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Mandatory International Financial Reporting Standards Adoption and Cost of Equity Capital in Nigeria

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Abstract: This study examined the effect of mandatory International Financial Reporting Standards (IFRS) adoption on the cost of equity capital on Nigerian firms and whether the cost of equity capital effect after adoption of IFRS can be moderated by Return on Equity. The study covered a sample of 11 listed companies in the industrial goods sector for the period 2011 and 2013. The data for the study was secondary data generated from the annual reports and stock market report websites. The cost of equity capital was shown as the expected return on the basic value of a share and computed based on pre and post-adoption data. Findings from the study revealed that there is a significant positive relationship between the cost of equity capital and IFRS adoption indicating that the cost of equity capital increased. The market-based performance measure failed to have significant effect on the cost of equity capital after mandatory adoption. The study recommends that policies that improve domestic savings, as a principal source of equity capital, be enacted as an increase should lead to a reduction in the cost of equity capital, interest rates and increase the appeal of equity and foreign investments.

Keywords: IFRS; disclosure quality; cost of equity capital; information asymmetry

Introduction

The introduction of IFRS has many impending benefits to adopters to include greater comparability, reporting transparency, and lower transaction costs, information asymmetry for shareholders and consequent reduction in the cost of capital which should lead to increased transnational investment (Nassar, Uwuike, Uwuike and Abuwa, 2014; Brüggemann, 2011; Iyoha & Faboyede, 2011; Hoque, Monem & Zijl, 2013). The cost of capital is the rate of return demanded by shareholders for ownership of a company's existing securities from an investor's point of view (Castillo, Menéndez & Orgaz, 2014). In other words, it can be seen as the return that the market expects for their investment in a firm. From the company outlook, the cost of retaining a share price that is acceptable to the investors and offset their risk of ownership makes up the equity capital cost. The cost of capital is one of effective variables in the decision making model of company and an important concept in determination of added value to a company.

It can be observed that due to increased globalisation, governments around the world have supported International Financial Reporting Standards (IFRS) and presently, more than 140 nations require IFRS for publicly listed companies. The Nigerian government began contemplating adopting IFRS in 2007 which led the Central Bank of Nigeria (CBN) to direct banks to adopt IFRS from 2008 while directions were granted by Securities and Exchange Commission (SEC) to begin in 2009. However, the increased uniformity led to the mandatory compliance for every Nigerian company by the end of the 2012 financial year.

Prior studies provides that mandatory adoption of IFRS could ensure a decrease in the cost of capital through at least two different paths to include its high quality disclosure requirements which lower information asymmetry between firms and investors (Lambert, Leuz & Verrecchia, 2007) and enhanced information comparability (Nassar, Uwuigbe, Uwuigbe and Abuwa, 2014; Armstrong, Barth, Jagolinzer, & Riedl, 2010; Munteanu 2011). However, recent research (Prather-Kinsey, Jermakowicz, & Vongphanith, 2008; Li, 2010; Palea, 2013) suggest that many factors such as firms' reporting incentives, enforcement mechanisms, the quality of corporate governance and others can influence the cost of capital.

The motivation for the study stems from the mixed findings of previous studies that examine the effects of IFRS adoption on cost of equity as Lambert et al. (2007), Palea (2007), Lee and Chen (2011); Gkoukousi (2012) finds that IFRS adoption deceases cost of capital but Cuijpers and Buijink (2005), Dasgupta, Gan, and Gao (2010); Patro and Gupta (2014) shows that IFRS adoption increases cost of capital. There is also lack of literature to the best knowledge of researcher that such study is not available in an emerging market like Nigeria and additional gap exists as differences in corporate performance measures creates need for a country level analysis.

It is against these backdrops that this study based on a single country intends to ascertain the effects of mandatory IFRS adoption on the cost of equity capital in Nigeria. In addition, this study seeks to ascertain whether the firm performance moderates the influence of IFRS on cost of equity capital effects measured by Return on Equity (ROE).

The remainder of the work is organized as follows. The next section provides review on the theoretical framework, existing literature on mandatory IFRS adoption and the cost of equity capital and hypothesis development followed by the section 3 on the methodology. Section 4 provides the main findings and results; Section 5 discusses the results. The concluding section discusses the policy implications, recommendations and contribution to knowledge of the research.

Mandatory IFRS Adoption and Cost of Equity Capital

It has been suggested that mandatory adoption of IFRS is viewed to be sufficient in reducing cost of equity by way of improved transparency and comparability (Brüggemann, 2011; Horton, Serafeim & Serafeim, 2013). The increase in corporate disclosures should lower a firm's cost of capital by reducing information asymmetry as cost of capital is higher for firms

with more amount of private information (Lee, Walker and Christensen, 2008; Gao, 2010) and Easley and O'hara (2004) model establish that demand for a higher return arises to hold stocks with greater private information. While for comparability, the resulting increased numbers of analysts following a firm creates lower cost of obtaining information which reduce informational differences among investors and their estimation risk to eventually lower the cost of equity capital (Armstrong et al., 2010).

While empirical findings on the relationship between disclosure and cost of equity capital have been mixed, as evaluated by Botosan and Plumlee (2002), Palea (2007), Ly (2010), Munteanu, Ionascu, and Ionascu (2011), most theoretical studies have appraised a competitive pure exchange economy and predicted that international power politics in IFRS adoption and disclosure quality always reduce cost of capital (Easley and O'Hara, 2004; Lambert et al., 2007; Gao, 2010; Emeni, 2014). Though, Gao (2010) theoretical model on disclosure and Fox, Helliar and Veneziani (2013) has shown that this relationship does not hold under all conditions. Lambert et al. (2007) study on the indirect effect of disclosure also emphasise that cost of capital might rise with disclosure quality and the investment effect of disclosure plays an active role in its impact on cost of capital.

In general, the related research suggests that higher disclosure levels reduce the information asymmetry among investors to reduce cost of equity capital. This background further led Daske, Hail, Leuz, & Verdi (2008) to advocate for a common set of accounting standards showing firms information quality that would lower estimation risk to decrease the cost of equity capital.

Based on the theoretical background above, a large number of empirical studies have examined the effect of IFRS adoption on the cost of equity capital, where the expected cost of capital is calculated using implicit estimation techniques or proxies such as bid-ask spreads, price volatility or trading volume. On the German capital market, Leuz and Verrecchia (2000) show evidence that the move to IFRS reduces the information asymmetry component of the cost of capital by confirming that only relative bid-ask spread reduced. Brüggermann and Homburg (2007) based on their revised model later found that the adoption of international reporting standards showed no significant effect on bid-ask spreads which supports the findings of Daske (2006) on absence of cost of equity capital reduction for listed German firms.

