Perception of Individual Investor towards Financial Statement: A Study of Nepalese Stock Market

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Abstract

This study investigates the perceptions of individual investors towards financial statements in Nepal's stock market using a descriptive research design. A quantitative approach was employed, with a researcher-administered, questionnaire-based survey conducted among 100 respondents out of 135 distributed questionnaires (74.07% response rate). Data were gathered from ten brokerage firms in Kathmandu, with a sample diverse in age, gender, education, occupation, and income. The questionnaire addressed demographic profiles, investment experience, and perceptions of financial statements, evaluating key attributes like understandability, reliability, relevance, and decision-making usefulness on a 5-point Likert scale. The findings revealed that 73% of respondents were male, with the majority (45%) in the 36-50 age group. Half of the respondents had a Bachelor's degree, and 44% earned over NPR 40,000 monthly. Respondents found financial statements moderately understandable (mean score 3.68), with the income statement being the most understandable. Reliability was also rated moderately (mean score 3.11), with the income statement and balance sheet viewed as more reliable. Financial statements were deemed somewhat relevant (mean score 3.15), with the income statement again rated highest. Perceived decision-making usefulness scored moderately (mean score 3.23), with the income statement rated as the most useful. Strong positive correlations were found between the use of financial statements and their perceived attributes, emphasizing the value of frequent usage for better decision-making.

Keywords: *Financial statements, Reliability, Understandability, Reliability, Relevance, Decision-making usefulness*

1. Introduction

Financial statements reflect the true financial status of an organization for the fiscal year. Naser and Nuseibeh (2003) identified financial statements as the primary source of information for making investment decisions. These statements assist investors in making informed choices about future investments. According to Mala and Chand (2012), the dimensions of assets and liabilities significantly influence an organization and provide valuable guidance to investors. The key components of financial statements—income statement, balance sheet, cash flow statement, and statement of changes in equity/retained earnings—along with the accompanying notes and information in an annual report, are essential for sound decision-making (Norton & Porter, 2015). They also highlighted that the key attributes of useful financial information include understandability, relevance, faithful representation, comparability, and consistency. For accounting information to be truly useful, it must possess these qualities.

Investors cannot engage in investment activities without a solid understanding of financial concepts. Annual reports serve as the primary and most important source of information for making informed corporate investment decisions. Evaluating how financial statement information is used is crucial in investment activities. Mirshekary and Saudagaran (2005) analyzed how different investors utilize financial statement data and how various information sources influence investment decisions. A well-rounded, informed model for investment decision-making is also essential for investors to make rational investment choices. The accurate interpretation of financial statements is vital when investing in company shares. It is necessary to explore the perception of the information's attributes in financial statements and its relationship with their components.

2. Objective of the Study

The primary objective is to examine the perceptions of individual investor and its relationship between components of financial statements.

3. Research Hypothesis

H1: There is significant relationship between investor perception towards financial statements and understandability

H2: There is significant relationship between investor perception towards financial statements and reliability

H3: There is significant relationship between investor perception towards financial statements and relevance

H4: There is significant relationship between investor perception towards financial statements and decision making usefulness.

4. Literature Review

Fundamental analysis is an investing approach where an investor tries to choose winning stocks by analysing a company's earnings history, balance sheet, management, product lineand other factors that will affect its profitability and growth (Kulkarni & Kulkarni, 2013). Investors using fundamental analysis always look at the past performance of the company by comparing fiscal data from previous quarters and years to determine the future stock prices or growth. Kulkarni and Kulkarni (2013) further states that a fundamental analyst triesto determine a company's value by going through the balance sheet, cash flow statement, income statement and statement of changes in equity.

