The Importance of The Quality of Financial Reporting on Investors' Decision Making: A Case Study on the Banking Industry of Bangladesh

3 authors:

Afrida Mubasshira
Institute of Business Administration, DU

Dr. Md. Mamun Habib
Independent University, Bangladesh

Yeaseen Chowdhury
Bangladesh University of Professionals

International Journal of Applied Business and Management Sciences
Vol. 1, No. 1, 2020, pp. 103-112

ARF INDIA
Academic Open Access Publishing
www.arfjournals.com

THE IMPORTANCE OF THE QUALITY OF FINANCIAL REPORTING ON INVESTORS' DECISION MAKING
A Case Study on the Banking Industry of Bangladesh

A H M Yeaseen Chowdhury[1], Afrida Mubasshira[2] and Md. Mamun Habib[3]

[1]*Associate Professor, Faculty of Business Studies, Bangladesh University of Professionals*
E-mail: yeaseenchy@bup.edu.bd
[2]*Intern at The City Bank Limited Bangladesh*
[3]*School of Business & Entrepreneurship, Independent University, Bangladesh; E-mail: mamunhabib@iub.edu.bd*

Received: 10 February 2020	Revised: 13 March 2020	Accepted: 15 April 2020	Publication: 15 May 2020

Abstract: *Investment decisions are very critical and are of major importance to the investors because they involve the risk of loss of money. These investment decisions are made by the investors by using the financial information presented by the financial reports of the companies they are interested to invest in. So the quality of financial reporting has to be up to the mark so that the investors can make fruitful investment decisions. The major objective of this report was to find out the significant effect of financial reporting and the importance of ratio analysis on the investors' decision making and also to find out the importance of implementing internal control to improve the quality of financial reporting. The data were collected from primary sources through questionnaire and personal interview method. The major findings of the study involved the investors' perspective towards the importance of the quality of financial reporting and ratio analysis while they make investment decisions and also how the investors believe that the implementation of Internal Control over Financial Reporting will improve the quality of financial reporting and make the financial information more reliable to them when they make investment decisions.*

Keywords: *Investment Decisions, Financial Reporting, Ratio Analysis, ICFR.*

INTRODUCTION

It is the duty of the corporate officials to prepare and publish their reviewed financial reports to the stakeholders and other users. The investment decisions are very vital since huge, scarce and hard-earned money is involved. So it is a prerequisite for investors to have good knowledge of the cash flow management, value added report and dividend per share and other relevant financial information to avoid illogicality in investment choices.

The apparent relevance of the financial statements is to provide reliable information to the external investors so that they can take logical investment decisions. The importance of financial statements is hence cannot be denied for its contribution towards safe investment decisions. And the reliability of the financial statements can be provided by assured financial reporting. So the quality of financial reporting is very important as it is linked with providing reliable financial information to the investors for making investment decisions. This research has focused on analyzing the individual investors' perspective regarding the importance of the quality of financial reporting. The problem statement of this study is to find out the significance of financial reporting in investment decision making specifically in the banking industry of Bangladesh.

OBJECTIVES OF THE STUDY

General Objectives

The general objective of the report is to find out the contribution of financial statement in investment decision.

Specific Objectives

- To find out the significant effect of the quality of financial reporting on investors' decision to invest on shares
- To find out the importance of the use of ratio analysis on the investors decision making
- To find out the importance of Internal Control on improving the quality of financial statements

Research Questions

Q1 : Is there any significant effect of the quality of financial reporting in the investors' decision making in the banking industry of Bangladesh?

Q2 : Is ratio analysis used as a tool in the investment decision making in the banking industry of Bangladesh?

Q3 : Does internal control help in improving the quality of financial reporting?

Research Hypotheses

Ho : Financial Reporting Quality has no significant effect on Investors' decisions to invest on shares of companies

H_A : Financial Reporting Quality has significant effect on Investors' decisions to invest on shares of companies

H_O : Ratio analysis is not used as a tool in investment decision making

H_A : Ratio analysis is used as a tool in investment decision making

H_o : Internal Control over Financial Reporting will not improve the quality of financial reporting

H_A : Internal Control over Financial Reporting will improve the quality of financial reporting

REVIEW OF LITERATURE

The suitable communication of accounting information to user is paramount for making such information useful. This communication is achieved by producing financial reports and accounts. The single objective of financial reporting is valuation usefulness. (IASB & FASB, 2016).

