

# 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*

## 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

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.

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

- **Financing activities** their investment decision.

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

- **investing activities** 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.

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

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.
- 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

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 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

## MANAGEMENT INSIGHT

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

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,

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

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 **Null Hypothesis:** following hypothesis empirically: -

**H<sub>01</sub>** - The cash flow reported by the company don't have any impact on the shareholders' investment decision making.

**H<sub>11</sub>** - The cash flow reported by the company have impact on the shareholders' investment decision making.

**Table1.10.1**  
**Title: Ranking of the Statements of Assertions**

<b>Statement of Asserti ns</b>	<b>Average</b>	<b>Rank</b>
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 tendancy 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

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

**Table 1.10.4** decision making.  
**Title: Calculation of t-test statistics**

X	(X - $\bar{X}$ )	(X - $\bar{X}$ ) <sup>2</sup>
3.7536	-0.3840	0.147420793
3.5673	-0.5702	0.325128694
3.4928	-0.6447	0.415636982
4.6504	0.5129	0.263060238
$\bar{X} = 4.1375$	$\sum(X - \bar{X}) = 0$	$\sum(X - \bar{X})^2 = 2.174497746$

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

Where  $\bar{X}$  = Mean of the sample,  $\mu_0$  = assumed population mean,  $S$  =

And  $n$  = sample size

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

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

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

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

Source:

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

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

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.

**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

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

The (chi-square) test statistics i.e.

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

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

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.

between profession and Impact of cash flow

*Null Hypothesis (H<sub>0</sub>):*  
reported on the investment decision making

relationship between occupation and Impact of cash flow reported on the investment decision

*Alternative Hypothesis (H<sub>1</sub>):*

making. 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**



The chi-square test statistics, i.e.

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

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

		$\frac{(O_i - E_i)^2}{E_i}$
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

Source: 0.4912642

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

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 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

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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