

# CHAPTER ONE

## INTRODUCTION

### 1.1 Introduction

Origin of contemporary accounting lies in the efforts made in the 15<sup>th</sup> century and the development of double-entry and record keeping by Renaissance merchants to ensure that their business activities were known and measured. This was made possible based on the work of an Italian monk and mathematician, Friar Lucas Pacioli, who first published the fundamental principles of accounting in 1494 Smith, 2013(1). This was based on, what is today known as, “the double-entry principle” of recording transactions of entities.

Accounting as a language of business enables activities of an entity to be communicated to both internal users, i.e. management and external users like, investors, creditors, governmental agencies, employees, researchers and the general public. Accounting provides timely financial information about an entity and its activities or operations that are relevant, reliable and useful for decision makers. This financial information is embedded in what is termed ‘financial statements.’ Financial statements provide information relating to an organization’s financial status in relation to liquidity, financial strength, efficiency in performance and profitability. Generally, financial statements are classified into four groups, i.e., balance sheet, income statement, cash flow statement and statement of retained earnings. While preparing the financial statements, the Generally Accepted Accounting Principles (GAAPs) are complied with to make the statements relevant, reliable and useful.

Investment decisions are made based on analysis and interpretation of financial statements; as many successful investors made great use of these statements to decide companies with competitive advantage at the long run; such as Warren Buffett. The individual figures in financial statements may not be of much use until they are analyzed and compared over time, with competitors and industry standards. The term ‘financial statements analysis’ is also known as analysis and interpretation of financial statements, and refers to establishing meaningful relationship between various items of the two financial statements, i.e., income statement and position statement.

Thus, the analysis and interpretation of financial statements is essential to measure the efficiency, profitability, financial soundness and future prospects of the firm.

To assist the investor further in his quest to make investment decisions, the activities of companies at the capital market need to be considered. This enables the investor determine the performance of the companies he is preparing to invest in. Capital markets are markets for buying and selling equity and debt instruments. It is asserted that a well-organized and functioning capital market props economic development of a nation. This is achieved by mobilizing savings of those who have what may be regarded as idle fund and ensures that available resources are properly allocated. By this reasoning, the stock market by its operational rules value the worth of the shares of listed companies so that investors and other interested parties may decide to relate with a particular company or not. Investors, particularly would want to invest in a company that available information promises less risk and adequate returns. Investment could be made based on anchoring bias, which implies relying too heavily on the first information available without waiting for other variables to surface at the market place. The market supplies industry with fixed and working capital, finances medium-term and long-term borrowings of the central, states and local governments. Specifically, the capital market deals in ordinary shares or stock and debentures of corporations, and bonds and securities of governments. The capital market performs its functions through the stock exchange market. A stock exchange market facilitates the functioning of the capital market by providing the platform for buying and selling of shares, stocks, bonds, securities and debentures. Capital market includes the primary markets, where new shares and bonds issues are sold to investors, and secondary markets where existing shares and bonds are traded. On this note therefore, investors are in most cases compelled to monitor the activities of the companies in the capital markets so that informed investment decision could be made in conjunction with information derived from the analysis of the financial statements. In this research, we considered knowledge about the performance of the automobile companies as very crucial hence analysis of their performance is an important component of this research. This research therefore, deals with providing adequate information that will serve as a barometer to investors in considering investing decisions.

## **1.2 Background of the research**

In the 1930s, the work of Benjamin Graham gave birth to what is today known as ‘value investing’, that implies buying when the price of stock is low with the hope and intention that in future (not long time), the price will be revalued and then, the stock will be sold at a profit. But this idea was

not actually to determine the future value of stock in the market place and the earning capacity of firms in the future. However, it was to look at the stock value and earning capacity from different angle, even though he was mentored by Graham, Buffett was concerned with firms having competitive advantage at the long run. And to achieve this, he read and analyzed zillion of financial statements Buffett, Clark, 2011(2).

Several studies examined the extent to which financial statement analysis is relevant in investment decisions; while some even asked whether financial statements have lost their relevance Francis, Schipper, 1999(3). Value relevance of financial statements is affected by adoption of IFRS Christensen et al, 2015; Chalmers, Clinch, Godfrey, 2011(4, 5).

The essentiality of information in financial statement as catalyst for proper investment decisions have been expressed by authors, and cannot be overemphasized Brownlee, Ferris, Haskins, 1990; D'Amalo, 2010(6, 7). It is, therefore, imperative that this study embarked on a detailed study and analysis of the contents of financial statements to determine the performances of the selected automobile companies in India and Japan. In addition, the performance of the selected automobile companies in the capital markets are analyzed to determine whether their share prices are on steady rise, decline or stagnated, including other information such as 'noise' in the market being used to determine the stock performances of the selected automobile companies.