When technical analysis is combined with the company's fundamentals, the stock returns is significant mainly for portfolios with value stocks and small stocks. Mostly long-term investors, who are more concerned about the basics of the company, tend to focus more on the fundamental analysis and their strategies mainly involve buy, hold and other long-term investment strategies (Gould, 2016). Kumar, Mahapatra, and Sandhu (2013) surveyed the Indian stock market on the importance of fundamental and technical analysis over seven different forecasting horizons and found that for shorter time periods (less than 1 year), there was more dependence on technical analysis but for longer periods (greater than 1 year), and the dependence was more on fundamental analysis. Meigs and Meigs (1993) defines financial statement as a starting point for the study of accounting because most of the accounting information that occur in the daily operation depicts the terminology and concepts used in these financial statements. Benedict and Elliott(2011) define financial statement as a summarized report that indicates a firm's financial data during a period or its economic position at a given point of time. Duru (2012) defines financial statement as a statement that reflect a concise picture of the firm's profitability andfinancial position to the management and interested parties. Financial statements are used to communicate important information to the internal as well as external users to make decision(Norton & Porter, 2015). Brigham and Ehrhardt (2015) states that the financial statement indicates the situation of assets, earnings, cash flows, and dividends during the past years.

Financial statements are one of the major sources of information for lending decision (includes lending money to a firm) or/and investing decision that includes buying the sharesof the firm (Reilly & Brown, 2016). Reilly and Brown (2016) further states that informationfrom the financial statements can be used to calculate financial ratios and to analyze the operations of the firm to determine what factors influence a firm's earnings, cash flows, andrisk characteristics. Dauderis and Annand (2014), Norton and Porter (2015), and Brigham and Ehrhardt (2015) mentioned income statement, balance sheet, statement of cash flows and statement of stockholders' equity as the four basic financial statements while Reilly andBrown (2016) mentioned only three major financial statement- income statement, balance sheet and statement of cash flows.

Components of Financial Statements

Income statements

An income statement provides information about the firm's financial performance bysubtracting expenses from the revenues over a period of time (Dauderis & Annand, 2014). Norton and Porter (2015) defines income statements as the financial statement that summarizes the results of operations of an entity for a period of time and evaluates the profitability of a business. Reilly and Brown (2016) states that income statement contains information on the operating performance of the firm during some period of time. It indicatesthe flow of sales, expenses, and earnings during a period of time. In general, the income statement shows either the excess of revenues over expenses resulting net income or the excess of expenses over revenues resulting the net loss of an entity.

Expenses: Dauderis and Annand (2014) define expenses as the assets that have been usedup or the obligations incurred in the course of earning revenues. Norton and Porter (2015)states that an expense is the outflow of assets resulting from the sale of goods and services for a period of time. Wages, raw material expenses, salaries, utilities, depreciation, amortization interest, and taxes are some examples that lie under the expenses section.

Revenues: Dauderis and Annand (2014) defines revenues as the income that are achievedwhen a business sell products or services to a customer in exchange for assets. Revenueis the inflow of assets resulting from the sale of products and services for a period of time (Norton & Porter, 2015).
Net income/loss: Dauderis and Annand (2014) and Norton and Porter (2015) states thatthe excess of revenue over expenses is called net income whereas the excess of expensesover revenues is called net loss.

Balance sheet

The balance sheet (statement of financial position) is the financial statement that summarizesthe assets, liabilities, and equity of a company at a certain date that can be prepared on any day of the year, although it is most commonly prepared on the last day of a month, quarter, or year (Norton & Porter, 2015). The balance sheet shows what resources or assets the firmcontrols and how it has financed these assets (Reilly & Brown, 2016). It indicates the currentand fixed assets available to the firm at a point of time (at the end of fiscal year or the end of a quarter). Mala and Chand (2012) states that the dimension of assets and liabilities has many implications for an organization and it gives a right path to the investor regarding investment.

Assets: Current assets: Current assets are the assets that can be converted into cash within ayear such as cash, bank balance, short-term investments, marketable securities, account receivables, prepaid expenses and inventories (Brigham & Ehrhardt, 2015).

Fixed assets: Norton and Porter (2015) states that fixed assets are the assets that cannot be easily converted into cash within short time period is called fixed assets. It includes tangible and intangible assets.

Investments: Securities that are not expected to sell within the next year are includedunder the heading "investment" (Norton & Porter, 2015).

Liabilities: Current liabilities: Norton and Porter (2015) states that current liabilities are the obligation that is satisfied within one operating cycle or within one year. Accounts payable, notes payable, wage payables, and income tax payables are included undershort-term or current liabilities.