Daske et al. (2008) using a sample of 26 countries disclose evidence of a decrease in cost of equity capital almost before the mandatory adoption of IFRS but which later increases after adoption take place for countries where transparency is promoted and where legal enforcement is strong. Dasgupta, Gan, & Gao (2010) supports the evidence of positive anticipation effects in the capital market which was more apparent for voluntary adopting firms. However, Gao (2010) suggests this continued post adoption rise can occur only in the event of perfect competition between the investors and when the nature of new investments are perfectly elastic.

The positive findings of Palea (2007) on equity capital reduction after adoption using the first three quarters reports of 2004 and 2005 for sample of European banks is relevant as these firms are usually excluded from related studies. Gkougkousi (2012) also confirmed the findings though more evident for banks with lower quality of information environment before adoption using a cost of equity capital proxy of the average of four methods that are commonly used in research. However, Palea (2007) sample was small and based on early evidence which does not control for the effects likely to occur from institutional changes while Gkougkousi (2012) failed to consider and control possible effects of changes in enforcement and focused on institutional changes.

Dargenidou, McLeay and Raonic (2006) study on a sample of European firms with Ohlson & Juettner (2005) method to estimate equity cost, show that the adoption of IFRS increases cost of equity. The result conflicts with Prather-Kinsey et al. (2008) who using a sample of 157 European companies based on the PEG-model show that the mandatory IFRS adoption improved disclosure creating a decline in cost of equity capital across 2004-2006 regardless of the country's legal origin. Their findings were further supported by Lee, Walker and Christensen (2008) who examined the effect on the cost of equity capital based on PEG and AEG models within 1995-2006 but only significant for firms from high reporting incentive countries. They suggest the explanation that companies in countries with high reporting incentives and enforcement had greater reasons to totally observe IFRS rather than to implement partial adoption.

The result of Li (2010) supports that the IFRS mandate is associated with a significant reduction in the cost of equity capital for mandatory adopters based on a sample of 1,084 EU firms taking the average measures similar to Gkougkousi (2012) for 1995-2006. Further positive result was derived for the reduction in cost of capital when the transition period (2004-2005) is excluded as supported by Daske et al (2008). A distinction from Lee et al. (2008) includes the lack of control for country wide reporting incentives. Leung (2013) also confirmed the negative association within 2000-2009 but places emphasis on the individual and interactive effects of high reporting incentives on the cost of capital reduction. The findings support Li (2010) that cost of equity for mandatory IFRS adopters is significantly lower than voluntary firms.

Patro and Gupta (2014) focus on the effects of mandatory IFRS adoption on the cost of capital of 563 sample firms for a six year period between 2006 and 2011 controlling for firm specific variables. They observe that the estimated cost of equity based on the PEG model reduced for firms in Hong Kong and Philippines after adopting IFRS but increased for firms in China and Israel. They suggested that the adoption of the new standard plays a significant role in Hong Kong and Philippines and that the firm specific variables are not influencing the cost of equity capital in all the sample countries.

The country-level specific studies on mandatory adoption effects on cost of capital enables the separation of the results of country-level effects from cross-sectional comparisons. It has been suggested that a specific analysis by country basis with additional data for the post-

adoption period is required to capture and understand economic consequences of mandatory IFRS adoption. Ionascu et al. (2008) provide evidence of decline in the cost of equity capital of Romanian listed companies after adoption of IFRS based GAAP. They acknowledge that the ex-post cost of capital may have an effect on their results which is expected to generate an initial set of beliefs about the adoption of IFRS and the cost of capital in Romania.

Lee and Chen (2011) document a lower cost of equity capital for the German firms that were required to adopt IFRS than voluntary adopters from 12 industries within a six year time frame from 2002, with more positive results for firms that operate with higher asset liquidity. They conclude that the strength of asset liquidity regime is an important factor that determines cost of capital along with the IFRS adoption. Mihai, Ionascu and Ionascu (2012) supported the negative relationship for 27 firms in Romania after modelling the cost of equity capital as the expected return on the intrinsic value of a share. Based on the pre and post adoption period of 1998 and 2006, they concluded that the study is a starting point for adoption comparison in Romania.

Houqe et al. (2013) consider the effects of IFRS adoption on the cost of equity capital in New Zealand listed companies over a period of 1998-2009. Using the modified PEG ratio model, the result indicates that there is a significant negative association between IFRS adoption and cost of equity capital which affects both the mandatory adopters and the voluntary adopters of IFRS. Castillo et al. (2014) reveal a reduction in the PEG estimated cost of equity capital for 28 Spanish firms after IFRS adoption and controlling for a set of firm-risk and market variables using OLS regression analysis. This was attributed to the combined effect of disclosure and enhanced comparability with improved legal and institutional enforcement mechanisms. Their findings oppose Lee et al (2008) that show no post adoption reduction in cost of capital and views Spain as a low enforcement country which may be centred on the differences in sample periods that extends to 2006 and 2009 respectively.

Conceptual studies on the benefits and economic effects of IFRS adoption have documented diverse findings and conclusions. Munteanu (2011) review on major empirical papers showed a decrease in the cost of equity capital, most studies supporting a more significant effect especially for voluntary (serious) adopters. Palea (2013) show that evidences from EU countries indicates a positive effect of mandatory IFRS adoption along with the high influences of national institutional frameworks accounting for post-adoption differences. Tarca (2013) review also supports the notion of reduced equity capital cost but more likely within a high legal protection, professional and enforcement framework.

A recent review of ICAEW (2015) report positive effects on transparency, comparability, the cost of capital, market liquidity, corporate investment efficiency, international capital flows associated and analysts' ability to predict (Lourenço & Branco, 2015) for mandatory adoption of IFRS. The findings of Lourenço and Branco (2015) provide evidence of more positive effects for mandatory IFRS adopters than voluntary adopters which oppose Munteanu (2011) findings with relevance given to management incentives and institutional changes.

