THE RELATIONSHIP BETWEEN VOLUNTARY DISCLOSURE AND FINANCIAL PERFORMANCE OF SELECTED COMPANIES QUOTED AT THE NAIROBI SECURITIES EXCHANGE

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DECLATION

This thesis/Research Project is my original work and has not been presented for a degree award in any other University.

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DEDICATION

I dedicate this project to my family, friends and loved ones.

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ACRONYMS

AICPA - American Institute of Certified Public Accountants

BRRP - Business Reporting Research Project

CACG - Commonwealth Association for Corporate Governance

KCCG - Kenyan Centre for Corporate Governance

CICA - Canadian Institute of Chartered Accountants

CMA - Capital Market Authority

COEC - Cost of Equity Capital

CSR - Corporate Social Responsibility

EBIT - Earning Before Interest and Tax

EPS - Earning Per Share

EVA - Economic Value Added

FASB - Financial Accounting Standard Board

GAAP - Generally Accepted Accounting Principles

IAS - International Accounting Standards

IFC - International Finance Corporation

IFRS - International Financial Reporting Standard

LSE - London Stock Exchange

NOPAT - Net Operating Profit After Tax

NPV - Net Present Value

NSE - Nairobi Securities Exchange

NYSE - New York Stock Exchange

PMS - Profit Margin on Sales

ROE - Return On Equity Employed

ROI - Return On Investments

WACC - Weighted Average Cost of Capital

DEFINITION OF TERMS

Agency Cost: The cost incurred in an agency relationship where the principal seeks to ensure the agent is serving its best interests.

Capital Markets Incentives: These are economic benefits that entice and motivate investors to operate and invest in Capital Markets in order to maximize their wealth.

Corporate Governance: This refers to the systems, structures, procedures, rules and processes by which organizations are controlled and directed.

Cost of Equity Capital: This is the return that shareholders of a company expect to earn from their investment.

Corporate Social Responsibility: The initiatives taken by organizations to ensure that they assume responsibility for the effects the organization has in the society it operates in.

Earnings Forecasts: These are estimates provided by analysts with respect to the expected future earnings of a company.

Gearing: This refers to the level of a company's debt as compared to its equity in its capital structure.

Information Asymmetry: This is a situation where one party to a transaction has more information than the other such that they can take advantage of the other party's lack of this knowledge.

Liquidity: The extent to which an asset can easily be bought or sold in the market so as to meet short term obligations without loss of the assets value.

Litigation Costs: Specified amount of money required to be paid following a successful court action or legal suit.

Market Valuation: The price at which an asset would be charged in a competitive auction.

Monitoring Costs: Agency costs incurred by owners of finance in a company to ensure that restrictive covenants are adhered to.

Return on Investment: It is a measure of performance that evaluates the efficiency of one or more investments.

Stakeholder: A person or organization that has invested in a company and is affected or has an effect on the company and its operations.

Shareholder Value: The value that shareholders benefit from in a company due to the fact that they possess shares and management works towards growing these share prices and also their dividends.

Firm Value: The present value of future cash flows that maximizes the profit of the firm.

Value Added Statements: These are statements that explain the value that a business has added through utilization of its resources.

ABSTRACT

This paper sought out to examine empirically the relationship between Voluntary Disclosure and Financial Performance measure, Return on Investment (ROI), of selected companies quoted at the Nairobi Securities Exchange. Annual reports of 10 listed companies from the NSE 20-share index were investigated from the year 2011-2013. A disclosure checklist consisting of 49 voluntary disclosure items of information was used. A regression analysis was conducted on the data set using Excel 2007. Findings revealed that the individual predictor variables produced mixed results when regressed against ROI. However, the multivariate regression analysis depicted that there is a strong positive relationship between voluntary disclosure and financial performance measure, as evidenced by a Pearson Product Moment Correlation Coefficient (R) of 0.6235 obtained from the multiple linear regression model. As such, given a Coefficient of Determination of 0.3888, only 38.9% of the data points appeared on the linear plot indicating that 61.1% of the variations in ROI are reduced by taking into consideration other factors outside of the regression model. Additionally, the hypotheses developed as $H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$ were rejected suggesting there is a link between voluntary disclosure variables and ROI. Since voluntary disclosure comes with a cost, this study recommends that managers in organizations disclose more information voluntarily not only for the purposes of obtaining cheaper capital but also it increases transparency and accountability in annual reporting and this boosts the confidence of investors as they make investment and financial decisions.

CHAPTER ONE

INTRODUCTION

1.1. Background

One of the reasons why organizations are in existence is to create value to the consumer, often referred to as external value creation, which subsequently translates to surplus revenue for the shareholders (referred to as internal value addition). Stewart (1994) asserted that a firm that is able to create value to the customer is rewarded by the market through generation of greater cash flows which accrue to the shareholder.

Corporate voluntary disclosure is the additional information provided by managers over and above the statutory requirements stipulated in the accounting standards. Li and McConomy (1999) found out that firms in better financial conditions are more likely to voluntarily adopt new International Financial Reporting Standards (IFRS) environmental disclosures and hence become more profitable and reduce the cost of compliance.

Investors, being risk takers, are always keen on the financial performance of the company they wish to invest their resources in. A firm whose earnings are steadily increasing, and whose future prospects spell out a continued growth in overall business performance, tends to attract more investors and hence builds up on its growth and expansion through a subsequent boost in capital. It is imperative, therefore, that managers continually disclose both financial and non-financial information so as to increase transparency and capture the attention of potential investors.

Over the years researchers have developed a keen interest in the voluntary disclosure practices of organizations the world over. A case example is that of Botosan (2000) who observed that firms which disclosed more information in their annual reports enjoyed the benefits of lower cost of capital. As such,

disclosure can be viewed as a tool that aids in communicating information to different market players in an industry.

1.1.1 Voluntary Disclosure

The Business Reporting Research Project (BRRP) issued a steering committee report titled "Improving Business Reporting: Insights into Enhancing Voluntary Disclosure". According to this report voluntary disclosure refers to information surplus to the mandatory financial statements required by GAAP (FASB, 2001).Voluntary disclosure increases transparency and accountability in annual financial reporting hence attracting prospective investors and enabling all other users of these reports to make informed decisions. Companies that voluntarily disclose information enjoy the benefits of cheaper funds from capital markets which in turn translate to better investment appraisals by managers.

Disclosure plays a crucial role in mitigating capital market incentive problems (Healy & Palepu, 2001). Voluntary disclosure of financial information is also a vital component of the corporate governance framework and is regarded as an important indicator of earnings quality and hence good performance. Boesso and Kumar (2007) claimed that one of the determinants that led to the emergence of voluntary disclosure was the inadequacy of financial reporting, as perceived by investors and shareholders. Consequently, stockholders increasingly demanded openness and voluntary disclosure of information relating to performance and long range strategies.

In the opinion of Ross (1997) companies that provided more information disclosures reduced the occurrence of information asymmetry between the owners and managers and subsequently get to enjoy low costs of capital. For purposes of this study, information considered to be voluntary disclosures will be categorized as: General Corporate and strategic, Forward-looking, Financial and finally Socio-Environmental and Board disclosures.

1.1.2 Financial Performance

Performance measures are either quantitative or qualitative ways to characterize and describe performance. They are an apparatus used by organizations to manage progress towards achieving preset goals and in the process identify the key indicators of organizational performance and customer satisfaction. A good performance measure should be able to adequately describe the population to be measured, the mode of the measurement, and the data source and time period for the measurement.

With increasing pressure on a firm's performance to deliver adequate returns on investment for shareholders, managers have been devising ways of improving corporate financial performance to increase shareholders wealth. This is a worldwide phenomena being practised in U.S.A, U.K, Australia, Canada, Brazil, Germany and closer home South Africa. It has trickled down the Kenyan market to be practised by Standard Chartered, Barclays Bank, Coca-Cola and Unilever (Dalborg, 1999).

A major economic objective to be achieved by managers in organizations is wealth maximization for shareholders. This can be done through efficient allocation of resources. To achieve this goal, shareholders wealth is substituted by profit or cash flows or financial statements ratios. Shareholders, managers and other interested parties use the information provided by financial statements to forecast performance (Worthington & Tracey, 2004).

Investors recognize the potentials of a company, both current and future, through its market valuation. Thus, they always expect managers to increase the market value of the firm in anticipation of high returns on their investments. This is because a rise in the market value of a company's shares is considered an increase in wealth for the company. Poor growth prospects adversely affect firm value; therefore, an effective performance measure is one that reflects the extent of the growth (Gikonyo, 2008).