### **1.3 Identification of Problem**

Economies of different countries are competing on the part of development and growth. To pursue growth, focus must be on all segments of the economy, whether it is manufacturing, agriculture or services. The government has a responsibility to provide the necessary environment to drive the vehicle of growth, while the private sector must drive the process. To achieve this, funds must be invested. Investment involves the purchase of assets with the expectation that they will yield income in the future, or that if the assets are sold later, they will be at a profit. Organizations and individuals participate in investment, and because huge amount are always staked as investments, we should then be clear in our minds what we are about to do. This requires information, and information is said to be power. We need information about the global economy, the local economy, the industries, the individual companies, and stock performance at the capital market.

Investors need adequate information about the companies they wish to invest in. A potent source of information for the investor to determine the financial health, earnings, and profitability is the financial statements. And it is also the need for the investor to have knowledge about the performance of the stocks of the companies in the capital market that stock analysis is made. This is mainly sourced from daily or weekly movements of stock prices at the stock market, and other sources. This is achieved by undertaking fundamental analysis and technical analysis. Accounting data as revealed by the financial statements may not be very useful until they are analyzed and interpreted. Decades ago, luck or rule of the thumb was guiding investors, this cannot be said to be effective in a world that is driven by information and technology. The big challenge of investors is having adequate, reliable, timely information that are expertly analyzed and interpreted to guide them in making investment decisions. This study will examine how the accounting numbers revealed by the financial statements, their analysis and interpretations, and the product of fundamental and technical analysis will form the required information in the domain of the investor to help him make vital investment decisions.

#### **1.4. Objectives of the Study**

Main objective of the study is to assess how investors make decisions based on analysis and interpretation of financial statements and capital market performance of various companies' securities under study. This is, therefore, conducted to achieve the following objectives:

1. To understand financial statement analysis of the selected automobile companies for selected duration.
2. To evaluate the companies' comparative financial statements performance for India and Japan.
3. To understand stock market performance of selected automobile companies for the selected time duration.
4. To evaluate the companies' comparative stock market performance for India and Japan.
5. To understand investment behavior regarding financial statement analysis and stock market performance.
6. To build understanding about companies performance.

## **1.5 Brief Overview of the Automotive Sector**

An important segment that has led to fast growth of most economies is the automobile sector. There is hardly any sector that the presence of the automobile sector is not appreciated. The sector leads to the movement of men and materials necessary for economic development in a nation. This study is geared towards stimulating investment in the automobile sector, because it is a major driver of economic development in the world. The sector is a major contributor to world Gross Domestic Product (GDP), increase in Foreign Direct Investment (FDI), reduction in unemployment, and creation of competitive innovations.

One effective way to drive growth and development is Investment. Investment will mop up idle funds and make the funds available for productive use. Investment could be by every member of the society, whether private individuals, corporate bodies or even the government and her agencies.

To make profitable investment calls for critical information. The information required include, but not limited to, the sector or industry to invest, companies in the selected sector to invest, when to invest, the likelihood of guaranteed returns on the investment, the risk associated with the investment, etc.

These information and many more are provided by making analysis of financial statements and stock performance of companies at the capital markets, and other sources.

The automobile sector was not built in a single day, rather efforts of several individuals and corporate entities over several years and decades resulted to what is today referred to as the automobile sector. The evolution was worldwide though different countries came into the picture at different time periods. The automobile sector is a wide range of companies and organizations that are primarily concerned with the design, development, manufacturing, marketing, and selling of motor vehicles Encyclopedia Britannica, 2014(8). It began commercial production in the 1890s, with many manufacturers from different countries. The pioneer countries in this evolution were USA, Britain, Italy, Japan, Germany, etc. In 1929, automobile production was more than 32 million and US was a leading producer at this time. Italian inventors were also at the forefront of this evolution. Others were from England, America, Germany, Japan, China, India, and South Korea. The automobile sector has contributed greatly to world GDP and employment, hence

production has been growing since 1997 from 54 million to about 90 million in 2014 OICA, 1998; OICA, 2014(9, 10).

There is hardly any sector of an economy that the contributions of the automobile sector is not making positive contributions. This is suggestive that any economy that anticipates to grow must not ignore the automobile sector. It is important both at war time and peace time. War equipment and troops need to be mobilized, and the auto sector plays unquantifiable role in this direction.

The automobile sector contributes quite significantly to research and development in an economy. Huge amount is invested every year on research and development, leading to innovation in design and manufacture of automobiles. This is done through acquisition and/or development.