According to Vestine & Kule (2016), financial statement analysis performs a crucial role on investment decisions making and organization performances, which has been shown to be major force in investment decision making. Bank of Kigali used as case study by these two researcher made it understandable that, for any Bank to be successful, it should attempt to make use of financial statement analysis because accounting itself is a language of business, and before venturing into any business, one must know the right method to achieve the stated goals and objectives. So financial statement holds a great importance when it comes to make investment decisions. According to Patrick I, Tavershima & Eje (2017), investment decision making is significantly influenced by the financial information on dividend per share.

Suh Collins (2017) surveyed on sixteen employees of BAPCCUL's organization and found out that financial statement have an impact on investment decision making in organization.

According to Nwaobia, Kwarbai, Jayeoba & Ajibade (2016) in their research on the effect of financial reporting quality on investment decision using a sample of Nigerian manufacturing firms have stated that higher reporting quality increases investment decision.

Seyed (2014) orated that one of these factors is the quality of financial reporting which can facilitate the efficient allocation of capital in the economy. One of the most important facets of this fact is to improve the investment decisions.

Popoola, et al. (2014) investigated the published financial statements which they correlated with investment decision among commercial bank stakeholders in Nigeria. According to their findings, balance sheet is negatively correlated with investment decision whereas income statement, notes to the account, cash flow statement, and value added statement and five-year financial summary are positively correlated with investment decision making. They also found out that the components of published financial statement contributes to the investment decision making for commercial bank stakeholders.

According to Mercy (2014) financial statement does play a vital role in investment decision making and he recommends that without the consideration of a company's financial statements no investment decisions should be taken.

According to Michael (2013) in his critical investigation on the degree of reliance of the published financial statements by corporate investors found that one of the primary responsibility of management to the investors is to give a standardized financial statement evaluated and authenticated by a qualified auditor or financial experts and also investors depend heavily on the credibility of auditors/financial expert approval of financial statement in making investment decisions and as such published financial statement is very important in the investors' decision making. He recommended that adequate care and due diligence should be maintained in preparing financial statements to avoid faulty investment decisions which could lead to loss of funds and possible litigations.

The ability to present a good an accurate figure for accrual is known as financial reporting quality. Financial reporting quality is related to the accuracy with which a firm's stated financials reflects its operating performance and if they are useful in forecasting future cash flows. Nyor (2013).

Adebayo, et al. (2013) examined the impact of accounting information system in assisting organizations for making sound and effective investment decision. Their findings have shown that accounting information system is an important tool in investment decision making in today's world.

RESEARCH METHODOLOGY

The study adopted a descriptive survey design as qualitative analysis was conducted on the data collected. The data were collected from primary sources through the use of questionnaire and personal interview method. The collected data were analyzed using IBM SPSS statistic software 20. First the data were coded in MS Excel and then the coded data were analyzed using descriptive analysis of the IBM SPSS software 20.

The target population of this study was all the individual investors in the banking industry of Bangladesh of the following occupations- private service holder, public service holder, entrepreneur, banker, student, doctor, and engineer. Since the number of individual investors are unknown and the population size is huge, the sample size was calculated using the following formula-

n = {(Z score)$^{2\,*}$ standard deviation *(1-standard deviation)}/ (margin of error)^2

Here,

n = sample size

Z score = the constant value for the confidence level

Standard deviation = the expected variance in the responses by the researcher

Margin of error = how much error to be allowed by the researcher

The confidence level for this research has been set at 95%. According to the Z-score table, the Z-score at 95% level of confidence is 1.96. The margin of error is set to be 5% and the standard deviation is set to be .268 by the researcher to ensure that the sample size is large enough.

So, the sample size, n = {(1.96)$^{2\,*}$ .268 * (1-.268)}/ (.05)^2 = 301

So the total sample size was 301. Among this 301 sample the sample frame was determined by using purposive sampling technique.User

DATA FINDINGS AND ANALYSIS

The data were analyzed using the descriptive analysis of the IBM SPSS software 20. The information was grouped and sub grouped according to their classification as per objective of the study.

