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ON THE RELATIONSHIP BETWEEN INCOME STATEMENT COMPONENTS AND STOCK RETURNS: NIGERIA STOCK EXCHANGE

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Abstract

This paper carried out empirical investigation of the relationship that exists between income statement components and stock returns, using Nigeria stock exchange market stock returns as a case study. The paper makes use of the result of financial daily stock activities of Nigeria stock exchange between the periods of January 1st 2014 to January 31st 2014. In this study, twenty two (21) companies were randomly selected on the basis of data obtained from Nigeria stock exchange. By using Pearson Correlation Coefficient analysis, the result shows that there exist a strong relationship between component of income statement and the stock returns. Thus, the finding established main objective behind the adoption of new accounting policy (IFRS). The study therefore recommends that adequate and enough attention should be given to all the components of accounting variables while preparing statement of account.

Keywords: *Stock return, Total comprehensive income, other comprehensive income, Net income, Operating profit.*

JEL Classification: *G21, G32*

1. INTRODUCTION

Financial analysis involve a tedious and careful calculation, it is a process that does not give any room for mistake however small it might be, though in a more familiar language, this calculation is commonly referred to as accounting information. The main task lies on how to convey comprehensive information that would meet the needs of the investors who are the major player in the establishment of a company, the decision maker and the lender on which the soul and strength of a company attached. The total comprehensive income, the other comprehensive income, the net income and the operating income all these if carefully calculated and well manage, should be able to give the correct picture of how financially strong a company is, the lender would want to know if the money borrowed would be paid back on time, the investors would want to be sure the money invested or to be invested is well utilized in term of financial strength of a company.

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On January 1, 2012, the Nigerian Federal Executive Council approved as the effective date for adoption of International Financial Reporting Standards (IFRS) in Nigeria. For quoted companies and companies with significant public interest. The adoption includes all companies that trade on both the main board and the Alternative Securities Market (ASeM) of the Nigerian Stock Exchange. The FRCN has the statutory to establish financial reporting standards for all public interest entities not only quoted and unquoted companies but also government organizations, and not-for-profit entities that are required by law to file returns with regulatory authorities. The Nigeria act, 2011 requires that the FRC "promote compliance with the adopted standards issued by the International Federation of Accounts and International Accounting Standards Board". The council requires that the FRCN "promote compliance with the adopted standards by the International Federation of Accounting Standards Board. The jurisdiction's status of this act is that IFRS are required for the financial statements of all 'public interest entities'. The finding will be able to show whether the type of relationship that exist enhance the change in price of daily stock, market proceeding and moreover the obtain value and in general to what extend did the income statement components relating to stock returns.

The numbers of companies that are registered as participants in Nigeria stock exchange market does not matter in this instance, but the actual number of those that are actively participating in the daily marketing exercise, and their daily results as regard the stock price of each participant company are matter most on the daily trading prospect, and the stock results effect on the shareholders, The staff, The Lenders, the suppliers, the customers, and the company itself. It is the responsibility of a standard financial statement to clearly show the analysis of each of the accounting variable, especially those that are very crucial to the investment decision, production, entitlement, shareholders, the lenders and the consumers.

Most of the empirical accounting research works have attempted to find out the relevance of the stock prices, and the accounting variable of which this work is going to be a complimentary effort. Having collected the used information through Google search, the researcher needs to be meticulous about the obtained information by concentrating on those companies that are classified as been active in the stock exchange marketing activities although this research work was builds upon the work of Kanagaretnam et al (2008).