Hypothesis Development

As prior research suggests, the adoption of IFRS encompasses greater disclosure of information and more improved comparability which reduces estimation risk as a result of improved forecasting abilities of investors. This in turn reduces the estimated cost of equity capital. Based on the above findings, the following research hypothesis is proposed:

Hypothesis 1: The cost of equity capital is significantly associated with IFRS adoption

A general suggestion given from Wysocki (2010) and Christensen et al. (2013) holds that the effect of introducing new accounting standards depends on the incentives that the different firms have for compliance. In mandatory setting, there are different factors which may influence full adherence of IFRS to include market based profitability measures such as Return on Equity (ROE) creating reporting disparities. Thus, the informational content can be extensively varied to eventually manifest a positive or negative cost of equity. On this basis, mandatory adopting firms may improve commitment to implement IFRS financial reporting process and expect capital market benefits (Leung, 2013). Following Ali et al. (2012), Leung (2013) report negative association, though significant, between cost of capital and ROE whereas Dalton et al. (2003) and Castillo et al. (2013) is significant but the result is positive for the latter. Therefore, the study states the following hypothesis in null form:

Hypothesis 2: The cost of equity of mandatory adopters is not significantly associated with return on equity

Theoretical Framework

This paper adopts the signalling theory which provides structure to the study. The signalling theory holds that providers of capital are not in a position to distinguish the earnings ability of various firms if all they choose to disclose standard and mandatory information alone. Thus, voluntary disclosure is one of the signalling means, where companies would disclose more information than the mandatory ones required by laws and regulations in order to attract investments which arises due to information asymmetry problems (Shehata, 2014). The increased disclosure reduces this problem which creates lower estimation risk for investors to further decrease the cost of equity capital.

Under the signalling theory, the need of managers to disclose superior performance serves as bedrock of financial reporting. This desire encourages firms to adopt a form of superior standards in form of IFRS which improves transparency and promotes investors confidence to create a decline in equity cost. The theory could then justify the relationship between IFRS adoption and cost of equity capital. Therefore, $COEC = f(IFRSA)$. This theory further suggests that firms with good corporate performance tend to possess more incentives to readily provide disclosures which have a positive influence on investors to reduce equity finance cost. It has been confirmed in past empirical studies that a higher level of performance breeds greater disclosure for firms which reduce the information asymmetry.

Hence, it can be inferred that cost of equity capital is associated to firm performance which is measured in terms of Return on Assets (ROA) and Return on Equity (ROE). Therefore,

$$\text{COEC} = f(\text{ROA}, \text{ROE})$$

This theory may also explain the reason and incentive for bigger firms to become serious adopters as against smaller firms. These firms tend to experience better performance due to access to more resources and finance with the desire to show this which will serve as a positive signal to attract providers of capital. Therefore, bigger firms disclose more information that could lead to reduced equity capital costs indicating that firm size is correlated with the cost of equity capital, that is, $\text{COEC} = f(\text{FSIZE})$.

Methodology

This section describes the planned empirical research methods for this study. It considers the sample selection, the justification for such selection, the empirical model specification and variables measurements. This study adopted the cross sectional research design and this choice was made because the data was collected at a particular point in time of the sample period from the firms. The population for the study was a total of the 21 companies within the industrial goods sector while the target sample size was 11 after the exclusion of companies with at least one negative earnings in either of the sample periods. This was done following prior studies (Li, 2010; Leung, 2013; Hoque et al., 2013) because the use of such values would adversely influence the data results.

The study is carried out within a time-frame of two years for which 2011 was chosen for the prior adoption year and post-adoption period in 2013 as the mandatory adoption of IFRS standards in Nigerian firms started in the year 2012. The adoption year was also excluded to eliminate the transitional effects (Pranther-Kinsey et al., 2008; Lee & Chen, 2011). The sources of data used in the study were from secondary sources which were collected from the annual reports of firms and market reports website. The data was analysed using the Statistical Package for Social Sciences (SPSS) 21 which contains descriptive statistics and Ordinary Least Square technique that measures the relationship between the dependent and the independent variables while controlling for external factors.

Variables Measurement

The dependent variable cost of equity capital is the required return rate by investors for their investments in equity capital where COE is captured as the intrinsic value of a share (Mihai et al. 2012). This is expressed in terms of observable data such as earnings and share prices with the coefficient, β as a direct estimate of the cost of capital and its expected value should be positive and lower than 1. The ex-post measure is used by reason of low degree of efficiency of the market and unavailability of forecast data. The estimation proxy of Mihai et al. (2012) for cost of equity capital of a firm in period k by setting up the following model:

$$\log(\text{EPS}_{k+1}) = \alpha + \beta \text{MPS}_k + \varepsilon$$

where: eps_{ik+1} = the actual earnings per share of firm i in year $k+1$

MPS_{ik} = the actual share price of firm i in year k .

Similar to Dalton et al. (2003), the market based performance measure is denoted with Return on Equity (ROE) is the ratio of profit before interest and tax to the common equities.

Firm size could be an incentive as the bigger the firm, the greater level of disclosure which tends to lower estimation risk and suggests lower cost of equity capital (Petrova, Georgakopoulos, Sotiropoulos & Vasileiou, 2012). Though, ICAEW (2015) review argue that a form of bias towards bigger publicly-traded companies are prevalent in prior studies and suggest that small sized public companies should expect greater benefits after IFRS adoption. Prior literature evidences show a negative (Li, 2010; Petrova et al. 2012; Hoque et al. 2013), positive (Daske, 2006; 2008) and no significant (Prather-Kinsey et al. (2008), Patro and Gupta (2014); Castillo et al (2014) association with cost of equity capital. Thus, firm size (LOGTA) is defined as the natural log of current year total assets. It has been asserted that firms adopt strategies that show evidences of high performance in order to reduce uncertainty which retains its capital providers thereby ensuring lower cost of equity capital. Therefore, the level of operating performance may cost of equity as firms with high indicators are likely to have reduced cost. Prior studies (Lopes & Alencar, 2010; Dalton, Daily, Certo, & Roengpitya, 2003) document evidence of insignificant relationship between return on assets and the cost of capital while (Rehman & Zaman, 2011; Li, 2010; Leung, 2013; Castillo et al., 2014) show significant negative relationship except Rehman and Zaman (2011). Consistent with Leung (2013), Return on Assets (ROA) is used and defined as profit before tax divided by total assets.

Model Specification

The following regression model was estimated to examine the presence of significant relationship between cost of equity capital and the adoption of IFRS.

$$\text{Log}(\text{EPS}_{k+1}) = \alpha + \beta_1 \text{MPS}_{ik} + \beta_2 \text{ROE} + \beta_3 \text{IFRSA} * \text{ROE} + \beta_4 \text{LOGTA} + \beta_5 \text{ROA} + \epsilon$$

Where, COE indicate the measure for cost of equity capital, and MPS, ..., ROE are all independent and control variables measures as discussed above.

Data Analysis and Result

This deals with the presentation and analysis of the empirical results obtained from the estimation exercise. The table 1 provides descriptive statistics on the cost of equity capital and the independent variables. Difference in mean values for cost of MPS, EPS, log of assets, ROA, and ROE values were significantly different between 2011 and 2013. It is obvious that the firms experienced an increasing pattern in share price indicators after IFRS adoption in 2013. The mean of return on assets for the period 2011 & 2013 of 17.3% is viewed as an almost average value for the return on equity which is 31.6%. Size is the variable with the

largest standard deviation and the mean values for the variables were increased from 2011 to 2013.