The Significant effect of the quality of financial reports on investors' decision to invest

on shares: The respondents were asked whether they think the elements of the financial statements influence their investment decisions or not. About 81.3% investors believe that their investment decision is influenced by the elements of the financial statements. They said that they rely on the financial statements while they make their investment decisions. Then thee investors were asked if the financial reporting reveal the competence of management or not. About 73% of the investors believe that the financial reporting does reveal the competence of management. Competence of management is one of the key information that the investors consider while they make investment decisions. If the management is competent than they will report the financial statements according to the Financial Reporting Standards. Since they believe that the competence of the management is revealed by the financial statements, it means the reliability of this key information has to be provided by the companies which can be ensured by a good quality financial reporting. And financially 73.7% of the respondents said that the quality of financial reports play a significant role on the decision making in investing in company shares. Because they believe that the reliability of the financial information based on which they make investment decisions, depends on the quality of the financial reporting.

The importance of the use of ratio analysis on the investors' decision making: The respondents were asked about which variables they use while they make investment decisions. 36% of the investors said they use profitability ratios for evaluating the company before making investment decisions. Profitability ratios are basically operating profit margin, return on assets, return on equity etc. of a company. 33% of the investors said that they look into liquidity ratios for evaluating a company's performance. Liquidity ratios are basically current ratios. About 31% of the investors said they look into the gearing ratios for evaluating a company's performance before making investment decisions. This indicates how much important ratio analysis is to the investors in investment decision making process. About 73.7% respondents believe that the ratio analysis as presented in the financial statements help investors analyze the financial performance and position of the company. It indicates that ratio analysis is used as a tool in the investment decision making. Thus it can be said that the ratio analysis holds much importance in the investment decision making.

The importance of strong internal control on improving the quality of financial statements: Internal Control over Financial Reporting is a part of the Internal Control within the organization. It helps the investors by providing them the reasonable assurance of the financial statements reporting and makes sure that the financial reporting is done according to the Financial Reporting Standards. It tries prevents misstatement of financial statements. So, ICFR basically improves the quality of financial reporting. And according to 83.7% respondents surveyed believe that ICFR will help improve the quality of financial reporting.

TESTING OF HYPOTHESES

The test on the selected hypotheses have been showed below:

H$_o$: Financial Reporting Quality has no significant effect on Investors' decisions to invest on shares of companies

H$_A$: Financial Reporting Quality has significant effect on Investors' decisions to invest on shares of companies

Table: Chi-Square Tests

	Value	*df*	*Asymp. Sig. (2-sided)*
Pearson Chi-Square	24.455[a]	6	.0000000000000002
Likelihood Ratio	24.318	6	.000
Linear-by-Linear Association	7.222	1	.007
N of Valid Cases	300		

Sources: Calculated using IBM SPSS

P value = .0000000000000002

If we look at the result we can see that the p value is .0000000000000002 which is less than .05. Since p-value < .05, we will reject the null hypothesis and accept the alternative hypothesis. This therefore means that, Financial Reporting Quality has significant effect on Investors' decisions to invest on shares of companies.

H$_O$: Ration analysis is not used as a tool in investment decision making

H$_A$: Ration analysis is used as a tool in investment decision making

Table
Chi-Square Tests

	Value	*df*	*Asymp. Sig. (2-sided)*
Pearson Chi-Square	8.226[a]	6	.033
Likelihood Ratio	8.470	6	.206
Linear-by-Linear Association	4.532	1	.222
N of Valid Cases	300		

Sources: Calculated using IBM SPSS

P-value = .033

Since the calculated p-value is less than .05, the null hypothesis will be rejected. Therefore, this means that Ratio analysis is used as a tool in investment decision making.

H_o : Internal Control over Financial Reporting will not improve the quality of financial reporting

H_A : Internal Control over Financial Reporting will improve the quality of financial reporting

Table
Chi-Square Tests

	Value	*df*	*Asymp. Sig. (2-sided)*
Pearson Chi-Square	16.183[a]	6	.013
Likelihood Ratio	17.359	6	.008
Linear-by-Linear Association	2.307	1	.129
N of Valid Cases	300		

Sources: Calculated using IBM SPSS

P-value = .013

Here, p-value is also less than .05 which means the null hypothesis will be rejected. This means, Internal Control over Financial Reporting will improve the quality of financial reporting.

