji (2017) empirically investigated the effect of financial information on investment decision making by shareholders of banks in Nigeria. The study extracted secondary data from published annual reports of five selected banks in Nigeria for the period 2009 to 2015. Correlation matrix and regression analysis were used to analyze the data and the findings showed a positive relationship between the variables of the study. It was recommended that both existing and prospective investors can factor financial information relating to dividend per share, a proxy for financial information, while making investment decision in shares.

Uwah and Akpan (2019) examines the relationship between creative accounting and investment decisions by shareholders in Nigerian public companies. In this study survey research design where 61 professionals comprising chartered accountants, company secretaries, financial consultants/analysts, and seasoned academicians in the accounting profession were surveyed. Five hypotheses at 5% significance level are tested, while Correlation and Pearson product of moment correlation is used to measure the degree of association between the variables. The findings reveal that creative accounting has significant relationship with investment decision of investors and concluded that most investments in quoted companies are made as a result of creative accounting practices inherent in financial reports.

METHODOLOGY

In this study, *ex-post facto* research design is employed which uses information already documented was employed. The population of the study is made up of all quoted commercial banks in Nigeria for the period 2010 to 2018. As at 31st December, 2018 the total number of quoted commercial banks was sixteen. In a bid to obtain a sample size from the population, this study adopted Krejcie and Morgan, (1970) sample size technique which gave us a sample size sample of14 banks. However, banks that got listed after the study period (2010) or that got delisted before the end of the study period (2018) were deselected, thus the final sample size consist of 12commercial banks quoted on the floor of the Nigerian Stock Exchange market. Panel Least square regression was first employed for the analysis so that some regression diagnostic analyses can be conducted. However, the regression diagnostic which were conducted include; test for multicollinearity, test for fixed and random effects. The results reveal the presences of random and fixed effect and thus a Hausman specification test (0.5085) suggest that the random effect model is more appropriate. However, to correct for the random effect in the model, we adopted the Hierarchical Regression Estimator. All these were done to improve the reliability of the resulting estimates. We modified the study of Osuala, Ugwuma, & Osuji (2012) to express the econometric equation as:

$$divyd_{it} = \pi_0 + \pi_1 roce_{it} + \pi_2 dps_{it} + \sum_t$$

Where:

DIVYD = *Dividend Yield*

ROCE = *Return on Capital Employed*

DPS = *Dividend Per Share*

it = *(i = no of cross section and t = time periods)*

$\sum t$ = *Model Error Term*

RESULTS AND DISCUSSION

To examine the effect of financial statement ratio analyses on shareholders' investment decision of listed commercial banks in Nigeria, some regression post estimation test which include; test for multicollinearity, test for fixed and random effects were conducted. The descriptive statistics gives the insight into the nature of the sample banks in this study. The result is shown below:

TABLE 1 DESCRIPTIVE STATISTICS

Variable	Obs	Mean	Std. Dev.	Min	Max
divyd	108	5.023889	4.576673	0	19.05
roce	108	1.642315	2.326055	-9.53	9.54
dps	108	.4783333	.6427765	0	2.83

Authors Computation 2021

From the table above, it is observed that on average dividend yield is 5.024 with a minimum value of 0 and maximum value of 19.05. Similarly, we observe that on average, return on capital employed for the sample banks is 1.642 with a standard deviation of 2.326 and a minimum and maximum value of -9.53 and 9.54 respectively. For the variable of dividend per share, on average we observe that it is 0.47 with a standard deviation of 0.643 while dividend per share ranges from 0 to 2.83.

Test for Multicollinearity

Multicollinearity occurs when the explanatory variables in a regression model are correlated suggesting that there is a strong relationship between the independent's variables which violates the model's estimation. In this study like in most other related studies, we employed the variance inflation factor (VIF) technique to diagnose the presence or absence of multicollinearity in the model. Specifically, we adopt Greene (2009) which allows a cut-off value of 10. The results of the VIF test reveal a mean value of 1.22. Succinctly, we observed that the mean value is within the VIF threshold of 10 as recommended by Greene (2009), thus, there no room to suspect for the presence of multicollinearity.

Test for Fixed and Random effects

Wallace and Hussain estimator of component variances (a two-way random and fixed effects panel) was performed at a 0.05 level of significance. Over time, when this tool is applied researchers are usually faced with the option of choosing between using the fixed-effect panel model or the random-effect panel model. Therefore, to justify the choice of model, the Hausman specification test is largely suggested by scholars (Gujarati, 2004). Actually, this test checks for a more efficient model against a less efficient but consistent model. It ensures that the more efficient model also gives consistent results. The results reveal the presence of random and fixed effect while Hausman specification test (0.5085) suggest that the random effect model is more appropriate. However, to correct for the random effect in the model, we adopted hierarchical regression estimator and the results is presented below:

