

International Financial Reporting Standards and Foreign Direct Investment in Nigeria

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Abstract — International Financial Reporting Standards (IFRS) have been accepted in countries mainly because it is widely believed that those standards enhance transparency in the preparation of financial statements. Consequently, increased transparency should lead to enhanced Foreign Direct Investments (FDI). The purpose of this paper was to ascertain the impact of IFRS on FDI as it affects the Nigerian economy. Using data from secondary and primary sources, the results from the regression analysis showed that there is a positive but not significant relationship between FDI inflow and IFRS adoption. It was found that the longer a country uses IFRS, the higher the FDI. Furthermore, the perception of the business managers and preparers of financial statements towards FDI could signal their willingness to adopt IFRS. The study recommends that the financial reporting council of Nigeria (FRCN) should monitor compliance with the requirements of the reporting standards as this might help organizations in the long run to secure FDIs.

Keywords- International financial Reporting Standards, foreign direct investments, Nigerian economy

I. INTRODUCTION

Nigeria adopted International Financial Reporting Standards (IFRS) in September, 2010 but the implementation started with Public Limited Liability Companies in 2012. The IFRSs are standards set by the International Accounting Standards Board (IASB) which is the international body responsible for monitoring the preparation of financial statements worldwide. Before the advent of IFRS, most countries had their own national accounting standards which were issued by national accounting bodies [1]. For instance, the Nigerian Accounting Standards Board (NASB) was responsible for developing and issuing standards known as Statements of Accounting Standards (SAS) up to 2012 in Nigeria. This adoption is expected to improve corporate transparency especially in financial terms which in turn should lead to increase in Foreign Direct Investment (FDI).

Reference [2] claimed that preparation of financial statements in accordance with IFRS increased transparency in the statements thus, boosting the investment potential of the

country. This means that adopting IFRS will give investors more confidence in the financial statements since they have been prepared according to international standards. The term foreign direct investment arises as a result of removed hindrances across country borders and enhanced trade between countries. Reference [3] propounded that FDI arises as a result of OLI, an acronym that stands for Ownership, Location and Internalization. The motives underlying FDI include: market, resource, efficiency, and strategic asset seeking.

This research seeks to test whether the adoption of IFRS has increased foreigner's interest in investing into the companies in Nigeria. Specifically, this study ascertained whether the number of foreign investors has increased since IFRS adoption. This is important because one of the purposes of adopting IFRS among others is to increase the level of economic activity between and among countries. This study ascertained whether and to what extent IFRS adoption affects the rate of FDI. Also, this study examined whether there is a change in the level of acceptability of FDI between companies that have adopted IFRS and those that have not.

The remaining parts of the paper are literature review, methodology, findings, conclusion and recommendations.

II. LITERATURE REVIEW

According to [4], Foreign Direct Investment (FDI) occurs when there is an investment in a business organization by an investor from a foreign country. Usually, a business organization has FDI when the foreign investor owns not less than 10% of the ordinary shares of the business. This investment includes the purchase by the foreign investor of shares in the business organization located in another country (other than the home country of the foreign investor). Reference [5] was the first economist who gave reasons why FDI was the defining feature of the Multinational Corporation (MNC). He explained this in terms of its relative advantages compared with other forms of foreign operations. He claimed firms favour FDI to alternative modalities such as licensing or

cooperation because of reduction of rivalry in international markets. In addition, he said FDI allowed firms to better exploit their monopolistic advantages and diversified their risk.

In their study, [6] found that adopting IFRS increase the level of confidence of foreign investors which otherwise implies that there is a significant positive relationship between the adoption of IFRS and FDI. In addition, increasing the comparability of a firm with its counterparts could be a motivation for FDIs. This is best done by the style of reporting which is the essence of the IFRSs. The study emphasizes the comparability and not necessarily because the standards are better in themselves [7]. Similar to the aforementioned is the work of [8] where it was also found that FDIs inflow increase in countries where IFRSs add to the comparability between entities. In their work better comparability was measured by uniformity on the basis of financial reporting which is further premised on comparable entities using same accounting standards irrespective of their countries of operation. The introduction of IFRSs reduced information asymmetry across borders greatly and this has increased FDIs into countries where IFRS have been adopted. This is mainly because transparency has been enhanced and information into proposed investment is clear.