The approach in this work agreed that a positive good stock price is sufficient to determine firm value. and therefore serve as a standard agent from where we can evaluate the required information in accounting measure, with the knowledge that accounting attributes are regarded as relevant because they are statistically associated with the stock prices coupled with this vital relationship, Large body of evidence suggested that at certain time, investor under react to information contained in stock returns and at other time overreact. The objective of this research is to find out whether the provision of summary total comprehensive income, and the component of other comprehensive income together with net income, and operating profit in firm financial statements, has value-relevant over reporting traditional stock returns alone with the randomly picked Nigeria companies listed as active members of Nigeria stock exchange, the result which was obtained between January 1st, 2014 to January 31st 2014, will allow the researcher to find out for how long has the financial statement of the selected companies been taken care of accounting variables in their income statement preparation and of what important are they to the stock return. The researcher noted that despite the minimal number of sample of companies used, there was evident that effective result was obtained and that more numbers of participating companies in the future will just be a multiple of the result obtained in this case.

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The researcher has the intension to carry out the same exercise on 31st of December of 2016, 2018 and 2020 in the subsequent works; this would allow a comprehensive comparison on the performances of the adopted policy (IFRS) and the rate of associate of income component and stock return in the selected year.

2. LITERATURE REVIEW

Beresford, et al., (1998) discovered that comprehensive income may help resolve some difficult and challenging financial input issue, particularly in the area of financial instruments, and moreover reporting comprehensive income could enhance the ability to understand financial statement. Biddle, et al., (2006) revealed that comprehensive income defined by FASB statement 130 (NI_{130}), dominates both traditional net income (NI) and fully comprehensive (NI_{broad}) in explaining equity return but that NI dominates NI_{130} and NI_{broad} in explaining executive compensation. Cahan, et al., (2000) found no evidence that comprehensive income provide information, that is suggesting an incrementally value above the net income for New Zealand firms.

Chamber, et al., (2005) suggested that investors should pay greater attention to OCI and its components effect on pricing, those investors pay greater attention to OCI information reported in the statement of changes in equity. Choi, (2006) found some more evidence confirming that the disclosure of components of other comprehensive income is useful. Dhaliwal. et al., (1999) reported that summary comprehensive income disclosure is neither more strongly associated with market returns nor, a better predictor of future cash flows or future cash income than current net income. Isidro, (2006) found some weak evidence of predicted relationship between valuation errors, and duty surplus flow in the U.S. but discovered little evidence of such relationship elsewhere.

O' Hanlon and Pope (1999) discovered little evidence that other comprehensive income excluded from ordinary profit are value-relevant" for U.K. firms. Ou and Penman (1989) revealed that the return to the Pre strategy is improved if one restricts investment in the long position to stock with $Pr > 0.6$, and price low relative to earnings in cross-section, and the short position to stocks with $Pr < 0.4$ and price high relative to earnings in cross-section.

Nunez, (2013) established that accounting variables selected for the study can be used, to explain the profitability of the firms selected for the research work, and that majority of the variables considered have positive direct relationship with profitability. Those interpreting investor's relevance as accounting for equity have regarded income as the temporal elaboration of the equity account, and have argued in favor of comprehensive income. Since this shows total increase in the value of net assets. The exclusion of transitory fair value income components which was proposed by (Cauwenberg. 2007) was based on an incomplete notion of prediction, that there could be benefits from considering comprehensive income in addition to net income for the purpose of prediction.

3. METHODOLOGY

A sample of 22 companies was randomly selected based on the availability of satisfied information on active participating members of Nigeria stock exchange for the period of 31.

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December 2014 financial year, this list was chosen from the list of active classified members on daily activities of stock exchange from January to December 2014. Pearson Correlation was carried out on the results. The data approach was used for the whole financial year in all the situations set above, and each situation was estimated by running a correlation and the adjusted values across the various Pearson Correlation model. In the research work, Stock return is the depended variable designated as (SR) while accounting variables such as Net income, other comprehensive income, and Total comprehensive income are the independent variables; they are being represented as follows. The following terms are used to represent the component and the stock returns in the research work. For consistency, the model can be run on the identified variables just like Biddle and Choi (2006) and estimate the following equation.

$$ST_R = (\text{Operating Profit, Net Income, Other Operating Income, Total Comprehensive Income}) \quad (1)$$

