

A STUDY ON "IMPACT CASH FLOW REPORTING ON THE INDIVIDUAL SHAREHOLDERS' INVESTMENT DECISION MAKING"

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ABSTRACT

The investment by the retail investors is ought to be most critical in the capital market. The reason of this because they have the least amount of expertise in the domain of financial report analysis and understanding the basic concepts of the financial statements. Moreover, understanding accounting jargons is not a cup of tea for everyone. Thus, the research is an attempt to study the impact of cash flow reporting on the individual shareholders investment decision. The study reveals that the investors are not confident about the impact of the cash flow reported on their investment decision process.

Key Words : Investment Decision, Earnings, Cash flow.

CONCEPTUAL FRAMEWORK

The Cash flow statement is considered one of the most important financial statement from the point of view of information for investors. The cash flow statement provides the details of not only operating, financing and investment activities but it also provides the details of outcome from each activity in terms of real cash inflow or outflow. The profit and loss account at the same time only provides information about the operating activities output that too on accrual basis.

The retail investors often do not understand the complexity of the Balance Sheet and Income Statement. Earnings reported by the firms seem to be the most attracting variable but at the same time the most difficult one to understand and analyze. By looking at the figure of the profit reported in the Income Statement of the Company one cannot make any decision as the figure takes contribution of many combinations of expenses, losses, incomes and gains, sometimes actual and sometimes manipulated. Satyam Computer's scam

in the year 2009 is one of such case where the company manipulated their financial statements to showcase a higher profit and increased value of the assets in the balance sheet. Hence, understanding of the profit figure is always questionable and especially the knowledge of the retail investor is always at doubt. A study by Baker (1971) shows statements containing information about cost-volume-profit relationship had been found more useful by different groups of accounting information user.

Thus, the cash flow statement can become a source of information which can be easily understood by the investor's. This is because as the cash flow statement reports the inflow and outflow in real terms from different activities. And ought to be understood easily as compared to the other statements like Income statement and Balance Sheet. Financial statements are largely used by the institutional investors such as insurance companies, mutual fund companies and many more and then by the financial analysts. The uses of company's financial report by the

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retail investor has always been very minimal but at the same time it is the retail investor who fixes the higher return as one of the most important criteria for making an investment. Therefore, the researcher felt the need to study the impact cash flow reports on the retail investors' investment decision.

BUSINESS ACTIVITIES TO MEASURE

A business engages in three fundamental activities-financing, investing, and operating. Output of each of these activities has importance for the shareholders from the point of view of their investment decision.

- **Financing activities** are transactions involving external sources of funding. There are two basic sources of this external funding-the owners of the company who invest their own funds in the business, and creditors who lend money to the company. With this financing, the company engages in investing activities.
- **Investing activities** include the purchase and sale of (1) long-term resources such as land, buildings, equipment, and machinery and (2) any resources not directly related to a company's normal operations. Once these investments are in place, the company has the resources needed to run the business and can perform operating activities.
- **Operating activities** include transactions that relate to the primary operations of the company, such as providing products and services to customers and the associated costs of doing so, like utilities, taxes, advertising, wages, rent, and maintenance.

COMPANY'S FINANCIAL REPORTING

Financial reporting which is an integral part of an annual report may be defined as communication of published financial statements and related information from a business enterprise to third parties (external users) including shareholders, creditors, customers, government authorities and the public. It is the reporting of accounting information of an entity (individual, firm, company, government

enterprise) to a user or group of users. (Lal, 2002)

Significantly, a vital component of the annual report is the company's accounts- normally termed the financial statements. These key statements include:

- The profit and loss account or Income Statement with annexed schedules.
- The balance sheet with schedules annexed with it.
- The cash flow statement

The above statements provide the necessary information to the investors to make judgment about the output of the different business activities. Investors have resources in surplus which they are willing to invest. In order to decide which investment option provides the better opportunity, most often, they analyze companies' financial accounting information in making their decision. In fact, financial accounting information is essential to making good investment decisions.