Table 1. Descriptive statistics

Variable	Total (2011 & 2013)			Before IFRS (2011)			After IFRS (2013)		
	Mean	Median	Std. D	Mean	Median	Std.D.	Mean	Median	Std. D
EPS	2.261	1.195	3.229	1.783	1.290	2.036	2.738	0.8700	4.153
MPS	30.317	9.885	53.002	19.861	8.470	32.335	40.773	11.750	67.921
LOGTA	23.121	22.489	1.976	23.069	22.433	2.013	23.172	22.545	2.034
ROA	0.173	0.118	0.157	0.167	0.128	0.122	.0178	0.102	0.192
ROE	0.316	0.218	0.378	0.296	0.277	0.309	0.336	0.192	0.452

Source: SPSS Output, 2015

Table 2 denotes four results of the multiple regression analysis models appropriate to isolate the incidence and determine the individual and interactive effects of each independent variable on the dependent variable, cost of equity. The first result based on the initial model states that the coefficient of MPS in the post adoption period is higher (0.059) when compared with the value (0.056) of pre period which is highly significant. The next result occurs after introduction of the control variables where the values support positive and significant relationship between IFRS adoption and cost of equity indicating that sampled listed firms that have adopted IFRS in the period 2011-2013 incur significantly greater costs when obtaining capital funds. This supports the first hypothesis of the study and implying the significant role played by IFRS on capital cost.

The remaining two results pertain to the interaction effect of ROE on the influence of cost of equity capital after mandatory adoption as the interaction value in the pre adoption period (0.029) when compared the post adoption term (-0.049) establish a negative and insignificant relationship. Thus, reporting incentives for IFRS is greater in firms with high ROE indicating that IFRS is more effective in firms with better performance. Relating to the control variables, log of total assets has a positive but insignificant influence on cost of equity capital in both adoption periods which implies that larger firms are at a disadvantage compared to smaller firms. Besides, ROA has conflicting effects in both pre and post adoption periods but also appears insignificant.

Table 2. Effects of IFRS adoption on cost of equity and moderating effect of ROE

Variable	Pre adoption				Post adoption			
	Result 1	2	3	4	1	2	3	4
Constant	0.678 (0.092)	-4.047 (0.547)	-5.086 (0.515)	-5.086 (0.515)	0.327 (0.430)	-6.549 (0.473)	-1.254 (0.892)	-1.254 (0.247)
MPS	0.056 (0.000)	0.045 (0.040)	0.042 (0.078)	0.055 (0.001)	0.059 (0.000)	0.053 (0.003)	0.065 (0.004)	0.060
ROE			0.684 (0.717)	0.740 (0.513)			5.067 (0.203)	0.083 (0.323)
MPS*ROE				0.029				-0.049

				(0.056)				(0.068)
LOGTA		0.195 (0.515)	0.241 (0.489)			0.318 (0.429)	0.091 (0.821)	
ROA		2.598 (0.385)	1.456 (0.743)			-1.349 (0.599)	-14.455 (0.177)	
F-value	32.071	10.078	6.600	6.671	131.084	48.840	42.586	66.899
R ²	0.781	0.812	0.816	0.765	0.936	0.954	0.966	0.944

Source: SPSS Output, 2015

Note: p-values are in parenthesis.

Discussion of Findings

The results show that the positive association is significant at 5% level which supports the first hypothesis of the study and implies the significant role played by IFRS on capital cost. The cost of equity capital increased for firms after adoption which does not conform to the reasoning that lower cost of capital is an expected benefit of adopting IFRS as expressed by prior studies of Hoque et al. (2013), Tarca (2013); Castillo et al (2014) and regulatory bodies. This could be from the influence of firm's reporting incentives (Christensen et al., 2013) which are shaped by jurisdiction level factors and firm level measures, ownership structures and governance mechanisms (Brüggemann, 2011; Leung, 2013) on reporting practices.

This result supports the findings of Lee et al. (2008); Patro and Gupta (2014) and the opinion of enhanced regulatory environment to promote total IFRS adoption. This could be from the countries similarities in the form of low capacity of enforcement and market forces. It is also shown that the corporate measures are not significant to influence the change in the cost of equity capital for the sample industry which is similar to the findings of Prather-Kinsey et al. (2008), Lopes and Alencar (2010); Castillo et al. (2014).

Conclusion

The study observed that cost of equity capital increased for firms after mandatory IFRS adoption as compared to the period before adoption at a significant level which supports the hypothesis. This support the opinion in prior literature that an enabling environment increases the possibility of experiencing a reduction in equity capital costs. Therefore, future research should consider the role of other reporting incentives and institutional factors on effective adoption of IFRS and the effect of adoption on different sectors within the country.

Policy Implications of Findings

The findings of a positive significant relationship will create an avenue for policies on the issues of investments (equity and foreign), interest rates and employment.

1. This study suggests that this relationship is not suitable for investors by reason of the increased cost of equity indicating that firms will prefer to indulge in borrowing from financial institutions thereby influencing the degree of investments in equity. The country's rate of flow of foreign investments can also be involved as a decline may occur from higher cost of equity in comparison to other economies competing for available global resources.
2. The impact on policies relating to the interest rates prevailing in the economy can be as a result of the borrowing effect. The pressure on the lending capacity of the financial institutions can escalate due to high cost of obtaining equity which would subsequently the interest rates demanded from the companies.
3. The effect of higher cost of obtaining equity capital and increased operating could initiate a stringent cost reduction attitude for the firm that may lead to reduction in the volume of operation causing a decline in the rate at which labour is employed. The aggregate behaviour of these firms within the economy could then lead to an increase in the unemployment level.

Policy Recommendations

The above implications provide a basis for the suggestion of policies relating to domestic savings. This is viewed as principal source of equity capital against foreign savings for which an increase should lead to a reduction in the cost of equity capital as well as interest rates which so therefore makes equity and foreign investments much more appealing. The policies should be streamlined on means of influencing domestic savings for a long term benefit through the decrease of national deficit.

On the part of the firms, policies that influence the form of personal taxation will have an effect on cost of equity creating a decline which improves their operational efficiency and avenue for further employment of labour.

Contribution to Knowledge

This study makes important contributions which include the lack of support for signalling theory by the evidence shown that suggests the performance measures such as ROA and ROE does not have a significant impact on cost of equity capital. Therefore, higher operating firms do not necessarily disclose more information through IFRS adoption to lower cost of equity capital which shows the limited application of the theory. Moreover, the resulting policies

derived from the findings can serve as bedrock to the regulatory authorities in influencing and controlling the increased cost of equity.