Shareholder value has traditionally been measured by such indicators as return on equities (ROE), return on investments (ROI) and net income. Subsequently, the introduction of Economic Value Added (EVA) benchmarks a company's income against its cost of capital, which its promoters believe is a better indicator of both year-after-year growth and the adequacy of capital replacement. Accordingly, while the traditional measures are morally concerned with accounting returns, EVA leans towards economic returns to the extent that it deals with discounting the replacement cost of capital to arrive at the returns. However, it is difficult to obtain the requisite data which is indispensable to the calculation of the measure especially taking into consideration the privacy of such data as interest on debts (Kariuki, 2008). Therefore, this study measured the financial performance of a company by the use of ROI owing to its simplicity, comparability and that it is a basic tool in measuring both profitability and performance.

1.1.3 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) came into existence in the early 1920's when Kenya was under British colony. It was an informal market for local securities. When the NSE became operational in 1954, a self-regulatory framework was adopted whose main responsibility was to develop the stock market. After Kenya gained independence, the stock exchange continued to grow and became a major financial institution. In 2006, the facilities restructured from the original "handshake over coffee" mode of trading to an automated trading system. It is currently the fourth largest stock exchange in Africa when it comes to trading volumes. Through coordination with other authorities such as Central Depository System (CDS) and the Capital Markets Authority (CMA), the NSE provides clear guidelines on trading activities in the Kenyan market (NSE, 2011).

Listed companies in Kenya are required to produce quarterly and semi-annual financial statements as well as audited annual reports. Financial statements are to be prepared according to International Financial Reporting Standards (IFRS)

and audited using International Standards on Auditing (ISA). The Institute of Certified Public Accountants (ICPAK) together with the CMA and NSE has also established the Financial Reporting Award (FiRe) that reviews the annual reports of participating companies and gives awards to the statements that most comply with IFRS. The CMA Guidelines additionally encourage companies to disclose additional information on director and management remuneration.

As at 1st January 2014, listed companies at the NSE numbered 61, grouped into 11 sectors as shown graphically in Figure 1.1 below.

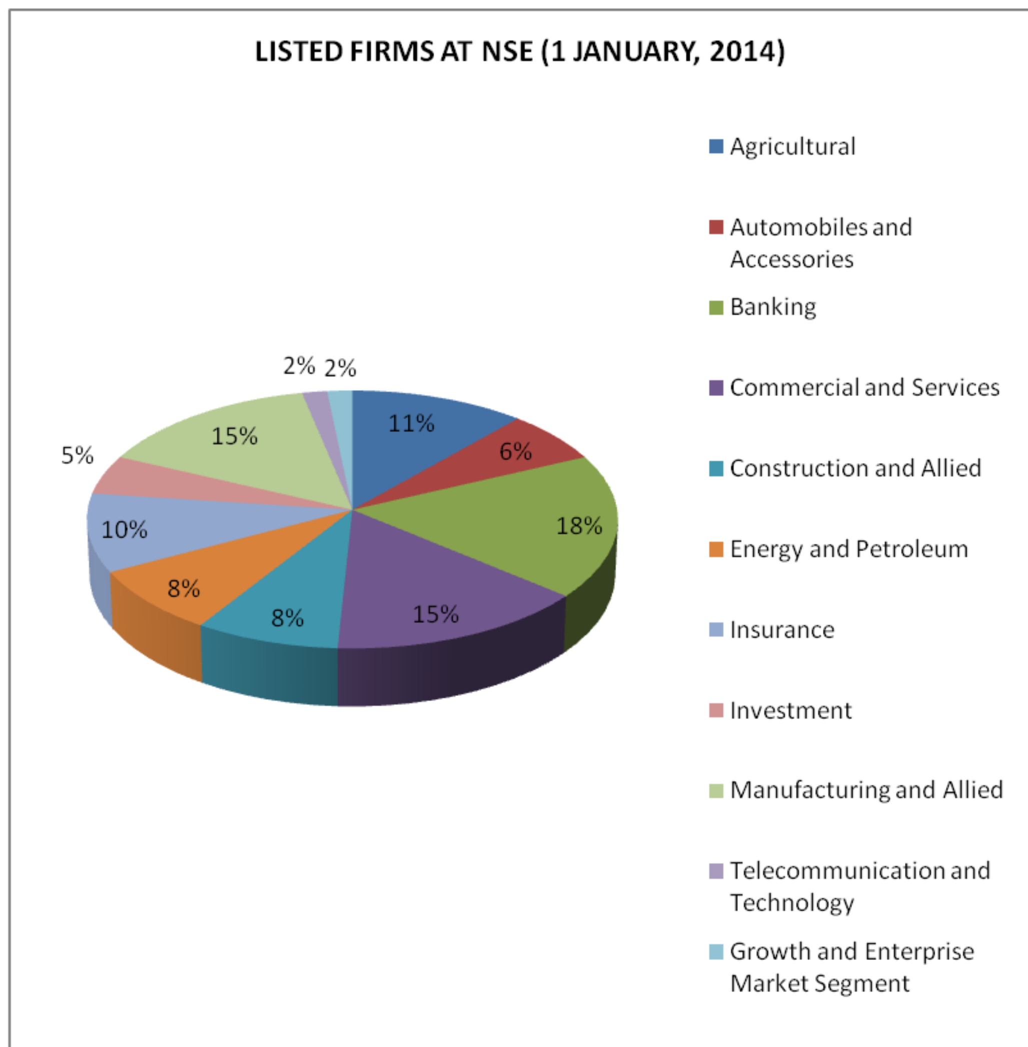


Figure 1.1: Listed Firms at NSE as at 1st January, 2014

Source: Researcher (2014)

Banking sector is the largest sector represented with 18% of the total firms quoted at the NSE followed by Commercial and Service sector and Manufacturing and Allied with 15% each. Telecommunication and Technology and Growth and Enterprise Market Sectors were the lowest each with 2% of the total firms quoted. Agricultural sector, which is one of the country major economic sectors in Kenya, is represented by 11% of the population. The analysis per sector can be linked to Kenya Economic review report 2013 where financial sector is expected to drive high levels of savings and financing of Kenya's investment needs.

1.2. Statement of the Problem

Corporate financial reporting, specifically annual reports, are a crucial tool in communicating vital information about a company, both financial and non-financial information (Barako, 2007). Potential investors in Kenya obtain vital information on trading activities of listed companies at the NSE through their annual reports and other bulletins from the CMA. Through onsite and offsite market surveillance, CMA fosters investor's confidence by ensuring rules, regulations and requirements for trade are complied with and market integrity is sustained. This results in orderly, fair and efficient markets in Kenya. This regulatory framework makes NSE a good and effective platform to gauge performance of companies, especially those that can be publicly scrutinized.

Over the years, a growing interest in voluntary disclosure practices have been exhibited by many researchers (Kang & Gray, 2006). Some have tested the association between voluntary disclosure and several aspects such as profitability (Verrecchia & Webber, 2006) cost of equity capital (Botosan, 2000) and stock liquidity. These studies, however, were centered in industrialized economies with very few studies done in the context of developing nations. More importantly, most of these literatures are leaning more on factors that influence the extent of voluntary disclosure.

In Nigeria, Salawu (2012) sought out to determine the extent and forms of voluntary disclosure of financial information on internet reporting. She based her study on the Nigerian Stock Exchange. Findings revealed that out of the total of 139 companies with websites, only 77 of them disclosed financial information on their web pages while the remaining 62 did not.

Studies done in the Kenyan context include a study by Lopokoiyit (2012) who investigated the effect of corporate governance practices on share prices of companies listed at the NSE. He found a direct relationship between corporate governance practices and share price. Also, Asava (2013) looked at the effect of voluntary disclosure on stock returns of companies listed at the NSE. Her study revealed that there was no relationship between voluntary disclosure and stock returns.

Given that voluntary disclosure of information comes with a cost, it is imperative to find out whether or not there is a corresponding benefit in the form of good earnings reports. The question that begs therefore is whether there is a relationship between voluntary disclosure and financial performance of companies quoted at the Nairobi Securities Exchange.

1.3 Objectives

1.3.1 General Objective

The primary objective of this study was to determine the relationship between voluntary disclosure and financial performance measure of ROI for selected companies listed at the NSE.

1.3.2 Specific Objectives

These included:-

i. The effect of voluntary disclosure of general corporate and strategic information on financial performance.

ii. The effect of voluntary disclosure of financial information on financial performance.

iii. The effect of voluntary disclosure of forward-looking information on financial performance.

iv. The effect of voluntary disclosure of socio-environmental and board disclosures on financial performance.

1.4 Research Hypothesis

For purposes of this research, both a null and an alternative hypothesis were developed to test the nature and significance of the relationship between the various items of voluntary disclosure and the measure of financial performance ROI for the listed companies selected from the NSE.