The statement of cash flows can be an important source of information to investors. It provides the details of the output from the all kinds of business activities of an entity. Investors use the relationship between net income (revenues minus expenses) and operating cash flows (cash flows from revenue and expense activities) to forecast a company's future profitability. Comparison of operating cash flows and investing cash flows help to assess a company's ability to repay debt. Financing activities provide information to investors about the different sources of external financing of the company.

INVESTMENT DECISION

Investment is defined as an act of sacrificing current resources in expectation of the growth in the value of such resources in future. Making a decision of investment can be studied in three stages: first to buy any securities, second to hold those for a period and lastly to decide to sale them.

In the first stage of Investment, the investors have the past or current financial information of

the company where he/ she thinks to invest. The decision comes out on the basis of the investors' understanding of the past or current financial or non-financial information available to him or her. The decision of making the investment becomes even more suitable to the investors in fulfilling their expectations, if they could as accurately as analyse the future trends of the company's performance and position in the market. The different information used by the investors is acquired from different sources and the financial report published by the company becomes one of the most important sources of information. The financial report help the investor to understand the current status of the company and further enables it to compare the same with the other, which helps in positioning of the company.

Once the investor is done with the first stage of the investment decision, the second stage that is the decision of how long to hold it, also needs a continuous analysis and observation of the company's performance and of the market trends. Here the company's growth trend as compared to the industry and market trend plays a vital role. Investors very often get scared by the unusual movements in the stock market and make hasty decision to sale their investments, but a good investment strategy always suggest buying more if the fundamentals of the company are strong even if the market falls. Because, if company's fundamentals are strong it can recover in the long term and the investor may average their investments. Investments need continuous evaluation and revision in order to meet the expectations of the investors.

Lastly, the decision to sale any investment is indeed the most crucial and complicated decision because the movement we sale any investment the market either takes an upward, downward or continues to show the same trend. Now these trends actually decide whether the decision of selling the investment was correct or wrong. If the market falls then it gives a feeling that decision of selling the investment was correct and on the other hand, if the market takes an upward trend then it makes the investor feel bad as he or she might have earned more if they could

have hold the investment for some more time. Thus, setting the exit point in the capital market is the most difficult decision that the investor takes.

At all these stages the investor need to do some amount of analysis which helps them to estimate the company growth aspect and their expectations fulfillment with the right investment. The company's financial reports have always played a very important role in providing the information to the investor at each stage of their investment process.

REVIEW OF LITERATURE

The study of the existing literature helps the researcher to draw the inference of the study and also helps to acquire in depth knowledge about the subject. The following are the review of some related literature:

Baker et al (1973) conducted a study in metropolitan Washington D.C. They used 33 factors which are used in the investment analysis and the investors were instructed to indicate the relative importance of each factor on 5 point scale. The future economic growth and prospects were reported of the most importance to the individual investors followed by other 15 factors.

Franco et al (2008) develop a new metric of and study the capital market consequences of firm comparability. According to them investors, regulators, academics, and researchers all emphasize the importance of comparability. They find that analyst following is increasing in comparability, and that comparability is positively associated with forecast accuracy and negatively related to bias and dispersion in earnings forecasts. Their results suggest comparability enhances a firm's information environment, a benefit to capital market participants.

Hollister et al (2008) in their study for nine countries they found that the components of accrual accounting earnings provide information incremental to that of current cash flows from operations in explaining next year's cash flows from operations. They relate the usefulness of accounting earnings components for explaining near-term cash flows to certain country

characteristics-common/code-law jurisdiction, accrual index, shareholders' rights, and uncertainty avoidance. Their study provide evidence that accounting accruals generated by shorter horizon, code-law regimes provide more incremental explanatory power for short-term predictions than those of longer horizon, common-law countries.