Long-term liabilities: Long-term liabilities are the obligations that will not be paid within the one operating cycle or within a year (Norton & Porter, 2015). Notes payables and bond payables are included under this heading.

Stockholders' Equity: The stockholders' equity represents the owners' claim on the assets of the business that arise from the contributed and earned capital (Norton & Porter,2015). Under this heading, common stock, preferred stock, paid-in capital, and retainedearnings are included.

Cash flow statement

Reilly and Brown (2016) indicate that the statement of cash flows includes the firm's cash inflow and outflow based on the most recent year's income statement and changes on the balance sheet items based on the two most recent annual balance sheets. The statement of cash flows has three parts: cash flows from operating activities, cash flow from investing activities, and cash flows from financing activities. The total cash flows from three parts willgive the net change in the cash position of the firm that should equal the difference in the cash balance between ending and beginning balance sheets. So, particularly, cash flow statement shows cash position or the movement of cash inflow and cash outflow of the firm.

Cash flow from operating activities

Brigham and Ehrhardt (2015) describes net cash flow from operations as the net incomestated on the income statement including changes in net working capital items like receivables, inventories plus adjustments for non-cash revenues and expenses such as amortization and depreciation. Reilly and Brown (2016) indicates that this section includes the sources and use of cash that arise from the regular or day-to-day operations of the firm.

Cash flow from investing activities

Reilly and Brown (2016) indicates that the cash flow from investing activities is the change in the amount of plant and equipment plus the change in the investment accountbetween two most recent balance sheet. If net amount represents the source of funds suchas sale of plant or equipment, then the changes are positive; otherwise, they are negative.

Cash flow from financing activities

Brigham and Ehrhardt (2015) defines financial activities as raising cash by issuing short-term debt, long-term debt, or stock. Under this activity, cash inflows are created by increasing notes payable, long-term liability and equity (bonds and stock). Cash outflowsare resulted by redemption of the liabilities or the repurchase of common shares or dividend payments.

Statement of changes in equity

Dauderis and Annand (2014) states that the statement of changes in equity providesinformation about how the balances in share capital and retained earnings changed during the period. Brigham and Ehrhardt (2015) states that statement of changes in equity includesissue of new share capital, issue of right share, proposed bonus share, and proposed dividend.The statement starts with the beginning equity balance, and then adds or subtracts the itemssuch as issue of new share capital, profits and dividend payments to give an ending balance.

5. Research Methodology

Descriptive research design was used to assess the perceptions of individual investors toward financial statements in the Nepalese stock market. A quantitative approach was utilized, involving a researcher-administered questionnaire-based survey to gather and quantify data. The study targeted the entire population of individual investors in Nepal's stock market, utilizing a non-random convenience sampling method for data collection. Out of 135 issued questionnaires, the study successfully gathered responses from 100 participants, resulting in a response rate of 74.07%. Data was collected across ten brokerage firms situated in Kuleshwor, Khichhapokhari, Putalisadak, Tripureshwor, and Kamaladi. The sampling approach was intentionally designed to ensure diversity, capturing a broad spectrum of respondents from different age groups, genders, educational backgrounds, occupations, and income levels. Primary data was collected using a structured questionnaire with closed-ended questions. The questionnaire was divided into sections, focusing on the respondents' demographic profiles, investment experiences, and perceptions of financial statements. The key areas of inquiry included components of financial statements such as the income statement, balance sheet, cash flow statement, and statement of changes in equity, as well as perceptions of financial statements' understandability, reliability, relevance, and decision usefulness, all measured using a 5-point Likert scale. Data analysis was conducted using SPSS and MS Excel, with descriptive statistics as well as Pearson correlation.