In India, the auto sector is one of the largest in the world with an annual production of 21.48 million vehicles in the financial year 2013-14. The sector account for 22 per cent of the country's manufacturing Gross Domestic Product (GDP). The monumental growth in the sector is attributable to improvement in standard of living of the middle class and government initiatives that encouraged foreign direct investment in the sector. The automobile sector in India manufactures more than 20.4 million vehicles and exports more than 2.9 million vehicles in a year Agarwal, 2014(11). The encouragement and promotion of eco-friendly, and hybrid vehicles are other means through which the government of India has brought about the growth in the automobile sector. The current standing of the Indian automobile sector in the world speaks volume as it indicates tremendous growth. According to the Automotive Components Manufacturers Association of India (ACMA), the world standings for the automotive sector of India is as follows Make in India, 2015(12):

Largest tractor manufacturer

2nd largest two-wheeler manufacturer

2<sup>nd</sup> largest bus manufacturer

5th largest heavy truck manufacturer

6<sup>th</sup> largest car manufacturer

8<sup>th</sup> largest commercial vehicle manufacturer.

The leading companies in this sector are Tata Motors Ltd, Ashok Leyland, Maruti Suzuki, Eicher Motors Ltd, TVS Motors Co Ltd, Bajaj Auto Ltd, Hero Motors Corp Ltd, Mahindra & Mahindra Ltd, and Force Motors.

In Japan, the auto sector is one of the most prominent and largest sectors in the world. Japan has been on the top three of the countries with most cars manufactured since the 1960s, surpassing Germany. The automotive sector in Japan rapidly increased from the 1970s to the 1990s, overtook U.S. as the production leader with up to 13 million cars per year manufactured and significant exports. Japan is now the third largest automotive producer in the world with annual production above 9 million automobiles in 2012 Switzerland Global Enterprise, 2014(13). The country is home to a number of companies that produce cars, construction vehicles, motorcycles, ATVS, and engines. Japanese automobile manufacturers include Toyota, Honda, Daihatsu, Nissan, Suzuki, Mazda, Mitsubishi, Subaru, Isuzu, Kawasaki, Yamaha, and Mitsuoka. Cars designed in Japan have won the European car of the year, International car of the year and World car of the year awards many times.

Invariably, the study is considering whether making investment decision should be based on analysis of financial statements and market performance of the various companies. Hereby is the importance of financial statements and market performance analysis.

The system of financial reporting is now mandatory, especially for listed companies throughout the world. This essentiality of the financial statements for financial decisions has led to huge commitment of resources in ensuring that the contents of financial statements are reliable. The International Financial Reporting Standards (IFRS) and other earlier standards of various countries are in this direction. And more attention is paid to activities in the capital market to determine the direction of stock price before making investment decisions.

The automobile sector can be classified in two broad groups:

1. Light Motor Vehicle: Two wheeler, three wheeler, and four wheeler.
2. Heavy Motor Vehicle: More than four wheeler.

Most of the automobile manufacturing companies produce more than two categories while others specialize on one or two categories.

## **1.6 Profile of the selected automobile companies**

This section is mainly devoted to profile of the selected automobile companies in terms of year of commencement, country of domicile, types of end product, probable position in the sector in each country, capitalization, estimated sales volume and revenue, and other vital information for the purpose of this research.

### **1.6.1 Ashok Leyland limited**

Ashok Leyland limited, formerly Ashok Motors based in Chennai, India and operating six plants at Ennore, Hosur, Bhandara, Alwar, Pantnagar, Sengadu village was founded in 1948 by Raghunandan Saran. The company was named after the only son of the founder, Ashok Saran. After the death of Ashok in air crash, a partnership with Leyland which he initiated was perfected, and the company changed its name to Ashok Leyland in 1954. The products include tractors, buses, heavy duty vehicles, engines, and commercial vehicles. It has a net income of US\$4.3 billion in 2014, US\$2.3 billion in revenue in 2015, and had 11,552 employees in 2014 Ashok Leyland, 2014(14).

### **1.6.2 Eicher Motors limited**

Eicher automobile company was founded in 1948 and incorporated 1982 in Gurgaon, India. The company designs, manufactures and markets trucks, buses and related components. Eicher motors ltd has a revenue base of US\$1.3 billion as at 2014 and US\$450 million as net income in 2012 and had 2500 employees in 2012. It is indeed one of the leading automobile manufacturers in India. The company owns the most cherished Royal Enfield Motorcycle in India, which has continuously been in the production of well-liked motorcycles all over the globe. A joint venture with Volvo group VE Commercial Vehicles Limited, designs, produces, and markets fuel-efficient trucks and buses. The company is at the forefront of modernizing commercial transportation in India and many developing economies. Revenue in 2014 was US\$1.3 billion and Net income of US\$460 million in 2012. EML has an employee record of 2,500 in 2012.

