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FORECASTS IN PROSPECTUSES AND ACTUAL PERFORMANCES OF SOME SELECTED NIGERIAN COMPANIES

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ABSTRACT

To what extent can one rely on forecasts in prospectuses issued by Nigerian companies? What legal remedies are available to investors/shareholders when directors fail to achieve ich forecasts? In answering these and other similar questions, the paper compared forecasts in the prospectuses of selected Nigerian companies with actual results. The selected companies cover almost all spheres of the Nigerian economy bunking manufacturing, the conglomerates and oil and gas sectors-for different periods. Using paired sample t-tests on key variables like turnover, earning per share and dividend per hart, it was discovered that a greater percentage of the sampled companies failed to meet their forecasts. Since not all long-term strategies are profitable in the short-run potential estors and existing shareholders should not base their investment decisions on profit forecasts alone but should consider other socio-economic and political factors

Keywords: Forecasts Actual Performances Turnover Earnings Per share Dividend per Share

INTRODUCTION

The accuracy of published financial forecasts has been the focus of accounting and finance researchers for years Most studies of management forecasts according to Neil and Jennifer (2000) have focused upon earning per share estimates published by established companies as part of their disclosure policy. Forecast is indeed growing within other contexts, such as within Initial Public Offers (IPOs)

The study of forecast accuracy can be instructive with regard to several capital issues. Information asymmetry and signaling research suggest that forecast disclosures can be useful in conveying news about company value (Patell, 1976, Penman 1980, Waymire 1984, Lev and Penman 1990). Therefore, understanding the extent to which published forecasts can accurately predict the future should be of concern to the market: forecasts perceived as unreliable should be discounted while those considered more accurate should command greater attention.

In the US, profit forecasts and other forward-looking statements are essentially banned. In fact, a fierce battle broke out between the board of Telstra and the advisers to its $10 billion float over key project projections. The board was determined to resist what it regarded as unrealistically optimistic earnings forecasts that would form the basis of the market valuation of Telstra.

But are there remedies for investors who relied on forecasts in prospectus before making their investment? In Kerr v Danier Leather, Danier's shareholders brought a class action against Danier, its CEO. At trial, Justice Sidney Lederman found Danier, the CEO and CFO liable to the shareholders. He held that though no material change had occurred, Danier had failed to disclose material facts that arose after the date of its prospectus but before closing. The decision was appealed and on December 15, 2005, the Ontario Court of Appeal released its decision. This case was cited by Kent et al (2006).

The desire to bring this and other aspects of prospectus forecasts to public knowledge motivated this exercise. The objective of this paper therefore is to ascertain the extent to which one can rely on forecasts in prospectuses issued by Nigerian companies. The rest of this paper is divided into four sections. Section two with review of related literature. Section three is on research methodology and model specification le section four is on research findings and discussions. Section five summarizes and concludes the paper.

VIEW OF RELATED LITERATURE

A prospectus contains "forward-looking statements," which include information relating to future events, future financial performances, strategies, expectations, competitive environment and regulations. Words such as ‘may’, ‘should’, ‘could’, ‘would’, ‘predicts’, "potential" ‘continues" "expects’, ‘anticipates, ‘future’, ‘intends’, "plan," "believes," "estimates," and similar expressions, as well as statements of future tense identify forward-looking statements. These forward-looking statements include without limitations, statements regarding:

-projections, predictions, expectations, estimates or forecasts as to the company's financial and operating results and future economic performances.

-proposed new product and service offerings.

-expectations that. that regulatory developments or other matters will not have material adverse effect on the company’s financial position, results of operations or liquidity, and

-management's goals and objectives and other similar expressions concerning matters that are not historically facts.

Forecast research can improve our understanding of the IPO under-pricing phenomenon (Neil and Jennifer, (2000). It is generally accepted that under-pricing is positively associated with the level of uncertainty surrounding business quality and the price that the firm's share will command once it begins trading: that is, the ex-ante certainty of the issue (Ritter 1984, Beatty and Ritter 1986). A number of proxies for ex-ante uncertainty have been associated with under-pricing. Of interest is the fact that under-pricing has been associated with auditor/ investing accountant's reputation (Titman and Trueman 1986, Simunic and Stein By 1989), percentage of ownership retained by the vendor (Leland and Pyle 1977, Beatty 1989), firm size (Chalk and Peavy 1986), firm's age (Beatty 1989), number and nature of uses of proceeds (Beatty and Ritter 1986, Jog and Riding 1987) and industry (Ritter 1984, Jog and Riding 1987).