1.4.1 There is no link between General Corporate and Strategic Information and Financial Performance (ROI)

General and strategic information comprises of information about the size of a company, its economic outlook, the mission statement, historical data and background, business strategies, market share analysis, competition and also a description of major goods and services. There are no studies conducted on this broad category of disclosure. However several aspects included in this category have been tested. For example, Amir and Lev (1996) found that by disclosing information on market share analysis, firms in the wireless communication industry increased their firm value. Also, Jensen and Meckling (1976) noted that larger firms incur higher agency costs due to the fact that they employ heavy investments in capital. Marston and Polei (2004) support this claim by asserting that higher disclosure levels reduces agency costs that may be brought up by a conflict of interest between managers and owners of finance. The following hypotheses was developed:

Null: There is no link between disclosure of general corporate and strategic information and ROI for firms quoted at the NSE. ($H_0 : \beta_1 = 0$)

Alternative: There is a link between disclosure of general corporate and strategic information and ROI for firms quoted at the NSE. ($H_1 : \beta_1 \neq 0$)

1.4.2 There is no link between Financial Information and Financial Performance (ROI)

Investors are interested in information relating to liquidity ratios, gearing ratios, return on shareholders' funds and value added statements. Financing decisions are affected by the optimal capital structure that a firm maintains. Wallace and Naser (1995) and Hossain et al. (1995) noticed that there exists a positive link between leverage and the level of disclosure. Likewise, by providing a historical analysis, disclosure helps to improve the capability of investors to assess future earnings by making better earnings forecasts (Barron et al., 1999). Hence, the following hypotheses were stated:

Null: There is no link between disclosure of financial information and ROI for firms quoted at the NSE. ($H_0 : \beta_2 = 0$)

Alternative: There is a link between disclosure of financial information and ROI for firms quoted at the NSE. ($H_1 : \beta_2 \neq 0$)

1.4.3 There is no link between Forward-looking information and Financial Performance (ROI)

According to Celik et al. (2006) forward- looking information helps to forecast the future of a company in terms of performance and strength of the management in place. Information on profit forecasts, sales revenue forecast and earnings per share forecasts is included in this category of disclosure. If management generates inaccurate predictions over and over again, the credibility of any future forecasts may be dismissed, which may result in a potential increase in the cost of capital especially to investors. Regardless of whether managers are motivated by possible litigation costs or the need to guard their reputation, Skinner (1994) argues that management earnings forecasts may reduce expected legal costs by reducing the likelihood that an imminent mandatory disclosure will result in a large negative stock price response. Companies that wish to obtain external sources of finance may be inclined to disclose more forward-looking information in order to gain the

confidence of the providers of these funds. Clarkson, Kao & Richardson (1994) stated that firms in search of external sources of finance are more likely to provide voluntary forward-looking information relating to estimated future earnings irrespective of the existing competition in the industry. Hence, the following hypotheses were developed:

Null: There is no link between disclosure of forward-looking information and ROI for firms quoted at the NSE. ($H_0 : \beta_3 = 0$)

Alternative: There is a link between disclosure of forward-looking information and ROI for firms quoted at the NSE. ($H_1 : \beta_3 \neq 0$)

1.4.4 There is no link between Socio-Environmental and Board disclosures and Financial Performance (ROI)

One way in which stakeholders and other interested parties can assess the effects of an organization on its environment and hence form an opinion about the reputation of the company is through an analysis of the company's Corporate Social Responsibility (CSR) practices. According to Fama and Jensen (1983a), nonexecutive members of the board act as a reliable means to minimizing the impact of agency conflicts between managers and owners. Franks et al. (2001) argued that these nonexecutive members are considered important in ensuring that the essential mechanisms needed to enhance the effectiveness of the board are in place. In their study, Haniffa and Cooke (2002) established that a significant positive relationship exists between percentage of ownership attributed to foreigners and the level of voluntary disclosure. This lead to the development of the following hypotheses:

Null: There is no link between socio-environmental and board discourses and ROI for firms quoted at the NSE. ($H_0 : \beta_4 = 0$)

Alternative: There is a link between socio-environmental and board discourses and ROI for firms quoted at the NSE. ($H_1 : \beta_4 \neq 0$)

1.5 Significance of the Study

Voluntary disclosures provide an extra way for investors to judge a company's performance. This study will, therefore, enable the investors to make better investment decisions and better capital allocations. It will also emphasize on increased transparency which reduces information asymmetry that may exist between the investors and the management team. Moreover, managers will be in a position to make out the extent to which they should disclose particularly considering the cost accompanying disclosure so that it does not outweigh the benefits of cheaper capital. This study will likewise extend the literature on voluntary disclosure hence posing an eye opener to academicians to conduct further research on this area.

1.6 Assumptions of the Study

In this study, it was assumed that, companies quoted in the NSE consistently publish their annual reports. It was also assumed that companies quoted in the NSE make profits and that all companies once quoted in the NSE remain stable. Additionally, it was assumed that companies voluntarily disclose information regarding their operations to their share holders.

1.7 Organization of Study

This study report is organized into five chapters. Chapter one includes the background of the study, statement of the problem, objectives of the study, research hypothesis, significance of the study, assumptions of the study and organization of the study. Chapter two presents an overview of the literature relevant to the study including a theoretical and conceptual framework. Chapter three analyzes the research design, population of the study, sample and sampling techniques, data collection, data analysis and presentation and also validity and reliability tests. Chapter four delivers the findings and discussions thereto whereas Chapter five concludes the research by presenting a summary

of the findings, conclusions, recommendations, limitations of the study and suggestions for further research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the concept of voluntary disclosure and its relationship with a firm's financial performance at the NSE. It developed a theoretical framework that analyzed several theories which had been developed to explain the significance of voluntary disclosure with respect to business entities and investors. These were Agency, Signaling, Legitimacy and Stakeholder theories. It also looked into the empirical evidence in relation to voluntary disclosures. Moreover, it identified the different categories of items considered voluntary disclosures and their relationship to financial performance. Further, it examined the various measures of financial performance, looking at which measure would best be suited for the purposes of this research. Finally, this chapter critiqued the literature relevant to this study and identified any research gaps that other researchers capitalized on in the quest to study the effects of voluntary disclosures of various aspects of a firm.

2.2 Theoretical Framework

The theory of Voluntary Disclosure was first instigated by Verrecchia (2001) when he identified three elements of disclosure. These are explained in table 2.1 below.

Association-Based Disclosure	Looks at how disclosure is related to the activities of investors seeking to maximize their wealth in the capital market environment.
Discretionary-Based Disclosure	Looks at the level of discretion that managers exercise when it comes to disclosure that aids in firm valuation.
Efficiency-Based Disclosure	Examines the efficiency of disclosures.

Table 2.1 Elements of Voluntary Disclosure (Verrecchia, 2001)

Investors, particularly in public companies, were removed from the management of their assets and therefore required financial disclosure to make rational decisions on how their resources were managed (Masita, 1978). After Verrecchia's introduction to the concept of Voluntary Disclosure, several theories have since then been fronted to relate voluntary disclosure with business entities and investors. These are Agency, Signaling, Legitimacy and Stakeholder theories.

2.2.1 Agency Theory

Agency theory sets out to explore the relationship between a principal and an agent. Jensen and Meckling (1976) depict an agency relationship as one whereby a principal(s) appoints an agent and delegates authority to the agent to act on his behalf.

Managers are often empowered by the owners of the firm to make decisions on their behalf. A potential agency problem arises where shareholders are not kept in the loop with respect to some important information that managers have access to, consequently causing information asymmetry among them. The agent, who is the manager, usually has an information advantage over the principal, who is the shareholder. This in turn creates a conflict of interest, which ultimately results in agency costs. Hence the principal needs to be keen to ensure that he is not exploited by the agent.

Voluntary disclosure is one way of ensuring agency problem is minimized especially if managers who possess confidential information about a firm are able to use their informational advantage to make dependable communication to interested parties in order to maximize firm value (Barako, 2007). Healy and Palepu (2001) considered that disclosure of non-mandatory information is expected to reduce agency costs.

In view of the fact that organizations constantly strive to obtain additional funds from capital markets at as low a cost as possible, managers are motivated to provide more reliable information. This helps to reduce the monitoring costs incurred by shareholders in an attempt to prevent exploitations by management.

2.2.2 Signaling Theory

A signal is a movement, action or sound that is used to communicate instructions or information. For instance, in a recruitment exercise, prospective job applicants strive to 'signal' their capabilities through well written curriculum vitae's that clearly outline their strengths in terms of work experience, educational background and even mental and physical abilities.

In like manner, signaling theory as advanced by Ross (1977) suggests that if investors are not able to effectively differentiate with certainty between two firms which they perceive to be performing equally well, the firm that performs better will ensure that they provide a 'signal' so as to catch the attention of these investors and enjoy a positive company reputation. They may do this by disclosing additional information unbeknown to investors and which will positively affect the outlook of the company. Similarly, it should be noted that not disclosing any information at all is also a signal.