The summary of the hypotheses testing:

SL No.	*Hypotheses*	*Null Hypotheses Accept / reject*
1	**H_o:** Financial Reporting Quality has no significant effect on Investors' decisions to invest on shares of companies **H_A:** Financial Reporting Quality has significant effect on Investors' decisions to invest on shares of companies	Rejected
2	**HO:** Ration analysis is not used as a tool in investment decision making **HA:** Ration analysis is used as a tool in investment decision making	Rejected
3	**H_o:** Internal Control over Financial Reporting will not improve the quality of financial reporting **HA:** Internal Control over Financial Reporting will improve the quality of financial reporting	Rejected

DISCUSSION

According to the data analysis, the importance of the quality of financial reporting in the investment decision making is vigilant. The study shows that the elements of the financial statements influence most of the investors while they make investment decisions. This proves that any misstatements in the financial statement will lead the investors making wrong investment decisions. So financial reporting should be done properly to avoid any misstatement or fraudulent activities. It also shows that most of the investors believe that the quality of financial reporting has a significant effect on their investment decision making. It proves that their investment decisions are dependent of the quality of financial reporting. There is also the importance of ratio analysis in the investment decision making according to most of the investors. And finally the survey shows that according to most of the investors the Internal Control over Financial misstatements of the financial statements and provides the investors with reasonable assurance of the elements of the financial statements based on which the investors make valuable investment decisions.

CONCLUSION AND RECOMMENDATION

This study has focused on the importance of the quality of financial reporting on the investors' decision making. All the objectives of the study is inter-related. The results of the study has shown that investment decision depend on the elements of the financial statements and also ratio analysis. In order to make the elements and ratios reliable to the investors financial reporting should be done in accordance to the Financial Reporting Standards. Hence, the quality matters a lot when it comes to investment decision making. If the quality of the financial reporting is not proper than the financial statements will not be reliable to the investors. And to improve the quality of the financial reporting investors believe ICFR should be implemented within the organization. ICFR will help investors with reliable financial statements and prevent the misstatements of the financial reports and also fraudulent financial reporting. Followings are the few recommendations by the researcher based on the study:

It is proven in this research that the elements of financial statements play vital role in investment decision making, the banking industry of Bangladesh should try to be more careful regarding the reporting of the elements of financial statements.

The banking industry of Bangladesh needs to improve the quality of financial reporting. In order to make the investment opportunities attractive, the assurance of a reliable financial reporting can only be achieved if the internal control within the organizations is strong enough. The implementation of ICFR can be taken into account for making the financial reporting more reliable. Which will eventually prevent from any kind of misstatements and fraudulent financial reporting within an organization.

For further study, the span of the population can be enlarged in order to get more accurate results regarding the importance of the quality of financial reporting.

REFERENCES

Atrill, P. & McLaney, E. (2015). Accounting and finance for non-specialists. 9th Edition. Plymouth: Pearson.

Benedict, A. & Elliott, B. (2011). Financial accounting. An introduction, 2nd Edition.

Brealey, M. (2003). Principles of corporate finance (7th ed). Patterson.

Damodaran, A. (2012). Financial Statement Analysis, New York Universities, Stern School of Business.

Easley, D. (2010). Financial statement and investment decision. *International Journal of Business and Commerce,* 3(8), 58-69.

Elton, E.J., Gruber, M.J., Brown, S.J. & William N. (2013). Investment Analysis, 8th Edition.

Paperback: John Wiley & Sons, 2010.

Morning Star. Introduction to Financial Statement, John Wiley & Sons. 2010.

Pelger, (2016). 'Practices of standard-setting – An analysis of the IASB's and FASB's process of identifying the objective of financial reporting', 51-63.

Suh, S. C. (2017). 'The role of financial statement in the investment decisions of a micro finance institute (MFI). Case Study Bamenda Police Cooperative Credit Union Limited, Yaounde branch (BAPCCUL Yaounde)', 8-10.

Vestine, M. & Kule, J. W. (2016). 'Effect of financial statement analysis on investment decision making. a case of bank of kigali', Vol. 5, No. 06, 282-283.