While the econometric equation is given by:

$$STR_{it} = \alpha_0 + \beta_1 OP_{it} + \beta_2 NI_{it} + \beta_3 OC_{it} + \beta_4 TC_{it} + \mu_{it} \dots \dots \dots (2)$$

Where:

Stock returns	ST _R
Operating profit	OP _P
Net income.	NI _I
Other operating income	OO _I
Total cooperating income	TC

4. FINDINGS AND DISCCUSION

From the result in table 1 below, the two tailed significant of the income component together with stock returns indicated the strong association exist among the components and the stock returns. The Pearson correlation coefficient showed the closeness in term of value while the interpolation value N clearly indicated that one component is an integral part of the others. The two tailed coupled with positive value of constant N indicated a complete role being played by each of the component. Total comprehensive income and operating profit showed significant correlation of 0.01 levels with two tails, while net income was having correlation of significant at 0.05 levels. Operating profit and Net income showed strong association with stock return by having the same two tailed Pearson correlation of 0.01 levels.

Though total comprehensive income, net income and stock return have negative Pearson correlation, but the fact that operating profit was positive gave indication of how they relied on each other for accurate and stable information about the financial capability of a company. A correlation 0.01 and 0.05 level with two tailed was an evident of strong association of the components. It was observed that aggregate comprehensive income was more value relevant than net income. Aggregate comprehensive income was strongly relevant in explaining prices. But comprehensive income was more strongly associated with price in term of explanatory power. Unlike the result of Cauwenberg (2007) that have its sources from an incomplete notion of

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prediction, this study showed more evidence from comprehensive income together with net income when it comes to prediction.

Table 1 Showing Correlation Results

		Stock Return	Operating profit	Net Income	Other Compr	Total Compr
Stock Return	Pearson Correlation	1	.607**	-.543*	-.321	-.567**
	Sig. (2-tailed)		.004	.011	.157	.007
	N	21	21	21	21	21
Operating Profit	Pearson Correlation	.607**	1	-.975**	.096	-.982**
	Sig. (2-tailed)	.004		.000	.679	.000
	N	21	21	21	21	21
net income	Pearson Correlation	-.543*	-.975**	1	-.165	.999**
	Sig. (2-tailed)	.011	.000		.474	.000
	N	21	21	21	21	21
Other Comp. Income	Pearson Correlation	-.321	.096	-.165	1	-.122
	Sig. (2-tailed)	.157	.679	.474		.600
	N	21	21	21	21	21
Total Comp. Income	Pearson Correlation	-.567**	-.982**	.999**	-.122	1
	Sig. (2-tailed)	.007	.000	.000	.600	
	N	21	21	21	21	21

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

5. CONCLUSION AND RECOMMENDATION

In this study, the relationship between the stock return and account variables was clearly established and it was shown that there existed a strong relationship between the variables and the stock returns. An important function of complete statement report could be that, it conveys the required information to the outside world decision maker in and outside the company, the investor, the lender, the consumers, the suppliers and the workers, and finally the government who decide the decree to the establishment of such company.

The study concluded that income statement vis-a-vis, total comprehensive income, other comprehensive income, Net income, Operating profit selected for study, all showed positive evident of association with stock return. It was discovered that total comprehensive income contributing more to the realization of stock return objectively than any other components. Unlike Ngunze (2013) who made a contribution that accounting variables cannot be used to explain stock return because such information is already reflected in the stock market sales price. This study emphasized the use of accounting variable to explain stock return because, this would allow the common men to get the information especially those that are not involved in stock exchange activities. All the income components are associated with firm performance, and each makes its own contribution toward achieving a strong stock returns. Thus, the finding established the main objective behind the adoption of new accounting policy (IFRS). The study therefore recommends that adequate and enough attention should be given to all the components of accounting variables while preparing statement of account. Future work should be on finding the same objective but with different years as stated before.

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