Ross (1977) asserts that managers prefer to signal in the form of disclosures so that they can mitigate against problems associated with lack of disclosures. In line with signaling theory, managers will settle for disclosure over non-disclosure. However, it should be noted that the costs of disclosure should outweigh the benefits. Signaling theory advocates that firms considered "healthy" in terms of better earnings and performance will probably disclose more information than "distressed" firms (Ross, 1977). Distressed firms are those whose performance is spiraling down probably due to economic recession and poor management strategies (Wruck, 1990).

2.2.3 Legitimacy Theory

Legitimacy theory has widely been used in relation to socio-economic and environmental disclosures. It stems from the fact that business organizations have a moral obligation to operate within the norms of the society at large. According to Dowling and Pfeffer (1975) legitimacy theory is a condition whereby the value systems of an organization are in harmony with those of the society. Organizations do not only work in the interest of their investors, but they also ensure that their actions do not negatively affect the environment in which they conduct their business by avoiding pollution and other illegal activities. Hence, if managers make out that the operations of their organizations are contrary to what society expects of them, then there is need to immediately reinforce legitimacy (Dowling and Pfeffer, 1975).

Society normally permits entities to continue with their operations for as long as they meet their expectations. For that reason, there exists a 'social contract' between an organization and the society in which it operates (Deegan, 2002). If a company's activities are not carried out with the societal norms in mind, the community will work to ensure the company ceases its operations. This amounts to threats to organizational legitimacy and adversely affects the company's corporate image and reputation. This is the reason why most companies would prefer to disclose their efforts towards Corporate Social Responsibility (CSR) in their annual reports to communicate their legitimacy to the community.

2.2.4 Stakeholder Theory

Stakeholder theory looks at how managers strive to create value and their responsibility to a company's stakeholders. No matter what a company's ultimate goal is, managers are expected to always work towards satisfying the interests of the people or groups that are affected by their actions and inactions. According to Gray and Owen (1987) stakeholders exercise a considerable amount of control over an organization's resources and hence, managers are obligated to provide them with the necessary information that may aid them in decision making, even if it is environmental in nature.

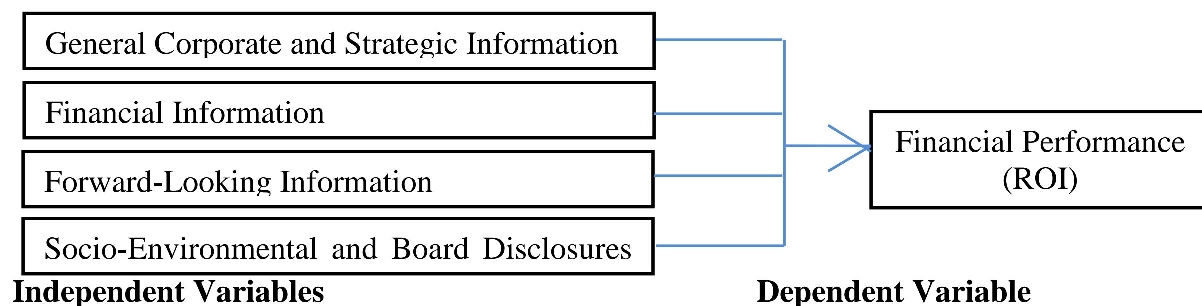
One of the economic objectives of business organizations is to maximize shareholders wealth. This can be achieved through creation of superior products of high quality and offering top notch services for customers. This value creation process can be evident through efficient operational processes, repeat purchases from customers and an improved corporate image. Managers are aware that failure to create such value may result in withdrawal of support and investment from the stakeholders. Thus, for an organization to continue existing in its full operational capacity, the support of stakeholders was necessary. This was the reason why managers will choose to disclose information voluntarily to their stakeholders so as to enable them to make better investment, financial and social responsibility decisions.

The greater the influence that stakeholders have on a company, the more the company must work to their advantage. Literature hints that companies provide disclosures voluntarily for various reasons most of which could be related to satisfying various stakeholder groups including adversarial stakeholders (Gray & Bebbington, 2001).

2.3 Conceptual Framework

This section will deal with the Operationalization of the variables of the study, that is, measures of voluntary disclosures and measures of financial performance.

Figure 2.1 Conceptual Framework



Source: Researcher (2014)

Voluntary disclosure items can be summarized into four categories: General corporate and strategic information disclosure, Socio-Environmental and Board disclosures, Forward-looking disclosures, Financial Information disclosures.

2.3.1 General Corporate and Strategic Information

The General company information relates to information that outlines the activities of managers in the organization which includes company size, company policies, procedures, brief historical background, the vision and mission statements, organization structures, description of major goods or services, description of market, and marketing networks for finished goods and services (Hope, 2003).

Strategic information on the other hand relates to a company's current business strategies, the effects of these strategies and how the organization achieves competitive advantage using its strategic position. Such information includes disclosures relating to competition in the industry. The importance of disclosing these strategic elements of an organization in annual reports is highly recommended by CICA (2001).

According to Kang and Gray (2006) company size is perhaps the most consistent corporate-specific characteristic which has been found to be associated with the level of voluntary disclosure. In the study conducted by Ahmed and Courtis (1999), firm size is seen to have a positive and significant relationship with disclosure. Likewise, Papadognas (2007) observed that the size of a firm is key to determining its profitability. Another factor is market share analysis. This involves an analysis of the market growth, penetration and dominance. Most companies with a larger market share exhibit higher profit margins hence better financial performance. According to Amir and Lev (1996) disclosing information that is not financial in nature increased firm value in the wireless communications industry.

2.3.2 Financial Information

Financial information is derived from the financial reports prepared from the books of accounts and analyzed in various categories to include income statements, balance sheet, statement of cash flows and statement of changes in equity. These reports are presented to the stakeholders in annual general meetings where auditors read and explain their contents (Hope, 2003). Voluntary disclosure items in the financial information category include: liquidity ratios, gearing ratios, return on assets, value added statements and a historical summary of financial statements for at least three years.

Companies are expected to fulfill their financial obligations; both short-term and long-term, when they arise. This is because investors and other lenders of funds will always look at the risk of default before putting money into the business. It is therefore prudent for firms to ensure that they protect their going concern status. Firms with high liquidity are often seen as being financially stable and will exhibit more disclosures (Belkaoui & Kahl, 1978; Cooke, 1989). Wallace et al. (1994) however defended a low liquidity position by suggesting that firms of that nature might disclose more information to give an explanation for their status.

Hossain and Hammami (2009) purported that financial results released are the foundation of an organization's budget and performances. The analysis involves comparing a firm's performance with that of other firms in the same industry and evaluating trends over time. Financial analysis involves the use of simple mathematical techniques, an understanding and appreciation of business strategy and future prospects through an examination of financial statements. Financial ratios are a vital analytical tool. According to Jaggi and Low (2000) debt management ratios play a key role in financial management. The extent to which a firm uses debt financing is what is called financial leverage. Ahmed and Nicholls (1994) argued that in countries where most funds are sourced through financial institutions, companies are likely to make more information

disclosures in their annual reports in the event that they are servicing huge debts in their books.

The gearing ratio shows how much the borrowed amount from creditors is used to generate profit for the organization. $Gearing\ ratio = {Debtcapital}/_{Equitycapital}$. On the other hand, total assets turnover ratio measures the utilization of all the firms operating assets in relation to turnover. $Total\ asset\ turnover\ ratio = {sales}/_{total\ assets}$. Profitability ratios show the combined effect of liquidity, assets management and debt on a firm's operating results. Without profit a firm would be unable to attract outside capital. Owners, creditors, and management pay closer attention to boosting profits because of the great importance placed on earnings in market place.

2.3.3 Forward-looking Information

According to Celik et al. (2006) forward- looking information helps to forecast the future of a company in terms of performance and strength of the management in place. Information on profit forecasts, sales revenue forecast and earnings per share forecasts is included in this category of disclosure. If management generates inaccurate predictions over and over again, the credibility of any future forecasts may be dismissed, which may result in a potential increase in the cost of capital especially to investors.

Forward-looking information is considered an important topic in a firm's disclosure because of its capability to convey value-relevant information to external users (Amir & Lev, 1996). More attention has been devoted to forward-looking disclosure by professional and .regulatory bodies. The Jenkins Committee (AICPA, 1994) suggests that forward-looking information is essential in order to meet the needs of various users of annual reports. Skinner (1994) argues that management earnings forecasts may reduce expected legal costs by reducing the likelihood that an imminent mandatory disclosure will

result in a large negative stock price response. Following Baginski et al. (1993) it is evident that analysts' forecasts can be improved by forward-looking information that is of superior quality hence attracting more investors which translates to better financial prospects for a company.

2.3.4 Socio-Environmental and Board Disclosures

The Kenyan Centre for Corporate Governance (KCCG) issued a guideline on disclosures and corporate reporting in 2005. This draft emphasized on corporate social responsibility and board and ownership structure. These constitute the social and board disclosures. Other items in this category include information about employees; the number of employees, their productivity and morale levels and also workplace safety.