Reference [9] showed that the adoption of a high quality set of harmonized accounting standards increases trade and FDI since the higher quality of financial statements also boosts financial transparency and comparability, and decreases rate of differences in information among agents in different countries. Reference [2] stated that FDI inflow is higher into a country that is developing and has adopted IFRS than that in an underdeveloped economy. [1] stated that among countries that have adopted IFRS, uniformity, better interpretation and comparability of financial statements are the implications of the adoption. He also said that global capital markets can be easily accessed by foreign companies, which will enable them to make investments across borders. Furthermore, Nigerian companies will prepare more reliable financial statements as a result of IFRS adoption which will be uniform and comparable with those of international companies and will be easier to interpret. This will definitely boost investor's confidence and attract investments in Nigeria.

According to [10], in African countries especially, FDI inflow arises because of the existence of vast natural resources and market size. The three largest recipients of FDI are South Africa, Nigeria and Angola – all are natural resource rich nations. Nigeria is one of the countries in Western Africa

richly endowed with natural resources. The United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2006 shows that FDI inflow to West Africa is mainly dominated by inflow to Nigeria, who received 70% of the sub-regional total and 11% of Africa's total. Out of this Nigeria's oil sector alone receive 90% of the FDI inflow. The Nigerian Government adopts several policies to attract FDI in this globalization era. Particularly, the government implemented IMF monitored-liberalization of its economy, which welcomes foreign investors in the manufacturing sector, offers incentives for ownership of equity in all industries except key industries like military equipment".

The adoption of IFRS by Nigeria is also one of the moves by government and standard setters to increase FDI flow to Nigeria. This is why it is important to research on whether the adoption has yielded positive results so far in increasing FDI flow into the country.

III. METHODOLOGY

This study used both secondary and primary data. Primary data was collected from managers and preparers of financial statements in companies that have adopted IFRS and the secondary data was obtained from the World Development Indicators. One sample t-test was used to test the primary data and was analyzed using descriptive analysis whereas secondary data was analyzed using correlation and regression analysis.

The population for the survey includes companies that have adopted IFRS in the preparation of financial statements. The sample size of this study includes twenty (20) companies in Nigeria that have adopted IFRS. Fifty (50) copies of questionnaire were administered to managers and preparers of financial statements in the selected companies. The study was conducted Lagos and Ogun States.

IV. DATA PRESENTATION AND ANALYSIS

There were forty-six (46) responses and the responses were graded using the Five Likert Scale. The response to the first question has a mean of 2.87 and a standard deviation of 1.392. This shows that the average respondent agreed that there were Foreign Direct Investors in their organizations before IFRS adoption in Nigeria. The response to the second question has a mean of 1.93 and a standard deviation of 1.063. The mean shows that the average respondents did not necessarily agree that since Nigeria adopted IFRS, there has been an increase in foreign interest. The response to the third question has a mean of 2.61 and a standard deviation of 1.437 and this shows that

the average respondents agreed that new interest by foreigners will be embraced.

The responses to the fourth question had a mean of 2.63 and a standard deviation of 1.511. which shows that the average respondents agreed that more foreigners should invest directly in Nigeria. The responses to the fifth question had a mean of 2.63 and a standard deviation of 1.511. This shows that the average respondents agreed that there should be government incentives towards increased FDI in Nigerian companies. The responses to the sixth question had a mean of 2.70 and a standard deviation of 1.504 which shows that the average respondents agreed that FDI will bring about economic development in Nigeria. The responses to the seventh question had a mean of 2.57 and a standard deviation of 1.559. This shows that the average respondents agreed that there should be more FDI than portfolio investment.