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Mandatory International Financial Reporting Standards Adoption and Cost of Equity Capital in Nigeria

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Abstract: This study examined the effect of mandatory International Financial Reporting Standards (IFRS) adoption on the cost of equity capital on Nigerian firms and whether the cost of equity capital effect after adoption of IFRS can be moderated by Return on Equity. The study covered a sample of 11 listed companies in the industrial goods sector for the period 2011 and 2013. The data for the study was secondary data generated from the annual reports and stock market report websites. The cost of equity capital was shown as the expected return on the basic value of a share and computed based on pre and post-adoption data. Findings from the study revealed that there is a significant positive relationship between the cost of equity capital and IFRS adoption indicating that the cost of equity capital increased. The market-based performance measure

failed to have significant effect on the cost of equity capital after mandatory adoption. The study recommends that policies that improve domestic savings, as a principal source of equity capital, be enacted as an increase should lead to a reduction in the cost of equity capital, interest rates and increase the appeal of equity and foreign investments.

Keywords: IFRS; disclosure quality; cost of equity capital; information asymmetry

Introduction

The introduction of IFRS has many impending benefits to adopters to include greater comparability, reporting transparency, and lower transaction costs, information asymmetry for shareholders and consequent reduction in the cost of capital which should lead to increased transnational investment (Nassar, Uwuigbe, Uwuigbe and Abuwa, 2014; Brüggemann, 2011; Iyoha & Faboyede, 2011; Hoque, Monem & Zijl, 2013). The cost of capital is the rate of return demanded by shareholders for ownership of a company's existing securities from an investor's point of view (Castillo, Menéndez & Orgaz, 2014). In other words, it can be seen as the return that the market expects for their investment in a firm. From the company outlook, the cost of retaining a share price that is acceptable to the investors and offset their risk of ownership makes up the equity capital cost. The cost of capital is one of effective variables in the decision making model of company and an important concept in determination of added value to a company.

It can be observed that due to increased globalisation, governments around the world have supported International Financial Reporting Standards (IFRS) and presently, more than 140 nations require IFRS for publicly listed companies. The Nigerian government began contemplating adopting IFRS in 2007 which led the Central Bank of Nigeria (CBN) to direct banks to adopt IFRS from 2008 while directions were granted by Securities and Exchange Commission (SEC) to begin in 2009. However, the increased uniformity led to the mandatory compliance for every Nigerian company by the end of the 2012 financial year.

Prior studies provides that mandatory adoption of IFRS could ensure a decrease in the cost of capital through at least two different paths to include its high quality disclosure requirements which lower information asymmetry between firms and investors (Lambert, Leuz & Verrecchia, 2007) and enhanced information comparability (Nassar, Uwuigbe, Uwuigbe and Abuwa, 2014; Armstrong, Barth, Jagolinzer, & Riedl, 2010; Munteanu 2011). However, recent research (Prather-Kinsey, Jermakowicz, & Vongphanith, 2008; Li, 2010; Palea, 2013) suggest that many factors such as firms' reporting incentives, enforcement mechanisms, the quality of corporate governance and others can influence the cost of capital.

The motivation for the study stems from the mixed findings of previous studies that examine the effects of IFRS adoption on cost of equity as Lambert et al. (2007), Palea (2007), Lee and Chen (2011); Gkoukousi (2012) finds that IFRS adoption decreases cost of capital but Cuijpers and Buijink (2005), Dasgupta, Gan, and Gao (2010); Patro and Gupta (2014) shows that IFRS adoption increases cost of capital. There is also lack of literature to the best

knowledge of researcher that such study is not available in an emerging market like Nigeria and additional gap exists as differences in corporate performance measures creates need for a country level analysis.

It is against these backdrops that this study based on a single country intends to ascertain the effects of mandatory IFRS adoption on the cost of equity capital in Nigeria. In addition, this study seeks to ascertain whether the firm performance moderates the influence of IFRS on cost of equity capital effects measured by Return on Equity (ROE).

The remainder of the work is organized as follows. The next section provides review on the theoretical framework, existing literature on mandatory IFRS adoption and the cost of equity capital and hypothesis development followed by the section 3 on the methodology. Section 4 provides the main findings and results; Section 5 discusses the results. The concluding section discusses the policy implications, recommendations and contribution to knowledge of the research.

Mandatory IFRS Adoption and Cost of Equity Capital

It has been suggested that mandatory adoption of IFRS is viewed to be sufficient in reducing cost of equity by way of improved transparency and comparability (Brüggemann, 2011; Horton, Serafeim & Serafeim, 2013). The increase in corporate disclosures should lower a firm's cost of capital by reducing information asymmetry as cost of capital is higher for firms with more amount of private information (Lee, Walker and Christensen, 2008; Gao, 2010) and Easley and O'hara (2004) model establish that demand for a higher return arises to hold stocks with greater private information. While for comparability, the resulting increased numbers of analysts following a firm creates lower cost of obtaining information which reduce informational differences among investors and their estimation risk to eventually lower the cost of equity capital (Armstrong et al., 2010).

While empirical findings on the relationship between disclosure and cost of equity capital have been mixed, as evaluated by Botosan and Plumlee (2002), Palea (2007), Ly (2010), Munteanu, Ionascu, and Ionascu (2011), most theoretical studies have appraised a competitive pure exchange economy and predicted that international power politics in IFRS adoption and disclosure quality always reduce cost of capital (Easley and O'Hara, 2004; Lambert et al., 2007; Gao, 2010; Emeni, 2014). Though, Gao (2010) theoretical model on disclosure and Fox, Helliar and Veneziani (2013) has shown that this relationship does not hold under all conditions. Lambert et al. (2007) study on the indirect effect of disclosure also emphasise that cost of capital might rise with disclosure quality and the investment effect of disclosure plays an active role in its impact on cost of capital.

In general, the related research suggests that higher disclosure levels reduce the information asymmetry among investors to reduce cost of equity capital. This background further led Daske, Hail, Leuz, & Verdi (2008) to advocate for a common set of accounting standards

showing firms information quality that would lower estimation risk to decrease the cost of equity capital.

Based on the theoretical background above, a large number of empirical studies have examined the effect of IFRS adoption on the cost of equity capital, where the expected cost of capital is calculated using implicit estimation techniques or proxies such as bid-ask spreads, price volatility or trading volume. On the German capital market, Leuz and Verrecchia (2000) show evidence that the move to IFRS reduces the information asymmetry component of the cost of capital by confirming that only relative bid-ask spread reduced. Brüggermann and Homburg (2007) based on their revised model later found that the adoption of international reporting standards showed no significant effect on bid-ask spreads which supports the findings of Daske (2006) on absence of cost of equity capital reduction for listed German firms.

