Chapter 24
IFRS, Foreign Investment, and Prevailing Institutional Structure in Africa

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ABSTRACT

We revisit the effectiveness of IFRS adoption for FDI attractiveness by considering the adopting country's institutional structure. Attention was on the extent of corruption control (as a measure of institutional structure). Data was tested on 42 African countries for the period 2001-2012. Using the Panel Corrected Standard Error (PSCE) estimation technique, our result suggest that the effect of IFRS adoption on foreign investment differs based on the level of corruption control instituted in the sample countries. When the variable – IFRS adoption, was tested for the sample with corruption control below the median value, the coefficient was either negative or insignificant. However, the opposite was seen for the category of countries with corruption control above the median value. This result was robust to the inclusion of alternative measures of corruption, foreign investment, and control of global financial crisis and legal origin of the country.

1. INTRODUCTION[1]

Since the promulgation of the International Financial Reporting Standard (IFRS) following the creation of the International Accounting Standard Board from the International Accounting Standard Committee in 2001, there has been an improvement in the global capital flow as one of the bi-product from the usage of IFRS for global financial reporting practice. IFRS was adjudged as a better form of financial reporting practice that applies more realistic measure of accounting numbers and promotes better disclosure of

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accounting transactions; thus reducing information asymmetry between preparers and users of financial information (Portes & Rey, 2005; Ramos, 2010; Wysocki, 2011; Gordon, Loeb & Zhu, 2012). Recent studies (e.g. Gordon, Loeb & Zhu, 2012; Chen, Ding & Xu, 2014) have emphasized the role of IFRS adoption as a catalyst to spur foreign investment. The main argument is that – since IFRS promotes better disclosure – then it reduces the cost of monitoring of subsidiaries and information barriers to cross border investments. Foreign investors – therefore – will be able to have access to high-quality information that enables them to make decisions as regards the prospects of their investments at a lower cost.

Institutions, on the other hand, includes those structures and frameworks by which authorities are exercised to provide incentives for productive economic activities. It includes those rules, decrees, policies, guidelines and frameworks, which shapes relationships among economic agents, ensures security of property rights and reduces any form of losses as a result of opportunistic behaviours of economic agents (see North, 1991; Williamson, 2000; Osabuohien & Efobi, 2013; Osabuohien, 2014; Efobi, 2015a). There are recounting empirical evidences suggesting a strong correlation between institutions and foreign investment (Asiedu, 2006; Busse & Hefeker, 2007; Asiedu & Lien, 2011; Anyanwu, 2012; Bandyopadhyay, Sandler & Younas, 2014). Investors seek to protect their investment and maximise their returns, and therefore will prefer to flow into countries that have a strong institutional structure to set up their investment.

Pointing directly at the main concern raised by Wysocki (2011)[2], this chapter looks at the extent to which the resulting FDI benefit from the adoption of IFRS is affected by the prevailing institutional structure in Africa. The main issue addressed is whether the prevailing institutional structures interferes with the extent to which IFRS adoption can inform foreign capital flow to Africa. This issue is of utmost importance in the African setting because of the increasing wave of the number of IFRS adopting countries in this region and the underlining reason being to improve financial reporting infrastructure in order to be able to attract more foreign investors. More frantic, some experts in the International Accounting Standards Board (IASB)[3] encourages African countries to see the adoption of IFRS as an opportunity for deepen their capital market participation, enhance inward investment to foster the growth of the private sector and provide a suitable investment climate for multinationals who would like to set-up their operations in Africa. This therefore makes the improvement of the volume of investment in Africa the central reason for the drive towards IFRS adoption. However, the quality of institutions in this region questions the realisation of the FDI benefit from IFRS adoption.

Focusing on corruption: this represents one of the main institutional palaver in most African countries and has been charged for the slow developmental process of these countries (Fosu, 2011; Asongu, 2012; Ackah, Turkson & Opoku, 2013; Asongu, 2013, 2014; Efobi, 2015a). There are incidences in some African countries where political leaders divert developmental resources for private interest (Easterly, 2008). The spill-over effect of the reoccurrence of such incidences is that the complimentary structures like infrastructure, human capital development, among others, will be unattended to thereby creating an unfavourable environment for investment and creating a disincentive for foreign investment inflow. More so, corruption erodes the capacity of the state to deliver efficient services to economic agents that would have hitherto desired to invest in such country. For instance, corruption increases the transaction cost of setting up an investment since those who control regulatory authorities can possibly circumvent instituted guidelines in order to derive specific rents. In contrast, countries with lower corruption will experience reduced transaction cost for investors as the requisite guidelines to be followed in setting up investment is rid of unnecessary delays and procedures to attract rent from the investors. Being this the case, we