In the context of IPOs, a company's prospectus provides an important source of information for investors. It contains information on past performances (if any), the present financial situation and, to varying degrees, expected future direction. In some markets, the inclusion of information about an IPO company’s future trade prospects in now mandatory (e.g. Nigeria). In other settings, disclosure is voluntary and reasonably common eg Australia, Canada, U.K-or rare and discouraged e.g. USA (Neil and Jennifer, 2000).

Jennifer (2000) conducted a research on forecast errors on Australian companies. The study the investigated th association earning forecast risk and conventional ex-ante uncertainty proxies used to explain IPO under-pricing. The results showed that revenue forecasts were smaller and less sensitive than those for profits. Using 203 Australian firms for a period of six years (1991-1996), Neil and Jennifer (2000) identified eleven variables as potential determinants of revenue and forecast errors. These are: age, size, forecast interval, equity retained by pre-offer owners, industry conditions, macro-economic conditions, audit quality, float motive, subscription price premium (over shareholders' funds per share), range of activities md international exposure.

Forward -looking statements should not be read as a guarantee of future performances or results and will probably not be accurate indications of when such performances or results will be achieved. Forward- looking statements are based on available information when the statements are made or on management's good faith and belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performances or results to differ materially from those expressed in or suggested by forward loooking statements. Important factors that could cause differences include but not limited to:

- A company’s history of operating losses.
- The highly competitive nature of the industry.
- System disruptions, power outrages and failures of third-party facilities and equipment.
- Ability to sustain the growth rate enjoyed so far. to manage rapid growth, train additional personnel and improve on controls and procedures.
- Ability to retain key personnel.

- Increasing regulations of services and imposition of federal, state and local government taxes.

Forward looking statements speak only as of the date the statements are made. Potential investors and existing shareholders should not put undue reliance on them. In fact, this is usually stated in most prospectus issues worldwide, Nigeria inclusive. Most prospectus contain a clause that the company has no obligation to update its prospectus to reflect actual results, changes in assumptions or changes in other factors affecting forecasts, except to the extent required by applicable securities laws.

But does the law permit directors to make reckless statements? The following example comes to hand The Australian Seventies and Investment Commission (ASIC) placed an interim stop order on the Barkworth Olives No & prospectus, over concerns that the forecasts in the prospectus contained information on future Olive prices that were not based on reasonable grounds The prospectus offered shares in the Land holding Company as well as interests in projects.

ASIC believed that investors would not be in a position to make an informed decision about investing from the prospective as the information in it was on future prices of olives, and in particular the estimated inflation rate during the next 20 years, was misleading. The interim stop order prevented the offer, sale, issue or transfer of securities under the prospectus.

A recent research work on this topic in Nigeria was by Banjo (2007). Using student t-test to analyze her data she found that most Nigerian companies that make promises to shareholders in their prospectuses do not fulfill them To her, most manufacturing companies find it hard to merge their actions with words. Moreover, the prospectuses of many of these companies seem to create a disparity with their actual performances. This, to her, is because performance is measured from financial perspectives, which should not be.

Many have indeed criticized financial measures because of their well-documented inadequacies, their backward looking focus and their inability to reflect contemporary value-creating actions. According to Banjo (2007) if improved performance (efficiency) fails to be reflected in the bottom line, management should reexamine the basic assumptions of its strategy and missions. Not all long-term strategies are profitable strategies (in the short-run). Measures of customers and shareholders' satisfaction, internal business performances, innovations and improvements are derived from the company's vied of the world and its perspectives on key success factors. These, according to her, make financial analysis more forward looing.

RESEARCH METHODOLOGY AND MODEL SPECIFICATION

Research Methodology

This paper made use of two sets of secondary data. The first set was on Turnover, Earnings Per Share (EPS) and Dividend Per Share (DPS) obtained from the Annual Reports And Accounts as published in the Fact book of the Nigerian Stock Exchange for seven randomly selected companies. This set of data served as the actual results of the selected companies. The seven companies used as case studies are from key sectors of the Nigerian economy. From the banking industry we have Intercontinental Bank Plc (2006, 2007) and GTB Plc (2002, 2003). The manufacturing sector has Evans Medical Plc (2003, 2004) and West African Portland Cement Company Plc (2005, 2006). The conglomerates have SCOA (2003, 2004) Pic and UTC Plc 2002, 2003) whiles the Oil and gas has Oando Nigeria Plc (2004, 2005).