Daske et al. (2008) using a sample of 26 countries disclose evidence of a decrease in cost of equity capital almost before the mandatory adoption of IFRS but which later increases after adoption take place for countries where transparency is promoted and where legal enforcement is strong. Dasgupta, Gan, & Gao (2010) supports the evidence of positive anticipation effects in the capital market which was more apparent for voluntary adopting firms. However, Gao (2010) suggests this continued post adoption rise can occur only in the event of perfect competition between the investors and when the nature of new investments are perfectly elastic.

The positive findings of Palea (2007) on equity capital reduction after adoption using the first three quarters reports of 2004 and 2005 for sample of European banks is relevant as these firms are usually excluded from related studies. Gkoukousi (2012) also confirmed the findings though more evident for banks with lower quality of information environment before adoption using a cost of equity capital proxy of the average of four methods that are commonly used in research. However, Palea (2007) sample was small and based on early evidence which does not control for the effects likely to occur from institutional changes while Gkoukousi (2012) failed to consider and control possible effects of changes in enforcement and focused on institutional changes.

Dargenidou, McLeay and Raonic (2006) study on a sample of European firms with Ohlson & Juettner (2005) method to estimate equity cost, show that the adoption of IFRS increases cost of equity. The result conflicts with Prather-Kinsey et al. (2008) who using a sample of 157 European companies based on the PEG-model show that the mandatory IFRS adoption improved disclosure creating a decline in cost of equity capital across 2004-2006 regardless of the country's legal origin. Their findings were further supported by Lee, Walker and Christensen (2008) who examined the effect on the cost of equity capital based on PEG and AEG models within 1995-2006 but only significant for firms from high reporting incentive countries. They suggest the explanation that companies in countries with high reporting incentives and enforcement had greater reasons to totally observe IFRS rather than to implement partial adoption.

The result of Li (2010) supports that the IFRS mandate is associated with a significant reduction in the cost of equity capital for mandatory adopters based on a sample of 1,084 EU firms taking the average measures similar to Gkougkousi (2012) for 1995-2006. Further positive result was derived for the reduction in cost of capital when the transition period (2004–2005) is excluded as supported by Daske et al (2008). A distinction from Lee et al. (2008) includes the lack of control for country wide reporting incentives. Leung (2013) also confirmed the negative association within 2000-2009 but places emphasis on the individual and interactive effects of high reporting incentives on the cost of capital reduction. The findings support Li (2010) that cost of equity for mandatory IFRS adopters is significantly lower than voluntary firms.

Patro and Gupta (2014) focus on the effects of mandatory IFRS adoption on the cost of capital of 563 sample firms for a six year period between 2006 and 2011 controlling for firm specific variables. They observe that the estimated cost of equity based on the PEG model reduced for firms in Hong Kong and Philippines after adopting IFRS but increased for firms in China and Israel. They suggested that the adoption of the new standard plays a significant role in Hong Kong and Philippines and that the firm specific variables are not influencing the cost of equity capital in all the sample countries.

The country-level specific studies on mandatory adoption effects on cost of capital enables the separation of the results of country-level effects from cross-sectional comparisons. It has been suggested that a specific analysis by country basis with additional data for the post-adoption period is required to capture and understand economic consequences of mandatory IFRS adoption. Ionascu et al. (2008) provide evidence of decline in the cost of equity capital of Romanian listed companies after adoption of IFRS based GAAP. They acknowledge that the ex-post cost of capital may have an effect on their results which is expected to generate an initial set of beliefs about the adoption of IFRS and the cost of capital in Romania.

Lee and Chen (2011) document a lower cost of equity capital for the German firms that were required to adopt IFRS than voluntary adopters from 12 industries within a six year time frame from 2002, with more positive results for firms that operate with higher asset liquidity. They conclude that the strength of asset liquidity regime is an important factor that determines cost of capital along with the IFRS adoption. Mihai, Ionascu and Ionascu (2012) supported the negative relationship for 27 firms in Romania after modelling the cost of equity capital as the expected return on the intrinsic value of a share. Based on the pre and post adoption period of 1998 and 2006, they concluded that the study is a starting point for adoption comparison in Romania.

Houqe et al. (2013) consider the effects of IFRS adoption on the cost of equity capital in New Zealand listed companies over a period of 1998-2009. Using the modified PEG ratio model, the result indicates that there is a significant negative association between IFRS adoption and cost of equity capital which affects both the mandatory adopters and the voluntary adopters of IFRS. Castillo et al. (2014) reveal a reduction in the PEG estimated cost of equity capital for 28 Spanish firms after IFRS adoption and controlling for a set of firm-risk and market

variables using OLS regression analysis. This was attributed to the combined effect of disclosure and enhanced comparability with improved legal and institutional enforcement mechanisms. Their findings oppose Lee et al (2008) that show no post adoption reduction in cost of capital and views Spain as a low enforcement country which may be centred on the differences in sample periods that extends to 2006 and 2009 respectively.

Conceptual studies on the benefits and economic effects of IFRS adoption have documented diverse findings and conclusions. Munteanu (2011) review on major empirical papers showed a decrease in the cost of equity capital, most studies supporting a more significant effect especially for voluntary (serious) adopters. Palea (2013) show that evidences from EU countries indicates a positive effect of mandatory IFRS adoption along with the high influences of national institutional frameworks accounting for post-adoption differences. Tarca (2013) review also supports the notion of reduced equity capital cost but more likely within a high legal protection, professional and enforcement framework.

A recent review of ICAEW (2015) report positive effects on transparency, comparability, the cost of capital, market liquidity, corporate investment efficiency, international capital flows associated and analysts' ability to predict (Lourenço & Branco, 2015) for mandatory adoption of IFRS. The findings of Lourenço and Branco (2015) provide evidence of more positive effects for mandatory IFRS adopters than voluntary adopters which oppose Munteanu (2011) findings with relevance given to management incentives and institutional changes.