Most stakeholders assess a company's reputation by its Corporate Social Responsibility (CSR) practices (Fombrun & Shanley, 1990).A practical approach to CSR helps firms to obtain huge sums of capital that might ordinarily be difficult to get. According to Investor Digest (2003) firms actively engage in social responsibility stand a greater chance of attracting the attention of blue chip export supply firms in the global supply chain.

Disclosures of employees, their productivity and participation, and employee turnover are not common in annual reports. This is due to the fact that the human resources element in organizations is quite unpredictable and difficult to control. That could be the reason why Brennan (2001) noted in his study that some companies provided very little and others no information at all about their employees.

Of greater importance in board disclosures is the information on the composition of the directors, their academic and professional qualifications, share ownership, the numbers, age, business and managerial experiences, and any other interests they might have in the company. Needless to say, the efforts of managers who contribute immensely towards improved performances in the

firm is revealed thorough voluntary disclosures and this serves to reduce agency conflict between them and directors of the firms. Recognizing managers efforts in management and towards increasing social responsibility provides a balance and increases efficiency in productivity.

Haniffa and Cooke (2002) asserted that there was indeed a need for foreigners to closely monitor actions undertaken by management. Also, Singhvi (1968) found that in India, companies dominated by foreign owners provided higher quality disclosures than local companies. Furthermore, since most of the companies were multinationals, the existence of foreigners in the board structure greatly influenced the approach of management in corporate financial reporting.

2.3.5 Measures of Financial Performance

Measures of financial performance can be categorized into traditional measures and modern measures. Traditional measures include Return on Equity employed, Profit Margin on Sales, Earnings per Share and Return on Investment whereas, an example of a modern performance measurement is Economic Value Added.

Profit margin on sales (PMS): Profit margin on sales is a profitability ratio that measures how much a company actually retains for every shilling of sales. Ailawadi and Harlam (2004) identified the determinants of profit margin as in the formula below.

$$Profit\ Margin\ on\ Sales = \frac{Net\ Income}{Sales}$$

This ratio helps to ensure cost control in companies. It is mostly used for inter-departmental comparison. It is not appropriate for comparing performances of two different companies in the same industry owing to the fact that these companies incur different types of expenses in their operations and financing activities and hence their profit margin ratios may differ due to differing

expenses. This ultimately rules out the appropriateness of this ratio for use in this study.

Earnings per Share (EPS): The firm's earnings per share is quite important to the present or prospective shareholders and managers. This ratio measures profitability from the shareholder's viewpoint (Pandey, 1998). Earnings per share represent the amount in shillings earned during the period on behalf of each outstanding ordinary share. It can be computed as follows:

$$Earnings\ Per\ Share = \frac{Earnings\ Available\ for\ Ordinary\ Shareholders}{Number\ of\ ordinary\ shares\ outstanding}$$

his ratio enables investors and shareholders to establish how much the company is making and earning on their behalf. Comparison of a company's EPS over the years can also enable investors to gauge the effectiveness and efficiency of management. However, EPS is easy to manipulate and can be affected by accounting policies hence is not a suitable measure for this study.

Return on Equity (ROE): This is the ratio of net profit or income after interest and taxes to ordinary equity. It relates net income to the amount invested by the shareholders. Koch, Desalvo and Kennon (2007) assert that ROE measures how effective a company is generating income as compared to funds generated by shareholders. According to Pandey (1998), it can be computed as:

$$Return\ on\ Equity = \frac{Net\ Income}{Equity\ emploled}$$

Shareholders invest in companies so that they can be able to obtain a return on their money and this ratio tells how well they are doing. If a company has a high ROE, it implies that the company is generating more cash internally which makes it more marketable as compared to other companies in the same industry (Venkatraman & Ramanujam, 1986). Since it considers earnings retained in previous years, it communicates to investors how their money is

being invested and the effectiveness of management. However, this measure only looks at shareholders equity and gives no consideration to debt (Arditti, 1967). This may mislead investors especially if the company is servicing huge amounts of debt but has a high ROE.

Economic Value Added (EVA): According to Stewart (1994), EVA is a measure of economic performance of companies, both internally and externally. It proposes that the equity capital used to earn profits must eventually be paid for. The profits accrued must be more than the initial capital invested. Companies which do not make profits operate at a loss, and since the return does not match the cost of capital invested, then, no wealth is created (Ivancevich, Konopaske & Matteson, 2002).

EVA applies the principal in the Weighted Average Cost of Capital (WACC) to adjust for no-cash expenses. WACC should be computed for preference share capital, bonds and other long term debt, and ordinary share capital. According to Stewart (1994) EVA can be computed as:

$$Economic\ Value\ Added = NOPAT - (WACC \times Capital\ employed)$$

$$WACC = K_{eg}\left(\frac{E}{E + D}\right) + K_d(1 - T)\left(\frac{D}{E + D}\right)$$

Where:

NOPAT is the Net Operating Profit after Tax.

K_{eg} is the cost of equity.

K_d is the cost of debt.

E is the market value of equity in the firm.

D is the market value of debt in the firm.

T is the tax rate.

Given that EVA is the best measure of economic performance it operates on premise that operational and capital costs are covered to give a credible impression to stakeholders. The shortfall exhibited by EVA is that it does not focus on the future; it deals with the present period (Chen & Dodd, 1997). However, even though EVA is a modern financial performance measure, has immense benefits, and outweighs the other traditional measures of performance such as ROI and ROE (in that it considers the shareholders value and cost of equity capital), it is hard to get the requisite data which is indispensable to the calculation of the measure especially taking into consideration the privacy of such data as interest on debts. It is also difficult to estimate the WACC at a given time.

Return on Investment (ROI): This is the most popular financial performance measure. The ratio measures the profitability of a firm in relation to its assets employed. It is computed by dividing earnings by total assets.

$$Return\ on\ investment = \frac{Net\ income}{Total\ assets}$$

The ratio measures the overall effectiveness of management in generating profits with the available assets. It helps the company to realize more income in form of return on investment, and gives information about a firm's effectiveness. It also is aids in decision making and profit maximization (Dehning & Richardson, 2002).

ROI is widely used because of its simplicity and adaptability. Grzegorz (2010) opined that ROI is not only simple to calculate but it can also be used by creditors and owners to evaluate a company's ability to make an adequate return. It can be used for comparison and benchmarking purposes for companies in a similar industry. ROI aids in determining the financial strengths of a company. An additional benefit of ROI is that it enables one to judge the efficiency and effectiveness of the management team. Thus, ROI is a versatile tool for determining both profitability and financial performance.

Nevertheless, the flexibility of ROI has a downside as asserted by Ross, Westerfield and Jordan, (2001) in that it can be influenced to satisfy a certain group of users. According to Harvard Professor Clayton Christensen managers will under-invest in high-return units and over-invest in poorly performing units if the measures of return affect their bonuses.

Given the above analysis, the researcher settled for the use of ROI as the measure of financial performance of the firms listed on NSE owing mostly to its simplicity, comparability and that it is a basic tool in measuring both profitability and performance.

2.4 Empirical Studies on Voluntary Disclosure

Cerf (1961) investigated the relationship between voluntary disclosure of information and its level of profitability as well as the size of the firm and its shareholders in the U.S Market. The purpose was to find out the connection between voluntary disclosure of information and its level of profitability. The methodology used was a descriptive approach and that he analyzed annual reports of 25 different companies that were listed on the New York Stock Exchange (NYSE). It was noted that there was a positive link between the above mentioned variables.

Leuz and Verrechia (2000) scrutinized 102 annual reports of German firms listed in the DAX 100 stock index over the course of 1998 to find out the economic consequences of increased disclosure. They used event study design as their methodology of research. Their finding suggested that firms that commit to either International Accounting Standards (IAS) or the U.S GAAP exhibit a higher turnover in terms of shares as compared to firms using German GAAP.

Botosan (1997) examined 122 manufacturing firms situated in America in a quest to establish whether there existed any association between disclosure and

cost of equity capital. The methodology of the study was a descriptive study coupled with correlation analysis based on the voluntary disclosures available in the annual reports for the year 1990. The findings were that firms that attracted lesser following by analysts proved that a higher level of disclosure is associated with lower cost of equity capital. On the other hand firms with a high analyst following depicted no association between the two measures probably because the disclosure measure is limited to the annual reports.

Likewise, Kristandl and Bontis (2007) investigated the relationship between the level of voluntary disclosure and cost of equity capital. They centered on 95 listed companies from Germany, Sweden, Denmark and Austria. Findings of the study revealed that an anticipated negative relationship existed between the cost of equity capital and the level of forward-looking information and an unforeseen positive relationship was noted between cost of equity capital and the level of historical information.