Fisher et al (2006) according to them success in investing largely depends on (a) discovery new and credible information rapidly and in more details than other do and (b) applying superior judgment to ascertain the relevance of the information to the decision at hand. An overwhelming weight is placed by analyst and investors on the information contained in the financial statements of firms. One critical reasons for this reliance lies in the vouchsafed nature of the statements because their form and contents is controlled under a variety of rules, regulation and statues. The investors tend to accept financial statements as the closest thing to complete credibility in information available to them.

Kothari et al (2003) in their research paper found that corporate disclosures, reports in the financial press, and analysts' reports and discussion of corporate performance all enhance the information reflected in stock prices.

The members of the Financial Crisis Advisory Group (FCAG) reported to the Members of the International Accounting Standards Board and the US Financial Accounting Standards Board (2009) that financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions and to regulators and other users. The confidence of all these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth.

STATEMENT OF PROBLEM

Thus the study is an attempt to find the answer to the statement, "What role the

company's cash flow reports play in the investment decision making process of the shareholder?"

OBJECTIVE OF THE STUDY

The study is conducted to study the impact of company's cash flow reporting on the shareholders' investment decision making.

RESEARCH HYPOTHESIS

The proposed study is expected to test the following hypothesis empirically: -

Null Hypothesis:

H_{01} -The cash flow reported by the company don't have any impact on the shareholders' investment decision making.

Alternative Hypothesis:

H_{11} - The cash flow reported by the company have impact on the shareholders' investment decision making.

RESEARCH METHODOLOGY

Nature of Research: The research is empirical and analytical in nature.

Data used: Primary data has been used for collecting responses from the individual investors. Primary Data has been collected using the questionnaire. Secondary has been collected for preparing the theoretical background and for the review of literature.

Scope of the Study: The present study covers the trading account holders registered at the different terminals of the sub- brokers operating in the Dibrugarh and Tinsukia town of Assam.

Population Size: In Dibrugarh and Tinsukia towns there are approximately 3,700 trading account holders registered at different terminals of Sub Broking firms as disclosed by the broking firms.

Sample Size: A sample of 349 retail investors has been taken to achieve the set objectives at 95 % level of confidence.

Method of Sampling : Simple random sampling method has been used to collect the

responses in the form of structured questionnaire.

Method of Survey: A questionnaire has been served to the respondent to elicit information related to their demographic details as well as their opinions or views on the impact of the reported earnings on the investment decision process. Respondent has been requested to provide their opinion on 7 Point Likert Scale against each statement of assertions. Each statement of assertions stands to identify the different measures of cash flow reported by a company.

Terminology Used: The terms 'Educated' and 'Non-Educated' has been used to categorised those investors who on an average believes that the reported earnings have impact on the shareholders' investment decision making and those who don't believes the same respectively. If a respondent's average opinion is less than the

average of the averages of all the respondents than he or she is considered a "Non-Educated" and vice-versa.

The term investor has been being used for the individual shareholder investor.

DATA ANALYSIS AND FINDINGS:

The data collected has been analysed using the statistics like simple average, Chi-Square test and has been represented using tables.

Analysis of the opinion of the respondents on the impact of cash flow reporting on the shareholders' investment decision making process.

The following statements of assertions has been used to collect the investors' opinion on the impact of the cash flow reporting on their investment decision.

Table 1.10.1
Title: Ranking of the Statements of Assertions

Statement of Assertions	Average	Rank
Amount of cash flow out of operational activities as a supporting information against profit shown in Profit & Loss Account.	4.2149	3
Amount of cash Sales tentatively indicates portion of cash profit	3.7536	4
Decrease in Cash and Bank balance in comparison to previous year's balance may indicate use of working capital for acquisition or construction of Fixed Assets.	3.5673	5
A sudden or unexpected sale of fixed assets may indicate the tendency of the company to slip off from its core activities.	3.4928	6
Volume of cash realised by issue of Equity share indicates standing of the Company in Financial Market.	4.6504	2
Increased amount of cash or cash equivalent indicates better liquidity	5.1461	1

Source: Primary data from questionnaire

Table 1.10.1 states the ranking of the different statements of assertions. The above assertions has been used to study the opinion of the investors about impact of cash flow reporting on their investment decision process. On the basis of the above table it is observed that the increased amount of cash or cash equivalent is considered the most important factor by the investors followed by amount of cash realised by issue of Equity share indicating standing of the

Company in Financial Market. Whereas, sudden sale of fixed assets is least observed by the investors' in their investment decision.