Hypothesis Development

As prior research suggests, the adoption of IFRS encompasses greater disclosure of information and more improved comparability which reduces estimation risk as a result of improved forecasting abilities of investors. This in turn reduces the estimated cost of equity capital. Based on the above findings, the following research hypothesis is proposed:

Hypothesis 1: The cost of equity capital is significantly associated with IFRS adoption

A general suggestion given from Wysocki (2010) and Christensen et al. (2013) holds that the effect of introducing new accounting standards depends on the incentives that the different firms have for compliance. In mandatory setting, there are different factors which may influence full adherence of IFRS to include market based profitability measures such as Return on Equity (ROE) creating reporting disparities. Thus, the informational content can be extensively varied to eventually manifest a positive or negative cost of equity. On this basis, mandatory adopting firms may improve commitment to implement IFRS financial reporting process and expect capital market benefits (Leung, 2013). Following Ali et al. (2012), Leung (2013) report negative association, though significant, between cost of capital and ROE whereas Dalton et al. (2003) and Castillo et al. (2013) is significant but the result is positive for the latter. Therefore, the study states the following hypothesis in null form:

Hypothesis 2: The cost of equity of mandatory adopters is not significantly associated with return on equity

Theoretical Framework

This paper adopts the signalling theory which provides structure to the study. The signalling theory holds that providers of capital are not in a position to distinguish the earnings ability of various firms if all they choose to disclose standard and mandatory information alone. Thus, voluntary disclosure is one of the signalling means, where companies would disclose more information than the mandatory ones required by laws and regulations in order to attract investments which arises due to information asymmetry problems (Shehata, 2014). The increased disclosure reduces this problem which creates lower estimation risk for investors to further decrease the cost of equity capital.

Under the signalling theory, the need of managers to disclose superior performance serves as bedrock of financial reporting. This desire encourages firms to adopt a form of superior standards in form of IFRS which improves transparency and promotes investors confidence to create a decline in equity cost. The theory could then justify the relationship between IFRS adoption and cost of equity capital. Therefore, $COEC = f(IFRSA)$. This theory further suggests that firms with good corporate performance tend to possess more incentives to readily provide disclosures which have a positive influence on investors to reduce equity finance cost. It has been confirmed in past empirical studies that a higher level of performance breeds greater disclosure for firms which reduce the information asymmetry. Hence, it can be inferred that cost of equity capital is associated to firm performance which is measured in terms of Return on Assets (ROA) and Return on Equity (ROE). Therefore,

$$COEC = f(ROA, ROE)$$

This theory may also explain the reason and incentive for bigger firms to become serious adopters as against smaller firms. These firms tend to experience better performance due to access to more resources and finance with the desire to show this which will serve as a positive signal to attract providers of capital. Therefore, bigger firms disclose more information that could lead to reduced equity capital costs indicating that firm size is correlated with the cost of equity capital, that is, $COEC = f(FSIZE)$.

Methodology

This section describes the planned empirical research methods for this study. It considers the sample selection, the justification for such selection, the empirical model specification and variables measurements. This study adopted the cross sectional research design and this choice was made because the data was collected at a particular point in time of the sample period from the firms. The population for the study was a total of the 21 companies within the industrial goods sector while the target sample size was 11 after the exclusion of companies with at least one negative earnings in either of the sample periods. This was done following

prior studies (Li, 2010; Leung, 2013; Hoque et al., 2013) because the use of such values would adversely influence the data results.

The study is carried out within a time-frame of two years for which 2011 was chosen for the prior adoption year and post-adoption period in 2013 as the mandatory adoption of IFRS standards in Nigerian firms started in the year 2012. The adoption year was also excluded to eliminate the transitional effects (Pranther-Kinsey et al., 2008; Lee & Chen, 2011). The sources of data used in the study were from secondary sources which were collected from the annual reports of firms and market reports website. The data was analysed using the Statistical Package for Social Sciences (SPSS) 21 which contains descriptive statistics and Ordinary Least Square technique that measures the relationship between the dependent and the independent variables while controlling for external factors.

Variables Measurement

The dependent variable cost of equity capital is the required return rate by investors for their investments in equity capital where COE is captured as the intrinsic value of a share (Mihai et al. 2012). This is expressed in terms of observable data such as earnings and share prices with the coefficient, β as a direct estimate of the cost of capital and its expected value should be positive and lower than 1. The ex-post measure is used by reason of low degree of efficiency of the market and unavailability of forecast data. The estimation proxy of Mihai et al. (2012) for cost of equity capital of a firm in period k by setting up the following model:

$$\log(\text{EPS}_{k+1}) = \alpha + \beta \text{MPS}_{ik} + \varepsilon$$

where: eps_{ik+1} = the actual earnings per share of firm i in year $k+1$

MPS_{ik} = the actual share price of firm i in year k .

Similar to Dalton et al. (2003), the market based performance measure is denoted with Return on Equity (ROE) is the ratio of profit before interest and tax to the common equities.

Firm size could be an incentive as the bigger the firm, the greater level of disclosure which tends to lower estimation risk and suggests lower cost of equity capital (Petrova, Georgakopoulos, Sotiropoulos & Vasileiou, 2012). Though, ICAEW (2015) review argue that a form of bias towards bigger publicly-traded companies are prevalent in prior studies and suggest that small sized public companies should expect greater benefits after IFRS adoption. Prior literature evidences show a negative (Li, 2010; Petrova et al. 2012; Hoque et al. 2013), positive (Daske, 2006; 2008) and no significant (Prather-Kinsey et al. (2008), Patro and Gupta (2014); Castillo et al (2014) association with cost of equity capital. Thus, firm size (LOGTA) is defined as the natural log of current year total assets. It has been asserted that firms adopt strategies that show evidences of high performance in order to reduce uncertainty which retains its capital providers thereby ensuring lower cost of equity capital. Therefore, the level of operating performance may cost of equity as firms with high indicators are likely to have reduced cost. Prior studies (Lopes & Alencar, 2010; Dalton, Daily, Certo, &

Roengpitya, 2003) document evidence of insignificant relationship between return on assets and the cost of capital while (Rehman & Zaman, 2011; Li, 2010; Leung, 2013; Castillo et al., 2014) show significant negative relationship except Rehman and Zaman (2011). Consistent with Leung (2013), Return on Assets (ROA) is used and defined as profit before tax divided by total assets.

Model Specification

The following regression model was estimated to examine the presence of significant relationship between cost of equity capital and the adoption of IFRS.

$$\text{Log}(\text{EPS}_{k+1}) = \alpha + \beta_1 \text{MPS}_{ik} + \beta_2 \text{ROE} + \beta_3 \text{IFRSA} * \text{ROE} + \beta_4 \text{LOGTA} + \beta_5 \text{ROA} + \epsilon$$

Where, COE indicate the measure for cost of equity capital, and MPS, ..., ROE are all independent and control variables measures as discussed above.

Data Analysis and Result

This deals with the presentation and analysis of the empirical results obtained from the estimation exercise. The table 1 provides descriptive statistics on the cost of equity capital and the independent variables. Difference in mean values for cost of MPS, EPS, log of assets, ROA, and ROE values were significantly different between 2011 and 2013. It is obvious that the firms experienced an increasing pattern in share price indicators after IFRS adoption in 2013. The mean of return on assets for the period 2011 & 2013 of 17.3% is viewed as an almost average value for the return on equity which is 31.6%. Size is the variable with the largest standard deviation and the mean values for the variables were increased from 2011 to 2013.