2.5 Critique of Literature Relevant to the Study

Whereas several studies have been undertaken to examine the likely effects of voluntary disclosure on a number of aspects of a firm (Fama & Jensen 1983; Comier et al 2005; Adams et al 1998; Comier & Gordon 2001) it is important to critically analyze their significance and relevance. For example the study conducted by Cerf (1961) is very relevant to this research. Cerf examined the connection between voluntary disclosure and its profitability level in the United States Market. This study is relevant because it was conducted on the New York Stock Exchange where companies are expected to provide disclosures of information in their annual reports and are likewise given an incentive to voluntarily disclose so as to gain a competitive advantage. The current researcher likewise intended to focus its population on the Nairobi Securities Exchange for similar reasons. Also, the methodology used in Cerf's study is very practical. Cerf used a descriptive approach, which is suitable since it can be able to gather, organize, tabulate and describe data more reliably. What's more, it makes use of graphs and tables for easy interpretation.

Thus, the current researcher agrees that there is a high likelihood that the findings from Cerf's study depicting a positive link could hold true.

Leuz and Verrechia (2000) in their study examined 102 annual reports of German firms listed in the DAX 100 stock index over the course of 1998 to find out the economic consequences of increased disclosure. According to their study, if a firm sets out to increase disclosures in their annual reports, information asymmetry is greatly reduced leading to lower cost of capital for the firm. This is because adverse selection is likely to occur given that there is information asymmetry between buyers and sellers in a transaction. Hence, the researcher agrees that incorporating more disclosures in annual reports reduces the chances of occurrence of information asymmetry between organizations and their shareholders or among prospective buyers and sellers. In their study, Leuz and Verrechia found that German firms decided to adopt International Accounting Standards (IAS) or the U.S GAAP for their annual financial reporting to the capital markets. This switch was thought to increase firm's dedication to disclosing more and enabled the firms to derive measurable economic benefits in form of lower capital.

The current researcher found the switch particularly relevant today for firms not using an international reporting regime since much discussion on high quality standards that are accepted world-wide is based on the assumption that higher disclosure standards reduce firms cost of equity. However, the current researcher found their methodology to be unsuitable. They used event study design which is more demanding in its data requirements, reduces the number of observations and hence limits the tests that can be performed. Even though it was difficult to document evidence of economic theory compelling commitment of firms, their finding suggested that firms that commit to either International Accounting Standards (IAS) or the U.S GAAP exhibit a higher turnover in terms of shares as compared to firms using German GAAP. This study is therefore important to this research as it outlines the economic benefits that firms stand to gain by increased disclosure practices.

2.6 Summary

This section has thoroughly discussed the theories that have been developed to expound on the significance of voluntary disclosure in the relationship between business entities and investors. These are Agency, Signaling, Legitimacy and Stakeholder theories. It has shown how the various items considered voluntary disclosures affect financial performance. Likewise it has discussed the different measures of financial performance and highlighted the best possible measure that could be used to ascertain whether there is a link between voluntary disclosure and financial performance of firms. This measure of performance is Return on Investment (ROI). Finally, by critically analyzing relevant literature pertaining to this study, it is evident that a study on voluntary disclosure practices of firms is very relevant to the Kenyan companies today.

2.7 Research Gap

While existing studies done in Kenya examine the relationship of voluntary disclosure to corporate governance (Lopokoiyit, 2012), CSR (Oyenje, 2012) or Stock Returns (Asava, 2013) there are very few studies that have thoroughly focussed on its relationship with financial performance metrics like ROI. Thus, there is still a dire need to dig deeper and conduct an in-depth analysis of the relationship between Voluntary Disclosure and the Return On Investments (ROI) of firms in Kenya. This is because, the cost of voluntary disclosure initiatives are complex and may not be quantifiable. This study therefore will focus on establishing whether there exists a relationship between the voluntary disclosure and the firms' financial performance of selected companies quoted at NSE in order to fill this research gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter considers the research design, population of the study, sampling design, data collection and analysis techniques and also validity and reliability tests that were used during the study. The population of interest consisted of all the companies quoted on the NSE. These companies are closely monitored by investors and their measures of performance are likely to be related to those considered in firm valuation.

3.2 Research Design

This study made use of a descriptive research design. This approach was suitable because it involves gathering data, organizing, tabulating, depicting, and describing the data. It can also be used for both qualitative and quantitative data. Moreover, it makes use of visual aids such as graphs and tables to assist the readers in understanding and interpreting the data. According to Kothari (2004) descriptive research studies are concerned with specific predictions, with narration of facts and characteristics concerning situation. This fits well with the current study since the research intended to establish a relationship between voluntary disclosure and financial performance. For purposes of this study, the dependent variable was the firm's financial performance, measured by ROI, while the independent variables were the four categories of voluntary disclosure namely: General Corporate and strategic information, Financial information, Forward-looking information and Socio-Environmental and Board disclosures.

3.3 Population of the Study

Population is the total of all items under consideration in the study. The population was drawn from the 61 companies quoted at NSE as at 1st January, 2014. The companies are subdivided into 11 sectors namely: banking, insurance, agricultural, commercial and services, automobiles and accessories, investment, manufacturing and allied, telecommunication and technology, construction and allied, energy and petroleum, growth and enterprise market segment.

3.4 Sample and Sampling Technique

The study sampling design involved a selection from all the firms in the population of interest which Kothari (2004) described as a census inquiry implying that the number of firms may be small but will result into high chance of accuracy. Patton (1990) stated that quantitative research ideally involves probability sampling to permit statistical inferences to be made. This study thus used criterion sampling, which is a kind of purposeful profitability sampling of cases on preconceived criteria, such as scores on an instrument. In this case, the sample consisted of 10 listed companies which were consistently listed and were relatively stable and best performing as measured by the NSE 20-share index from the year 2011 to the year 2013. These companies were chosen on the basis of average Market Capitalization as at Quarter 4 of 2013. Annual reports, which were the major source of data for this study, were readily available in full for the selected period.

3.5 Data Collection Methods

Secondary data was used in the study. This was because secondary data is easily available, accessible and saves time. Published annual reports of quoted companies from NSE were obtained from NSE handbooks, Capital Markets Authority website and also from the company's website. This consisted of annual reports of the companies in the sample from the year 2011 to 2013.

Kothari (2004) outlines that for secondary data source to be satisfactory, it should have the following characteristics namely: reliability, suitability and adequacy of data. NSE handbooks are considered to possess the above mentioned traits.

The financial statements for each company were subjected to the voluntary disclosure checklist shown in Appendix A. Each item disclosed was given a score of '1' and those items not disclosed '0'. The scores for each category were summed up for each of the years the company has disclosed and recorded to facilitate the process of data analysis.

3.6 Data Analysis and Presentation

The data collected was analyzed using both descriptive and statistical analysis tools with the help of Excel 2007. The values in respect of Net Income and Total Assets of the sampled companies for the period 2011-2013 were used to calculate ROI for each period. These values for ROI together with the voluntary disclosure scores for each of the companies in the sample were then presented in tables in their respective years. A regression analysis was conducted on the data obtained from the annual reports. To determine the relationship between voluntary disclosure and the financial performance of firms, a coefficient of correlation (R) was computed on the scores of voluntary disclosure against the firm's financial performance using the Pearson Product Moment coefficient of correlation. The results showed a correlation coefficient of 0.6235 hence meeting the primary objective and confirming the significance of this relationship.

The hypotheses developed in Chapter one was also tested for both the individual predictor variables and for the combined model (using p-value approach) to see whether the regression relation is significant. A t-test was used for the Univariate analysis. This is because the number of observations was less than thirty i.e. $n < 30.$ The equation for the t-test of the slope at $n - 2$ degrees of freedom for the significance of β was as follows:

$$t = \frac{b - \beta}{S_b}, where\ \beta = b \pm t \times S_b$$

Given that the combined model had four independent variables (General Corporate and Strategic information x_1 , Financial Information x_2, Forward-looking information x_3 and Socio-Environmental and board disclosures x_4) the regression equation was similar to that of Asava (2013). The model was as follows:-

$$y = \beta_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + e$$

Where: $y\ =\ Return\ On\ Investment$

$x_1 =\ General\ Corporate\ and\ Strategic\ Information$

$x_2 = Financial\ Information$

$x_3 = Forward\ - looking\ Information$

$x_4 = Socio - Environmental\ and\ Board\ Disclosures$

$e\ = error\ term$

A significance test for β_0 was conducted at a 5% level of significance (95% confidence interval). The test for significance of regression is a test to determine whether a linear relationship exists between the response variable *y* and a subset of the regression variables x_1, $x_{2,}$…… ,x_n. Given that; $H_0 = \beta_1 = \beta_2 = \cdots \beta_k = 0$, the null hypothesis was subjected to a test statistic i.e.

$$F = \frac{SSR/_k}{SSE/_{n-p}} = \frac{MSR}{MSE}$$

Where; $k = p - 1$

The critical value $F_{\beta}; k, n-p$ is the tabular value of F distribution, based on the chosen β_0 level and the degrees of freedom $p-1$ $(or\ k)$ and $n-p$. Thus in the above equation, if the test statistic $F > F_{\beta}, k, n-p$ then H_0 will be rejected meaning there is a significant relationship between the dependent and independent variables. The findings were then organized, summarized and presented in tables after which inferences and conclusions were made based on the data analyzed.