The average score of the opinion of the investors on the different statement of assertions is also analysed. This has been done in order to find out their stand on the impact of all these factors in their investment decision process. Table 1.10.2 represents the analysis of the assertions:

Table 1.10.2
Title: Analysis of the Assertions

Statement of Assertions	Average Score	Interpretation of the Average Score
Amount of cash flow out of operational activities as a supporting information against profit shown in Profit & Loss Account.	4.2149	Neither Agree nor Disagree
Amount of cash Sales tentatively indicates portion of cash profit	3.7536	Neither Agree nor Disagree
Decrease in Cash and Bank balance in comparison to previous year's balance may indicate use of working capital for acquisition or construction of Fixed Assets.	3.5673	Neither Agree nor Disagree
A sudden or unexpected sale of fixed assets may indicate the tendency of the company to slip off from its core activities.	3.4928	Disagree
Volume of cash realised by issue of Equity share indicates standing of the Company in Financial Market.	4.6504	Agree
Increased amount of cash or cash equivalent indicates better liquidity	5.1461	Agree
Average of the Averages	4.1375	Neither Agree nor Disagree

Source: Primary data from questionnaire

From the above analysis it is being observed that the investors neither agree nor disagree to the statements of the assertions. That means the company's reported cash flows may or may not have impact on the investors' investment decision making process.

Further, t- test statistics has been used to test the significance between the company's

reported cash flows and investors' investment decision making. For this purpose first of all the normality of the data has been checked using one sample Kolmogrov-Smirnov Test. The test has been conducted for average opinion of the respondents against each statement of assertions. The following table represents the statistics for the test:

Table 1.10.3 One-Sample Kolmogorov-Smirnov Test

N		VAR00001
Normal Parametersa	Mean	6
	Std. Deviation	4.1375
Most Extreme Differences	Absolute	.66110
	Positive	.221
	Negative	.221
Kolmogorov-Smirnov Z		-.164
Asymp. Sig. (2-tailed)		.542
		.931

a. Test distribution is Normal.

Source: Primary data from questionnaire

In the above table, it has been seen that the calculated Asymp Sig (p-values) is 0.931, which is greater than the 0.05. Thus, it can be interpreted that the data that considered for performing one-sample t-test is normally distributed.

Hence, t- test has been performed to test the significance between the company's reported cash flows and investors' investment decision making. For this purpose the population mean has been

taken from the pilot study conducted with a sample of 50 respondents i.e. 4.14.

Null Hypothesis (H_0): There is no significant relationship between Company's reported cash flow and the investors' investment decision making.

Alternative Hypothesis (H_1): There is a significant relationship between Company's reported cash flow and the investors' investment decision making.

Table 1.10.4
Title: Calculation of t-test statistics

X	(X - \bar{X})	(X - \bar{X}) ²
4.2149	0.0774	0.005985173
3.7536	-0.3840	0.147420793
3.5673	-0.5702	0.325128694
3.4928	-0.6447	0.415636982
4.6504	0.5129	0.263060238
5.1461	1.0086	1.017265868
$\bar{X} = 4.1375$	$(X - \bar{X}) = 0$	$(X - \bar{X})^2 = 2.174497746$

Source: Primary data from questionnaire

$$t\text{- test Statistics} = \frac{(\bar{X} - \mu_0) \cdot \sqrt{n}}{S}$$

Where \bar{X} = Mean of the sample, μ_0 = assumed population mean, $S = \sqrt{\sum(X - \bar{X})^2 / (n - 1)}$