5.1 List of Stock Brokerage Firms

Table 1: List of Stock Brokerage Firms

S.No.	Name of firms	Address
1	South Asian Bulls Pvt. Ltd.	Kuleshwor
2	Market Securities & Exchange Pvt. Ltd.	Khichhapokhari
3	Sewa Securities Pvt. Ltd	Tripureshwor
4	Asian Securities Private Ltd.	Putalisadak
5	Premier Securities Company Ltd.	Putalisadak
6	Deevyaa Securities & Stock House Pvt. Ltd	Putalisadak
7	Sweta Securities Private Limited	Putalisadak
8	Primo Securities Pvt. Ltd.	Putalisadak
9	Midas Stock Broking Company Pvt. Ltd.	Kamaladi
10	Shree Hari Securities Pvt. Ltd.	Kamaladi

(Source: Nepal Stock Exchange,2023)

6. Results and Discussion

6.1 Demographic Profile of Respondents

Table 2: Demographic Profile of Respondents

Particulars	Frequency/Percent
Gender	
Male	73
Female	27
Total	100
Age	
Below 20	2
20-35	33
36-50	45
Above 50	20
Total	100
Education level	
School Level	16
Intermediate Level	21
Bachelor's Level	48
Master's Level or above	15
Total	100
Occupation	
Student	15
Service	31
Business	22
Self-employed	32
Total	100
Income level	
Below 20,000	7
20,001-30,000	12
30,001-40,000	37
Above 40,000	44
Total	100

Table 2 presents demographic of the respondents in a study involving 100 individuals. In terms of gender, 73% of the participants were male, while 27% were female. Age distribution shows that a majority of respondents were between 36-50 years old, accounting for 45%, followed by 33% in the 20-35 age group, 20% over 50 years old, and a small proportion, 2%, below 20 years old. Educational attainment was diverse, with nearly half (48%) holding a Bachelor's degree, 21% having completed an Intermediate level of education, 16% at the School level, and 15% possessing a Master's degree or higher. The occupation of respondents varied, with 32% self-employed, 31% in service, 22% engaged in business, and 15% being students. Income levels were also varied, with 44% earning above 40,000, 37% earning between 30,001-40,000, 12% in the 20,001-30,000 range, and 7% earnings below 20,000. This demographic profile highlights a diverse group of respondents, covering various aspects of gender, age, education, occupation, and income levels.

6.2 Investor Perception towards financial statements

Table 3: Investor perception towards financial statements

	Minimum	Maximum	Mean	Standard Deviation
Understandability	1.00	5.00	3.6825	0.3860
Reliability	1.00	5.00	3.1125	0.3104
Relevance	1.00	5.00	3.1533	0.4440
Decision- making usefulness	1.00	5.00	3.2380	0.5608

Table 3 presents investors' perception towards financial statements on four key attributes: understandability, reliability, relevance, and decision making usefulness- evaluated on a scale from 1.00 to 5.00. The mean score for understandability is 3.6825, with a standard deviation of 0.3860, indicating that respondents generally found the financial information moderately easy to understand, with relatively low variability in their responses. Reliability has a mean of 3.1125 and a standard deviation of 0.3104, suggesting a slightly lower perception of reliability but with consistent responses. Relevance shows a mean of 3.1533 and a standard deviation of 0.4440, indicating that participants found the information somewhat relevant, though with more variability in opinion. Finally, decision usefulness has a mean score of 3.2380 and a standard deviation of 0.5608, reflecting a moderate perception of the usefulness of the information for decision-making, with the highest variability among the four attributes. Overall, these statistics provide insight into how respondents perceive the quality and utility of financial statements.

6.3 Correlation Matrix

Table 5: Correlation between use of financial statements and understandability

Use of Financial statements	Understandability	Sig. (2-tailed)
Income statements	0.781	0.000
Balance sheet	0.684	0.000
Cash flow statement	0.482	0.000
Statement of changes in equity	0.528	0.000

Table 5 shows the correlation analysis between the use of financial statements and their understandability reveals significant positive relationships across all components. The income statement shows the strongest correlation with understandability, with a coefficient of 0.781 and a p-value of 0.000, indicating a highly significant relationship. This suggests that as the use of income statements increases, so does their perceived understandability. The balance sheet follows with a correlation coefficient of 0.684, also with a significant p-value of 0.000, underscoring a strong positive association. The statement of changes in equity and the cash flow statement exhibit moderate correlations with coefficients of 0.528 and 0.482, respectively, both with p-values of 0.000, indicating that their understandability also improves with increased use, albeit to a slightly lesser extent than the income statement and balance sheet. Overall, these findings suggest that the more frequently financial statements are used by investors, the more understandable they are perceived to be, with the income statement being the most clearly understood.