3.7 Validity and Reliability Test

Kombo and Tromp (2006) defined validity as how truthful and accurate a test measures instruments as intended. In order to ensure the validity of the instruments of the study, construct validity was used. The main aim of construct validation is to subject a measure of a construct to a number of tests to establish its relation to other variables with which it should be associated either positively, negatively or practically not at all (Cronbach & Meehl,1955). The voluntary disclosure index was pre-tested on four listed companies chosen randomly to ensure the response rate was adequate and favorable.

Reliability, on the other hand, measures the degree of consistency with which research procedures deliver the same results, given similar conditions (Seale, 2004). The researcher used test-retest method to establish the reliability of the research instruments. According to Mugenda and Mugenda (1999) a coefficient of 0.60 or more will show that there is high reliability of data. The reliability of the research instruments in this study was 0.6235 which deemed the instrument reliable.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

This Chapter presents the research findings, analysis and discussion on the relationship between voluntary disclosure and financial performance of companies quoted on Nairobi Security Exchange. The data in this study was derived from the analysis of annual reports of 10 companies at the NSE 20 index chosen on the basis of market capitalization for Q4 of 2013. Out of the selected 10 companies, the researcher was able to obtain all the published reports from 2011 to 2013, representing 100% response rate as shown in Figure 4.1 below:

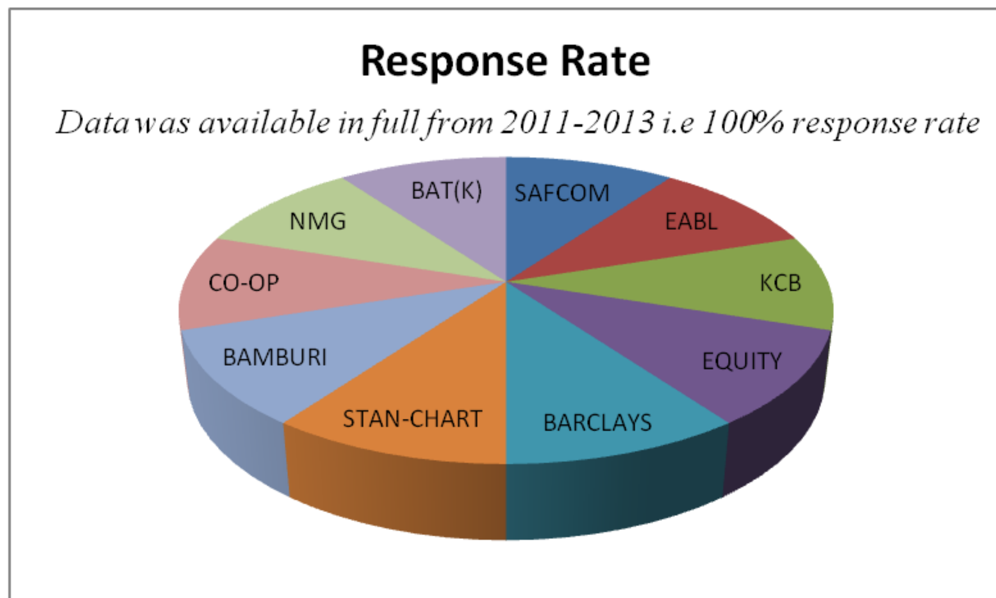


Figure 4.1: Response Rate

Source: Researcher (2014)

4.2 Descriptive Statistics

Analysis of the reports from the year 2011 to 2013 revealed the statistics in Table 4.1 below. According to the table, Return on Investment had a mean of

0.1527 and a standard deviation of 0.1293 indicating that the average distance each data point if from the mean is 0.1293 data points. This implies that the mean is providing a good representation of the data, since the standard deviation is very close to the mean, hence it is reliable. This is also depicted in the histogram below.

Table 4.1: Descriptive Statistics

Variable	**N**	**Mean**	**Std. Deviation**
ROI	30	0.1527	0.1293
General Corporate and Strategic Information	30	8.8000	1.0770
Financial Information	30	4.7667	0.9551
Forward-looking Information	30	5.7000	1.0693
Socio-Environmental and Board Disclosures	30	11.2000	1.1944

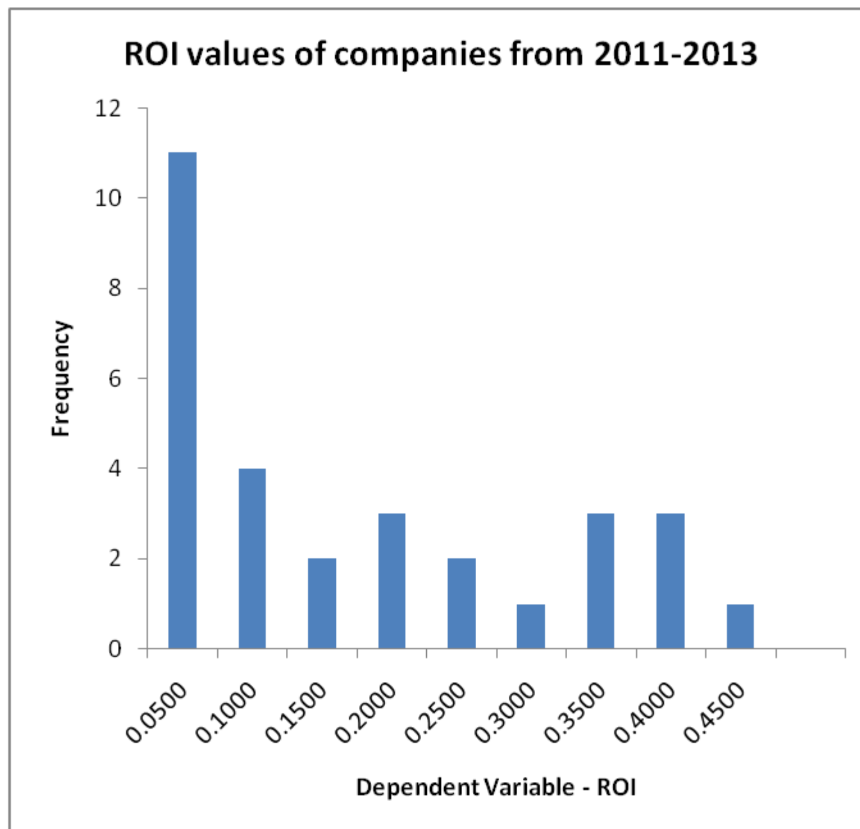


Figure 4.2: Histogram showing distribution of ROI

4.3 Univariate Analysis

This analysis sought out to examine whether there exists a relationship between each of the individual predictor variables of voluntary disclosure with Return on Investment.

4.3.1 General Corporate and Strategic Information and Financial Performance-ROI

The analysis sought to establish the effect of General Corporate and Strategic information on ROI for the three years. The scatter graph in figure 4.1 below depicted a negative linear relationship of the form $Y = 0.3841 - 0.0263X1$ with a coefficient of determination R^2 of 0.048 implying that only 4.8% of the variations in ROI are reduced by taking into account General Corporate and Strategic Information. Also, a coefficient of variation R of 0.2191 was obtained which indicates that there is a relationship between voluntary disclosure of General Corporate and Strategic Information and ROI. The test of the slope at

5% level of significance showed that the value obtained from the t-test 1.190<2.048 hence the null hypothesis $H_0: \beta_1 = 0$ was rejected implying that there is a link between disclosure of General Corporate and Strategic Information and ROI. These findings are summarized in table 4.2 and figure 4.1 below.