### **1.6.3 Mahindra & Mahindra**

Mahindra & Mahindra (M&M) automobile manufacturing company was incorporated in 1945 at Ludhiana, India by assembling Jeeps whose components were completely knocked parts from

Willys, US. The company has its headquarters in Mumbai, Maharashtra, India. It manufactures a wide range of products, such as tractors, jeeps, two & three-wheelers, and commercial vehicles. The company has a revenue base of US\$10 billion; net income of US\$600 million; total assets US\$10 billion; and number of employees of 34,612. It is among the world leading manufacturers of tractors and a market leader of suv manufacturers in India.

#### **1.6.4 Maruti Suzuki India limited**

The company, formerly known as Maruti Udyong Limited, was established in 1981 with headquarters in New-Delhi, India. The company has its manufacturing plants in two different locations in India, Gurgaon and Manesar, both at the northern part of India. These facilities have combined installed capacity of 900,000 units per year. It is among the ten top most automobile manufacturing companies in India. The company is a leader in the car segment of Indian automobile industry in terms of sales volume and revenue. It has a range of about 15 brands or models including but not limited to; Maruti 800, Alto, Ritz, Swift, Gypsy, Grand Vitara, Eeco, etc. As at 2012, it had about 37% of the Indian passenger car market. The company employs 12,900 workers as at 2015.

#### **1.6.5 Tata Motors Limited**

Tata Motors Limited, formerly known as Tata Engineering and Locomotive Company (TELCO) was established in 1945 in Mumbai, India... It is a multi-billion dollar organization whose marque are found in 175 countries around the globe. The company brands includes: Tata Indica, Tata Indigo, and Tata Safari. The company has employee strength of 60,000 and a turnover of \$42 billion, with total sales of more than 9 million vehicles.

#### **1.6.6 Honda Motor Company Limited**

Honda Motor Co. Ltd was established in 1946 with headquarters in Minato, Tokyo, Japan. The known products of Honda Motor Co Ltd. are commercial vehicles, luxury vehicles, motorcycles, scooters, electric generators, water pumps, etc. It had 198,561 employees in 2014 and has a net income of US\$5.75 billion in the same year.

### **1.6.7 Mazda Motor Corporation**

Mazda Motor Corporation was founded in 1920 with headquarters in Hiroshima, Japan. The company business is the manufacture and sales of passenger cars and commercial vehicles. It has 44,035 employees on its payroll. In 1931, the company started manufacturing its first vehicles, a line of three-wheel trucks. Mazda Motor Corporation was fortunate to survive the Hiroshima atomic bombing because it lay shielded behind a hill. The company is making steady progress in production, revenue, net income, and contribution to Gross Domestic Product; but recently, the company seems to be having turbulent times with production and sales.

### **1.6.8 Nissan Motor Company Limited**

Nissan Motor Co. Ltd is a Japanese automobile manufacturing and sales company, established in 1933 with headquarters in Yokohama, Kanagawa, Japan. The company currently manufactures vehicles in 20 countries. The products of the company are luxury vehicles, commercial vehicles, outboard motors, forklifts. It has different divisions of Datsun, Nissan, Nismo, and Infiniti. Nissan Motor Co. Ltd. had an output of 5,097,772 units in 2014; employs 142,195 consolidated employees in 2014 Nissan Motor, 2014(15).

### **1.6.9 Suzuki Motor Corporation**

Suzuki Motor Corporation of Japan was founded in 1909 with headquarters in Hamamatsu, Shizuoka, Japan. The company markets its products in 190 countries around the globe. The company's products include cars, outboard motors, and motorcycles. It has production output of 2,878,000 in 2011, Revenue of US\$31,367 billion in 2011 and number of employees was 52,731 in the same year.

### **1.6.10 Toyota Motor Corporation**

Toyota Motor Corporation is an automobile manufacturer based in Japan. It was founded in 1937. The company is a multinational corporation, having its headquarters in Toyota, Aichi, Japan. The company has a wide range of vehicles; buses, trucks, SUV, MUV, etc. As at 2015, it is recorded as the world's 13<sup>th</sup> largest company by revenue. It is the first automobile manufacturer to produce 10 million vehicles in a year. The company is world market leader in sales of hybrid electric vehicles. It has presence in most countries of the world, making it a global brand.