Hierarchical Regression Estimator

In hierarchical regression, the focus is on the change in predictability associated with predictor variables entered later in the analysis over and above that contributed by predictor variables entered earlier in the analysis. Change in R^2 (ΔR^2) statistics are computed by entering predictor variables into the analysis at different steps. A predetermined, theoretically based plan for the order of predictor variable entry, held at the discretion of the researcher, is imposed on the data. Statistics associated with predictor variables entered in later steps are computed with respect to predictor variables entered in earlier steps. Thus, ΔR^2 and its corresponding change in F (ΔF) and p-values are the statistics of greatest interest when using hierarchical regression (Wampold& Freund, 1987). The corresponding ΔF value for ΔR^2 would allow a researcher determine if the ΔR^2 statistics significantly improve the model's ability to predict the effect of the independent variable on the dependent variable. With a focus on ΔR^2, rather than on β or structure coefficients (Courville & Thompson, 2001; Thompson &Borrello, 1985), less attention is given to how predictor variables are reevaluated on the basis of their corresponding βs and structure coefficients when other predictors are added to the analysis, as was often done in stepwise regression. Specifically, the model summary obtained from the Hierarchical regression shows that the addition of a second predictor variable (Dividend per share) brought about a significant change in R^2 from 0.019 to 0.236. This indicates that about 24% (0.236) of the change in dividend yield is explained by the addition of dividend per share to return on capital employedas the predictor variables. Furthermore, a look at the F-statistics reveal an overall increase (33.294) when compared to the previous models. The p-value of 0.000 indicates that this change in the F-Statistics is significant at 1%. From the foregoing, since the explanatory power of R^2 in the second model is significantly (1%) better compare to the previous model, we adopt the 2nd model for interpretation and policy recommendation. The result is presented below.

TABLE 2 HIERARCHICAL REGRESSION ESTIMATES {2TH MODEL}

divyd	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
roce	-.1754917	.1829495	-0.96	0.340	-.5382467	.1872634
dps	3.820115	.6620507	5.77	0.000	2.507391	5.132839
_cons	3.484813	.5070543	6.87	0.000	2.479418	4.490208

R-Square Diff. Model 2 - Model 1 = 0.236 F(1,105) = 33.294 p = 0.000

Source: Author's computation (2021)

The hierarchical regression of the 2nd model presented above reveal the result of the variable of return on capital employed (ROCE) as follows: (Coef. = -0.1755, t = -0.96 and P -value = 0.340). Following the results above, it is revealed that the effect of return on capital employed on dividend yield (a measure of shareholders' investment decision) is negative and statistically insignificant during the period under review.Return on capital employed (ROCE) ratio compares a firm's earnings from its primary operations with the capital invested in the company and can serve as a reliable measure of corporate performance (McClure, 2010). Results obtained from this study reveal thatReturn on Capital Employed has no significant effect on shareholders' investment decision of quoted commercial banks in Nigeria during the period under review. We contradict prior studies of Drury, 2000; Skinner, 1990; White et al., 1998; who concluded that ROCE shows how effective

management are in the allocation of capital thus providing investment signals to the investors. However, companies with old assets and low written-down values might therefore incorrectly show higher ROCE calculations. The ROCE figure will be misleading because the capital structure does not adequately reflect long-term funding requirements, nor does it provide a sufficiently accurate asset base on which to judge management performance (Eilon, 1992).The hierarchical regression of the 2ndmodel presented above also reveal the result of the variable of Dividend per share (DPS) as follows: (Coef. = 3.820, t = 5.77 and P -value = 0.000). Following the results above, it is revealed that the effect of dividend per share on dividend yield measure of shareholders' investment is positive and statistically significant during the period under review.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). It also supports Pandy's criticism on the Miller and Modigiliani (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. Dividends are mostly paid out by companies that are in a better cash position and whose earnings can be said to best able and sound (Kania & Bacon, 2005). According to Denis and Osobov (2008), large, mature and more profitable firms are thought to be highly probable to pay dividends as they can even source for such funds to pay out dividends from cheap external debt sources at their disposal.

CONCLUSION AND RECOMMENDATION

The objective of financial information is emphasized by various accounting principles because investors and creditors use them in making rational investment decision. Financial statement fairly represents business and economic situation of a country, which if studied carefully can lead to the achievement of some financial and economic goals. The role of financial statement analysis in making investment decisions should not be overlooked as it helps investors to establish fiscal strength and weakness of the organization. Financial statement analysis can reveal the red flags of an investment opportunity. On the other hand, they can also reveal the strength of the banks as well as the potential profit of investing in an organization. In this study, we aim to evaluate the effect of financial statement ratio analyses on shareholders' investment decisions of quoted commercial banks in Nigeria. The scope of this study covers a 9year period ranging from 2010 to 2018. The outcome from the hierarchical regression estimation reveals that: Return on capital employed has an insignificant effect on shareholders' investment decision whileDividend per share has a significant positive effect on shareholders' investment decision of quoted commercial banks in Nigeria. Therefore, in line with the outcomes obtained, this study recommends that managers of quoted commercial banks whose intent is to positively signal its prospective and existing investors/shareholders should prioritize dividend payout policies which will most certainly drive up per share dividend ultimately providing good signal to shareholders' investment decision.

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