It was also discovered that the longer a country uses IFRS, the higher the FDI because 0.0416 shows a positive relationship although weak. Also, as natural resources increase, FDI inflow increases, this is because there is a positive relationship between natural resources and FDI inflow (0.9217). There is a strong relationship between natural resources and FDI inflow. The higher the GDP of a country, the higher the FDI inflow in that country, there is a positive relationship between the GDP and IFRS inflow (0.6888). The relationship between them is strong. The relationship between institutions and FDI inflow is a positive one. This means that the higher the institutions, the higher the FDI inflow into a country. These institutions have a strong relationship with FDI inflow.

The results from the regression analysis show that FDI inflow and IFRS adoption have a non significant relationship because the regression between them gives a value above 0.5 (ie>0.5). This means that IFRS adoption has an impact on FDI inflow but the impact is not significant.

The results of One-Sample Test have a calculated T value of 11.808, with a degree of freedom of 45 and 0.05 significance level because of its 2-tailed nature. The test has a p-value of .000 which is less than the significance level of 0.05. Alternatively, we got a tabulated value of 1.684 which is less than the calculated value at 0.05 level of significance. Hence, companies in Nigeria are willing to accept FDI.

V. FINDINGS, CONCLUSION AND RECOMMENDATIONS

This research was carried out with the main purpose of finding out the impact of International Financial Reporting Standards (IFRS) adoption on Foreign Direct Investment (FDI). The

finding from the field survey shows that the companies that have very good reputation globally have had a good level of FDI inflow before IFRS adoption. In some other companies however, the adoption of IFRS was the beginning of FDI inflow in the company. Based on the study, the managers and the preparers of financial statements used for this study would welcome FDIs if such opportunity opens up and the government is expected to provide incentives towards improvement of FDI inflow. The company's managers believe that FDI inflow would bring about economic development in Nigeria. From the primary data, it was observed that companies want more of FDI than portfolio investment in their companies. In West Africa, Nigeria has the highest rate of FDI along with Ghana. Countries such as Sierra Leone have very low inflow of FDI. Only nine, out of the sixteen West African countries have adopted IFRS.

From the above analysis and presentation, several conclusions were drawn. The researchers found that IFRS adoption does not impact FDI inflow into a country. However, other factors such as institutions, natural resources and Gross Domestic Product (GDP) among others impact the inflow of FDI significantly. Also, it was found that companies in Nigeria are open to the idea of FDI inflow. Finally, the fact that IFRS adoption does not impact FDI does not mean that the adoption of IFRS is not important in any Nation; IFRS adoption affects several variables that were not the topic for this research.

VI. RECOMMENDATIONS AND POLICY IMPLICATIONS

Based on the findings above, the following recommendations are made:

Developing countries in the world should not be in a hurry to adopt the IFRS standards if the Nation is not structurally prepared for it especially if the main aim of adoption is to increase FDI. This is because IFRS adoption does not impact significantly on FDI as obtained from the results of this study.

Also, in order to improve the level of FDI inflow, there must be an improvement in other sectors of the economy which impact FDI inflow. Such improvements include growth in institutions, extraction and development of natural resources as well as ensuring that the GDP increases constantly.

Furthermore, the Financial Reporting Council of Nigeria (FRCN) should monitor compliance with the requirements of the reporting standards by ensuring that organizations comply as this might help organizations in the long run to secure FDIs.

VII. SUGGESTIONS FOR FURTHER STUDIES

Further studies can focus on the impact of IFRS on other sectors of the economy as this research was only centered on FDI. Also, the technical challenges Nigeria is facing as a result of IFRS adoption should be researched on to find solutions to such challenges. The factors which were seen to have significantly affected FDI should be researched on and more reasons for FDI inflow can be examined.

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