The second set of data on the above variables was obtained from the profit forecasts in the prospectuses issued by the companies used as case studies for the period under review.

The statistical method employed for test of the hypothesis is paired sample t-test. This is because among other uses, the t-test is a statistical tool used to test the significance of the difference between two sample means observed at two points in time (Carver and Nash, 2000). This is an improvement on the ordinary student t- test used by Adereti and Sanni (2007), Banjo (2007) and Sanni (2008).

The paper tested only one hypothesis in its effort to make the research objective achievable. This is:

Ho: The directors of the companies used as case studies were not able to meet their forecasts on turnover, earnings per share and dividend per share.

Hi: The directors of the companies used as case studies were able to meet their forecasts on turnover, per share and dividend per share.

Model Specification

As earlier stated, the test of significant difference between two means carried out with calculated t-value is:

$$t_{cal} = \frac{Ma - Mf}{\sqrt{\frac{Va}{na} - \frac{Vf}{nf}}}$$

where:

Ma =Mean of Turnover, EPS or DPS (as the case may be) of forecasts in the prospects.

Mf = Mean of Turnover, EPS or DPS (as the case may be) of actual performance.

Va = Variance of Turnover, EPS or DPS (as the case may be) of actual performance,

Vf = Variance of Turnover, EPS or DPS (as the case may be) of forecasts in the prospectus.

na = Number of years of actual performance which must be equal to the one in the prospectus.

nf = Number of years covered by the forecasts in the prospectus

Decision Rule

Accept Ho if Calculated P-value > 0.05

Reject Ho if Calculated P-value < 0.05

FINDINGS AND DISCUSSIONS

On Turnover

	EVANS	UTC	WAPCO	SCOA	INTER*	GTB*	OANDO
Mean	(606779)	(1023658)	2289	(1254)	1582	(178)	(27431)
t-cal	(3.462)	(1.819)	0.669	(1.363)	1.084	(0.263)	(6.923)
P-value	0.179	0.320	0.625	0.403	0.474	0.836	0.091

Source: Computations from SPSS

*The forecasts were in respect of Scheme of merger with Equity Bank Plc, Gateway Bank Plc and Global Bank Plc

** Gross earnings were not included in the bank's forecasts. Profit before tax had therefore been used instead.

Based on the decision rule, we accept Ho if the calculated significant level is greater than 0.05. Thus, from the computations in Table 1 above; we conclude that the directors of EVANS Plc, UTC Plc, SCOA Plc, GTB Plc and OANDO Plc were not able to meet their forecasts as each of the P-values of 0.179 for EVANS, 0.320 (for UTC), 0.403 (for SCOA) and 0.09 (for OANDO) is greater than 0.05 thus making them not significant.. This is quite logical as in each case; actual performances are less than forecasts as indicated by the pared negative mean of each of them.

What of WAPCO Plc and Intercontinental Bank Plc? Though the mean of actual turnover/gross earnings exceeds forecasts (as indicated by the paired positive mean of each of them), the difference is not significant at 0.05 (0.625 for WAPCO and 0.474 for INTERCONTINENTAL). This tempts one to accept the Ho, thereby committing Type II error. This confusion arises because of the small number of years used for the forecast/ actual results and the resultant small degree of freedom (df). As rightly pointed out by Fagoyinbo (2004), the higher the degree of freedom used, the closer is the t-distribution towards the shape of normal distribution. Theoretically, (the) t-distribution is equal to normal distribution when the df is infinite in size i.e. over 30 or more).

For this reason we fail to accept Ho and conclude that the directors were able to meet the forecasts.

On EPS

Table II:Paired samples test (Actual less Forecasts). WAPCO SCOA

	EVANS	**UTC**	**WAPCO**	**SCOA**	**INTER***	**GTB***	**OANDO**
Mean	(0.690)	(0.158)	112.500	(40.400)	47.260	25.000	(428.00)
t-cal	(1.302)	(2.333)	0.966	(1.291)	5.304	1.000	(1.69)
P-value	0.412	0.258	0.511	0.420	0.119	0.500	0.34

Source: Computations from SPSS

*The forecasts were in respect of Scheme of merger with Equity Bank Plc, Gateway Bank Plc and Global Bank Plc.