Table 1. Descriptive statistics

Variable	Total (2011 & 2013)			Before IFRS (2011)			After IFRS (2013)		
	Mean	Median	Std. D	Mean	Median	Std.D.	Mean	Median	Std. D
EPS	2.261	1.195	3.229	1.783	1.290	2.036	2.738	0.8700	4.153
MPS	30.317	9.885	53.002	19.861	8.470	32.335	40.773	11.750	67.921
LOGTA	23.121	22.489	1.976	23.069	22.433	2.013	23.172	22.545	2.034
ROA	0.173	0.118	0.157	0.167	0.128	0.122	.0178	0.102	0.192
ROE	0.316	0.218	0.378	0.296	0.277	0.309	0.336	0.192	0.452

Source: SPSS Output, 2015

Table 2 denotes four results of the multiple regression analysis models appropriate to isolate the incidence and determine the individual and interactive effects of each independent variable on the dependent variable, cost of equity. The first result based on the initial model states that the coefficient of MPS in the post adoption period is higher (0.059) when compared with the value (0.056) of pre period which is highly significant. The next result occurs after introduction of the control variables where the values support positive and significant relationship between IFRS adoption and cost of equity indicating that sampled

listed firms that have adopted IFRS in the period 2011-2013 incur significantly greater costs when obtaining capital funds. This supports the first hypothesis of the study and implying the significant role played by IFRS on capital cost.

The remaining two results pertain to the interaction effect of ROE on the influence of cost of equity capital after mandatory adoption as the interaction value in the pre adoption period (0.029) when compared the post adoption term (-0.049) establish a negative and insignificant relationship. Thus, reporting incentives for IFRS is greater in firms with high ROE indicating that IFRS is more effective in firms with better performance. Relating to the control variables, log of total assets has a positive but insignificant influence on cost of equity capital in both adoption periods which implies that larger firms are at a disadvantage compared to smaller firms. Besides, ROA has conflicting effects in both pre and post adoption periods but also appears insignificant.

Table 2. Effects of IFRS adoption on cost of equity and moderating effect of ROE

Variable	Pre adoption				Post adoption			
	Result 1	2	3	4	1	2	3	4
Constant	0.678 (0.092)	-4.047 (0.547)	-5.086 (0.515)	-5.086 (0.515)	0.327 (0.430)	-6.549 (0.473)	-1.254 (0.892)	-1.254 (0.247)
MPS	0.056 (0.000)	0.045 (0.040)	0.042 (0.078)	0.055 (0.001)	0.059 (0.000)	0.053 (0.003)	0.065 (0.004)	0.060
ROE			0.684 (0.717)	0.740 (0.513)			5.067 (0.203)	0.083 (0.323)
MPS*ROE				0.029 (0.056)				-0.049 (0.068)
LOGTA		0.195 (0.515)	0.241 (0.489)			0.318 (0.429)	0.091 (0.821)	
ROA		2.598 (0.385)	1.456 (0.743)			-1.349 (0.599)	-14.455 (0.177)	
F-value	32.071	10.078	6.600	6.671	131.084	48.840	42.586	66.899
R ²	0.781	0.812	0.816	0.765	0.936	0.954	0.966	0.944

Source: SPSS Output, 2015

Note: p-values are in parenthesis.

Discussion of Findings

The results show that the positive association is significant at 5% level which supports the first hypothesis of the study and implies the significant role played by IFRS on capital cost. The cost of equity capital increased for firms after adoption which does not conform to the reasoning that lower cost of capital is an expected benefit of adopting IFRS as expressed by prior studies of Hoque et al. (2013), Tarca (2013); Castillo et al (2014) and regulatory bodies.

This could be from the influence of firm's reporting incentives (Christensen et al., 2013) which are shaped by jurisdiction level factors and firm level measures, ownership structures and governance mechanisms (Brüggemann, 2011; Leung, 2013) on reporting practices.

This result supports the findings of Lee et al. (2008); Patro and Gupta (2014) and the opinion of enhanced regulatory environment to promote total IFRS adoption. This could be from the countries similarities in the form of low capacity of enforcement and market forces. It is also shown that the corporate measures are not significant to influence the change in the cost of equity capital for the sample industry which is similar to the findings of Prather-Kinsey et al. (2008), Lopes and Alencar (2010); Castillo et al. (2014).

Conclusion

The study observed that cost of equity capital increased for firms after mandatory IFRS adoption as compared to the period before adoption at a significant level which supports the hypothesis. This support the opinion in prior literature that an enabling environment increases the possibility of experiencing a reduction in equity capital costs. Therefore, future research should consider the role of other reporting incentives and institutional factors on effective adoption of IFRS and the effect of adoption on different sectors within the country.

Policy Implications of Findings

The findings of a positive significant relationship will create an avenue for policies on the issues of investments (equity and foreign), interest rates and employment.

1. This study suggests that this relationship is not suitable for investors by reason of the increased cost of equity indicating that firms will prefer to indulge in borrowing from financial institutions thereby influencing the degree of investments in equity. The country's rate of flow of foreign investments can also be involved as a decline may occur from higher cost of equity in comparison to other economies competing for available global resources.
2. The impact on policies relating to the interest rates prevailing in the economy can be as a result of the borrowing effect. The pressure on the lending capacity of the financial institutions can escalate due to high cost of obtaining equity which would subsequently the interest rates demanded from the companies.

3. The effect of higher cost of obtaining equity capital and increased operating could initiate a stringent cost reduction attitude for the firm that may lead to reduction in the volume of operation causing a decline in the rate at which labour is employed. The aggregate behaviour of these firms within the economy could then lead to an increase in the unemployment level.

Policy Recommendations

The above implications provide a basis for the suggestion of policies relating to domestic savings. This is viewed as principal source of equity capital against foreign savings for which an increase should lead to a reduction in the cost of equity capital as well as interest rates which so therefore makes equity and foreign investments much more appealing. The policies should be streamlined on means of influencing domestic savings for a long term benefit through the decrease of national deficit.

On the part of the firms, policies that influence the form of personal taxation will have an effect on cost of equity creating a decline which improves their operational efficiency and avenue for further employment of labour.

Contribution to Knowledge

This study makes important contributions which include the lack of support for signalling theory by the evidence shown that suggests the performance measures such as ROA and ROE does not have a significant impact on cost of equity capital. Therefore, higher operating firms do not necessarily disclose more information through IFRS adoption to lower cost of equity capital which shows the limited application of the theory. Moreover, the resulting policies derived from the findings can serve as bedrock to the regulatory authorities in influencing and controlling the increased cost of equity.

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