Table 6: Correlation between use of financial statements and reliability

Use of Financial statements	Reliability	Sig. (2-tailed)
Income statements	0.708	0.000
Balance sheet	0.608	0.000
Cash flow statement	0.385	0.000
Statement of changes in equity	0.427	0.000

Table 6 represents correlation analysis between the use of financial statements and their perceived reliability reveals significant positive relationships, although the strength of these correlations varies across different financial statements. The income statement has the highest correlation with reliability, with a coefficient of 0.708 and a p-value of 0.000, indicating a strong and statistically significant relationship. This suggests that as the use of income statements increases, their reliability is perceived to be higher. The balance sheet also shows a strong positive correlation with reliability, with a coefficient of 0.608 and a significant p-value of 0.000. The statement of changes in equity and the cash flow statement exhibit weaker correlations with reliability, with coefficients of 0.427 and 0.385, respectively, both statistically significant with p-values of 0.000. These findings indicate that while all financial statements are positively associated with perceived reliability as their use increases, the income statement and balance sheet are viewed as more reliable compared to the cash flow statement and the statement of changes in equity.

Table 7: Correlation between use of financial statements and relevance

Use of Financial statements	Relevance	Sig. (2-tailed)
Income statements	0.604	0.000
Balance sheet	0.560	0.000
Cash flow statement	0.527	0.000
Statement of changes in equity	0.492	0.000

Table 7 represents correlation analysis between the use of financial statements and their perceived relevance indicates significant positive relationships, with varying strengths across different types of financial statements. The income statement shows the highest correlation with relevance, with a coefficient of 0.604 and a p-value of 0.000, suggesting a strong and statistically significant association. This means that as the use of income statements increases, they are perceived as more relevant by investors. The balance sheet follows closely with a correlation coefficient of 0.560, also statistically significant with a p-value of 0.000. The cash flow statement and the statement of changes in equity have slightly lower but still significant correlations with relevance, with coefficients of 0.527 and 0.492, respectively, both with p-values of 0.000. These results suggest that while all financial statements are considered relevant as their usage increases, the income statement is perceived as the most relevant, followed by the balance sheet, cash flow statement, and statement of changes in equity.

Table 8: Correlation between use of financial statements and decision making usefulness

Use of Financial statements	Decision usefulness	Sig. (2-tailed)
Income statements	0.814	0.000
Balance sheet	0.784	0.000
Cash flow statement	0.661	0.000
Statement of changes in equity	0.591	0.000

Table 8 represents correlation between the use of financial statements and their decision usefulness reveals strong positive associations, with significant correlations across all types of financial statements. The income statement exhibits the highest correlation with decision usefulness, boasting a coefficient of 0.814 and a p-value of 0.000, indicating a very strong and statistically significant relationship. This suggests that as the usage of income statements increases, they are considered highly useful for making decisions by investors. The balance sheet also shows a strong correlation, with a coefficient of 0.784 and a similarly significant p-value of 0.000. The cash flow statement, with a correlation coefficient of 0.661, and the statement of changes in equity, with a coefficient of 0.591, both maintain statistically significant relationships (p-value of 0.000). These findings imply that all financial statements are perceived as increasingly useful for decision-making as their use grows, with the income statement being the most influential, followed by the balance sheet, cash flow statement, and statement of changes in equity. Therefore, the study demonstrated a significant relationship between the use of the four key components of financial statements- income statements, balance sheets, cash flow statements, and statements of changes in equity- and investors' perceptions of these financial statements. It was found that these components are effective in assessing and validating investors' perceptions, aligning with the results reported by Ahmad and Raza (2016).

7. Conclusion

The study examines how individual investors perceive financial statements in the Nepalese stock market. It found that investors have a favorable view of financial statements, particularly regarding their understandability, reliability, relevance, and usefulness for decision-making. When making investment decisions, investors primarily focus on the income statement, followed by the balance sheet, statement of changes in equity, and cash flow statement. The study revealed a positive correlation between the use of financial statements (income statement, balance sheet, cash flow statement, and statement of changes in equity) and investors' perception towards financial statements.

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