And n = sample size

Here, S= 0.659469142, n= 6, $\mu_0 = 4.14$

Hence, t-test Statistics = -0.009152804

The calculated t value with 95% confidence level at 5 degrees of freedom is - 0.009152804. However, the tabulated t- test value with 95% confidence level at 5 degrees of freedom is 0.065. Since, the calculated value is less than the tabulated value, therefore, we accept our null hypothesis and conclude that there is no significant relationship between Company's reported cash flows and the investors' investment decision making.

For the purpose of performing the Chi-Square test the investor whose average score on the statement of assertions is less than the average of the all the respondents is categorised as "Non-

Educated Investor" and those whose average score is more is categorised as "Educated Investor".

Chi-square test for testing association between Gender and Impact of cash flow reported on the investment decision making

Null Hypothesis (H_0): There is no significant relationship between Gender and Impact of cash flow reported on the investment decision making.

Alternative Hypothesis (H_1): There is a significant relationship between Gender and Impact of cash flow reported on the investment decision making.

Table 1.10.5
Title: Table of expected frequencies on the basis of Gender

Count of Respondent Row Labels	Column Labels Educated	Not Educated	Grand Total
Female	42	27	69
Male	158	122	280
Grand Total	200	149	349

The chi-square test statistics i.e. $\chi^2 = \sum_{i=1}^n \frac{(O_i - E_i)^2}{E_i}$

Where O_i is the observed frequency and E_i is the expected frequency

(O_i)	(E_i)	$\frac{(O_i - E_i)^2}{E_i}$
42	39.54154728	0.15285163
158	160.4584527	0.037667008
27	29.45845272	0.20516997
122	119.5415473	0.05055974
	0.44624834	

Source: Primary data from questionnaire

$$\chi^2 = \sum_{i=1}^n \frac{(O_i - E_i)^2}{E_i} = 0.44624834$$

The calculated value of chi-square test statistics with 95% confidence level at 1 degrees of freedom is 0.446248343. However, the tabulated chi-square value with 95% confidence level at 1 degrees of freedom is 3.84 which greater than calculated chi-square value. Therefore, we accept our null hypothesis and conclude that there is no significant relationship between Gender and Impact of cash flow reported on the investment decision making.

Chi-square test for testing association

between Educational Qualification and Impact of cash flow reported on the investment decision making

Null Hypothesis (H_0): There is no significant relationship between Educational Qualification and Impact of cash flow reported on the investment decision making

Alternative Hypothesis (H_1): There is a significant relationship between Educational Qualification and Impact of cash flow reported on the investment decision making.

Table 1.10.6
Title: Table of expected frequencies on the basis of educational qualification

Count of Respondent Row Labels	Column Labels Educated	Not Educated	Grand Total
10th	9	8	17
Below Metric	2	4	6
HS	26	18	44
PG	28	28	56
Ph. D	5	3	8
UG	130	88	218
Grand Total	200	149	349

The chi-square test statistics i.e.

$$t^2 = \sum_{i=1}^n \frac{(O_i - E_i)^2}{E_i}$$

Where O_i is the observed frequency and E_i is the expected frequency

(O_i)	(E_i)	$\frac{(O_i - E_i)^2}{E_i}$
9	9.742120344	0.05653211
2	3.438395415	0.60172875
26	25.21489971	0.02444517
28	32.09169054	0.52169054
5	4.584527221	0.03765222
130	124.9283668	0.2058897
8	7.257879656	0.07588202
4	2.561604585	0.8076896
18	18.78510029	0.03281231
28	23.90830946	0.70025576
3	3.415472779	0.05053989
88	93.07163324	0.27636201
		3.39148008

Source: Primary data from questionnaire

$$t^2 = \sum_{i=1}^n \frac{(O_i - E_i)^2}{E_i} = 3.39148008$$

The calculated value of chi-square test statistics with 95% confidence level at 5 degrees of freedom is 3.39148008. However, the tabulated chi-square value with 95% confidence level at 5 degrees of freedom is 11.1 which greater than calculated chi-square value. Therefore, we accept our null hypothesis and conclude that there is no significant relationship between educational qualification and Impact of cash flow reported on the investment decision making.