Based on for the decision rule, the difference between the mean of actual EPS and forecasts is not significant at 0.05 for EVANS Plc, UTC Plc, SCOA Plc and DANDO Plc, thus making us fail to reject Ho This because eech of the P-values of 0.412 for EVANS, 0.258 for UTC 0.420 for SCOA and 0.340 for OANDO is greater than 0.05, thus making them not significant. In each case actual EPS are less than forecasts as indicated by the negative mean for each of them.

As for WAPCO Plc, Intercontinental Bank Plc and GT Bank Plc, actual EPS are mere than forecasts (as indicated by the positive mean for each of them), making us fail to reject Hi that the directors of these organisations were able to meet the forecasts despite their P-values being greater than 0.05 at earlier explained under turnover.

On DPS

Table III: Paired samples test (Actual less Forecasts).

	EVANS	**UTC**	**WAPCO**	**SCOA**	**INTER***	**GTB***	**OANDO**
Mean	(15.00)	(17.50)	12.50	(17.50)	7.50	26.50	(65.00)
t-cal	1.00	(1.40)	1.00	(7.00)	1.00	1.61	(0.30)
P-value	0.50	0.40	0.50	0.90	0.50	0.36	0.81

Source: Computations from SPSS

*The forecasts were in respect of Scheme of merger with Equity Bank Plc, Gateway Bank Plc and Global

Based on the decision rule, the difference between the mean of actual dividends and forecasts is not significant at 0.05 for EVANS PLC, D, EVANS, 40 DANDO, Plc, thus making us fail to reject Ho. This is because each of the P-value of 0.50 for EVANS, 0.40 for UTC, 0.90 for SCOA and 0.81 for OANDO is greater than 0.05, thus making them not significant. In each case, the mean of actual dividends is less than forecasts as indicated by the negative mean for each of them.

As for WAPCO Plc, Intercontinental Bank Plc and GT Bank Pic, the mean of actual dividends is more than forecast (as indicated by the positive mean for each of them), making us fail to reject Hi that the directors of these organizations were able to meet dividend forecasts despite their P-values being greater than 0.05 as earlier explained under turnover.

It is worthy of note that five (5) or 71% of the sampled companies were not able to meet their forecasts on turnover/gross earnings. Almost all the companies that were unable to meet their forecasts on turnover/gross earnings also failed on EPS and DPS. This is to be expected as both variables in most cases depend on turnover

The findings here are quite in agreement with an earlier research work by Banjo (2007) who concentrated her work on manufacturing companies. They are also in agreement with existing facts. That the directors of manufacturing companies used as case studies failed in their forecasts might be due to the industry's peculiar problens. As rightly observed by Mutallab (2007), manufacturing capacity fell to about 22.7% in 2007, representing 22 points and 30.7 points lower than 47% and 53.4% in 2004 and 2005 respectively. As for banks, consolidation had earlier taken place in 2005. By 2007, the industry balance sheet had grown by 36% while shareholders' funds rose by 48%. Net earnings grew by 9% while industry gross earnings was equivalent to 3% of the GDP (Mutallab, 2007). These might have contributed to the success stories of banks used as case studies. The merger of Agip Nigeria Plc and Unipetrol Nigeria Plc to form Oando in 2002 had earlier been found by Sanni et al (2008) not to lead to an increase in the company's profitability, two years after the merger. Thus, its failure to meet its forecasts should not be a surprise.

One of the limitations to this work, which must be pointed out, is the fact that the effects of inflation /time value of money had not taken into consideration.

CONCLUSION

The paper compared forecasts in prospectuses with actual performances of some selected Nigerian companies with a view of ascertaining whether the directors of these companies were able to meet such forecasts.

Reasons for not meeting forecasts were given. They include both macro and micro economic variables that might not have been envisaged at the time the forecasts were being prepared in all, more than fifty percent of the sampled companies were unable to meet their forecasts on variables used in this study – turnover/gross earnings, earning per share and dividend per share. As for those who base their investment decisions on profit forecasts, there appears not to be legal remedies for them yet, going by a decided case on this issue.

The findings here should not be generalized for all Nigerian companies as just seven out of the over 200 listed companies in the Nigerian Stock Exchange were used. Again, had other variables and periods been used, the result might probably have been different. The research itself covered the period prior to the 2008 global financial crisis. To base management's ability on a two-year profit forecast alone may not be fair as not all long-term strategies are profitable strategies at least in the short-run. Most of the literature reviewed (are outdated) and the cases cited by the paper were of foreign origin. Further research works should be conducted locally on this topic.

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