Chi-square test for testing association between profession and Impact of cash flow reported on the investment decision making

Null Hypothesis (H_0): There is no significant relationship between occupation and Impact of cash flow reported on the investment decision making.

Alternative Hypothesis (H_1): There is a significant relationship between occupation and Impact of cash flow reported on the investment decision making.

Table 1.10.7
Title: Table of expected frequencies on the basis of profession

Count of Respondent Row Labels	Column Labels		
	Educated	Not Educated	Grand Total
Business	55	43	98
Others	38	31	69
Salaried	70	51	121
Self Employed	37	24	61
Grand Total	200	149	349

The chi-square test statistics i.e.

$$\chi^2 = \sum_{i=1}^n \frac{(O_i - E_i)^2}{E_i}$$

Where O_i is the observed frequency and E_i is the expected frequency

(O_i)	(E_i)	$\frac{(O_i - E_i)^2}{E_i}$
55	56.16045845	0.02397886
38	39.54154728	0.060098
70	69.34097421	0.00626347
37	34.95702006	0.11939711
43	41.83954155	0.03218639
31	29.45845272	0.08066846
51	51.65902579	0.00840734
24	26.04297994	0.16026457
		0.4912642

Source: Primary data from questionnaire

$$\chi^2 = \sum_{i=1}^n \frac{(O_i - E_i)^2}{E_i} = 0.4912642$$

The calculated value of chi-square test statistics with 95% confidence level at 3 degrees of freedom is 0.4912642. However, the tabulated chi-square value with 95% confidence level at 3 degrees of freedom is 7.8147279 which greater than calculated chi-square value. Therefore, we accept our null hypothesis and conclude that there is no significant relationship between occupation and Impact of cash flow reported on the investment decision making.

CONCLUSION

Based on the study conducted for the sample collected from two towns, interpretation of the results suggests several conclusions:

- (a) Individual investors are neither agree nor disagree about the impact of cash flow reported on their investment decision. However, theoretically is has been observed

that the cash flows reports plays a very important role as the information about the cash generation capacity of the entity.

- (b) The Increased amount of cash or cash equivalent indicates better liquidity has the highest impact on the investment decision followed by the amount of cash realised by issue of Equity share indicates standing of the Company in Financial Market.
- (c) A sudden or unexpected sale of fixed assets have the least impact on the investment decision of the shareholders.
- (d) The category of gender to which the shareholders belongs does not have any impact on the use of cash flow into their investment decision making process. It interprets that the financial information are used irrespective of their gender by the investors.
- (e) The educational qualification of the shareholders also does not have any impact on the use of the reported cash flow into their investment decision making process. It interprets that the investors irrespective of their educational qualification depends on the same kind of analysis or source of information such as stockbrokers or advisory services.
- (f) Further it has also been found in the study that neither the occupational background of the investors affects the use of reported cash flows by them in the investment decision making process.

Therefore, it may be concluded that the cash flow reports seems to be used less by the individual investors. This may happen because of the population studied and the characteristics of the small town investors. It has also been observed that the gender, educational qualification and occupational background of the investors do not have any impact on their use of reported cash flows into the investment decision making process. The study concludes that investors with different demographic profile have almost same kind of opinion about the impact of Company earnings and cash flow on their investment

decision. The reason for this may be their dependence on the same kind of information source or may be using almost same amount of analysis. More ever, the individual investor mostly depends on the non-accounting information from different sources. Thus, the understanding of the financial reports plays a vital role in the use of such reports by the investors in their investment decision process.

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