Table 4.2: General Corporate and Strategic Information and ROI

Equation	**Parameter Estimates**		**Model Summary**			
	constant	B1	R²	R	Se_y	Df
Linear	0.3841	-0.0263	0.0480	0.2191	0.1305	28

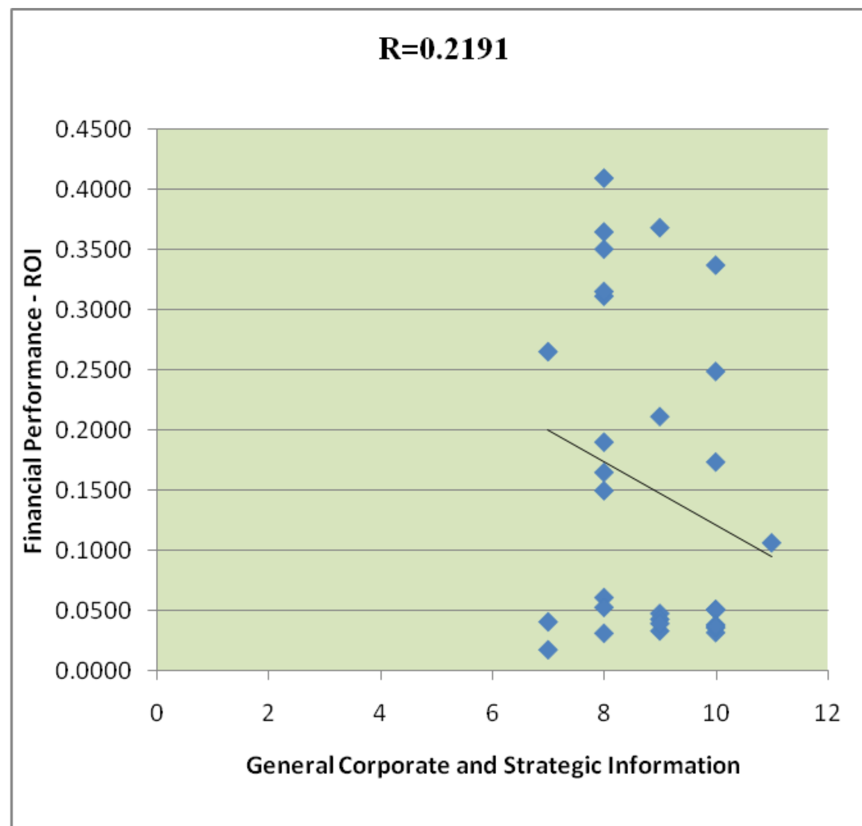


Figure 4.3: General Corporate and Strategic Information and ROI

4.3.2 Financial Information and Financial Performance-ROI

A regression analysis on voluntary disclosure of Financial Information and ROI established that there was a negative relationship between the two variables. In particular, the data set produces a coefficient of Determination R^2 of 0.3173 and correlation coefficient R of 0.5633. This implies that only 31.73% of the variations in ROI are explained by the variations in Financial Information. Moreover, for the slope at 5% level of significance, the t-statistic 3.611 is greater than the t-value from the tables hence resulting in the rejection of the null hypothesis $H_0: \beta_2 = 0$ and holding true the alternative hypothesis. Table 4.3 and figure 4.2 below present a summary of these statistics and the scatter graph showing the relationship between these two variables.

Table 4.3: Financial Information and ROI

Equation	**Parameter Estimates**		**Model Summary**			
	Constant	B1	R^2	R	Se_y	Df
Linear	0.5160	-0.0762	0.3173	0.5633	0.1	28

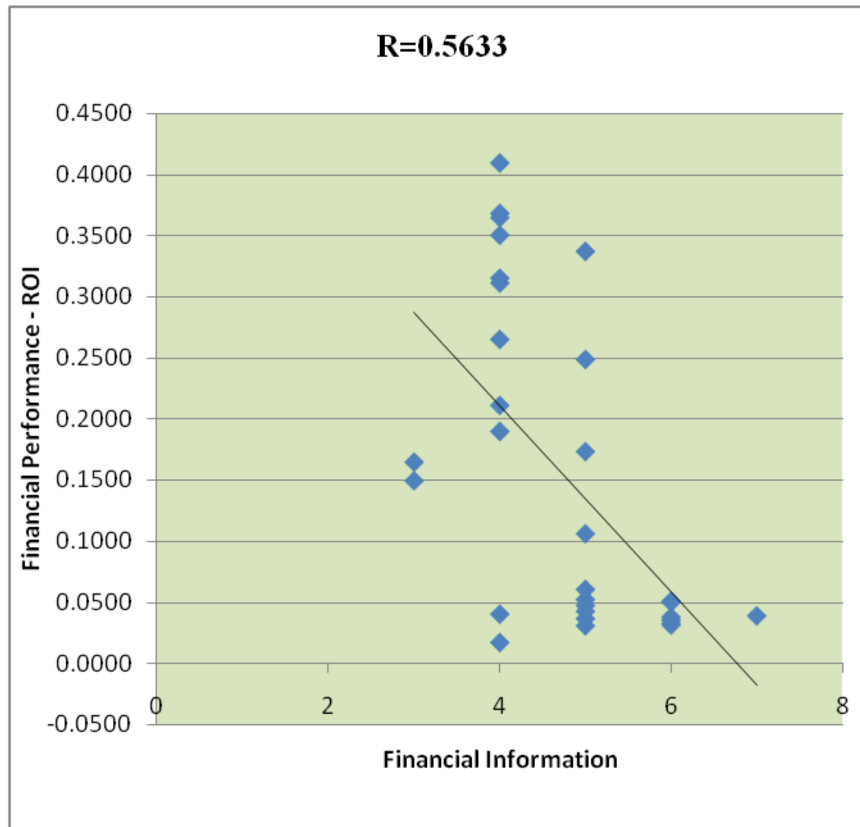


Figure 4.4: Financial Information and ROI

4.3.3 Forward-looking Information and Financial Performance-ROI

A regression analysis of the relationship between voluntary disclosure of forward looking information and ROI resulted in a Pearson Product Moment correlation coefficient of 0.0984(close to 0.00) signifying a weak positive relationship between the two variables. This relationship is illustrated in the scatter graph on figure 4.3 shown below. A test of the slope at 5% level of significance revealed a t-value of 0.524<2.048 hence indicating that the null hypothesis $H_0: \beta_3 = 0$ can be rejected, thereby confirming that there is a link between the two variables. Table 4.4 below presents a summary of these statistics.

Table 4.4: Forward-looking Information and ROI

Equation	Parameter Estimates	Model Summary

	Constant	B1	R^2	R	Se_y	Df
Linear	0.0847	0.0119	0.0097	0.0984	0.1331	28

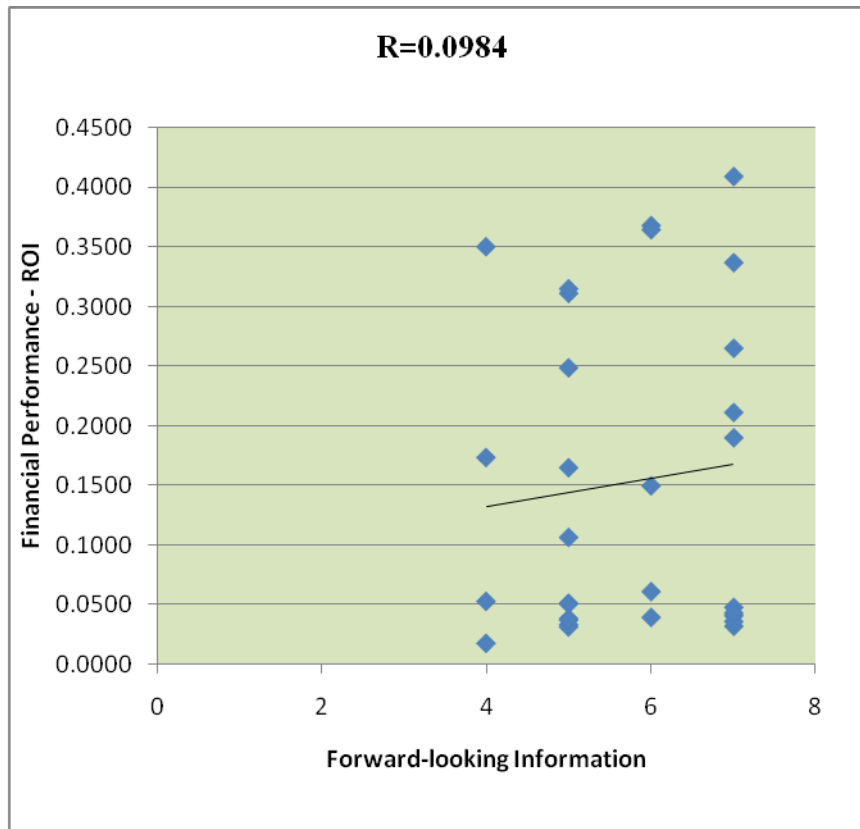


Figure 4.5: Forward-looking Information and ROI

4.3.4 Socio-Environmental and Board Disclosures and Financial Performance-ROI

On regressing the Socio-Environmental and Board disclosures scores with the ROI obtained from the companies, it was established that there exists a weak negative relationship between the two variables as evidenced by a Pearson Product Moment Correlation Coefficient, R, of 0.1349. The test for the slope at 5% significance level showed a t-value 0.719<2.048 indicating that the null hypothesis was rejected and hence the alternative hypothesis $H_1 : \beta_4 \neq 0$ holds true that there is a link between Socio-Environmental and Board Disclosures

and Financial Performance (ROI). Table 4.5 and figure 4.4 below illustrate these observations.

Table 4.5: Socio-Environmental and Board disclosures and ROI

Equation	Parameter Estimates		Model Summary			
	Constant	B1	R^2	R	Se_y	Df
Linear	0.3163	-0.0146	0.0182	0.1349	0.1326	28

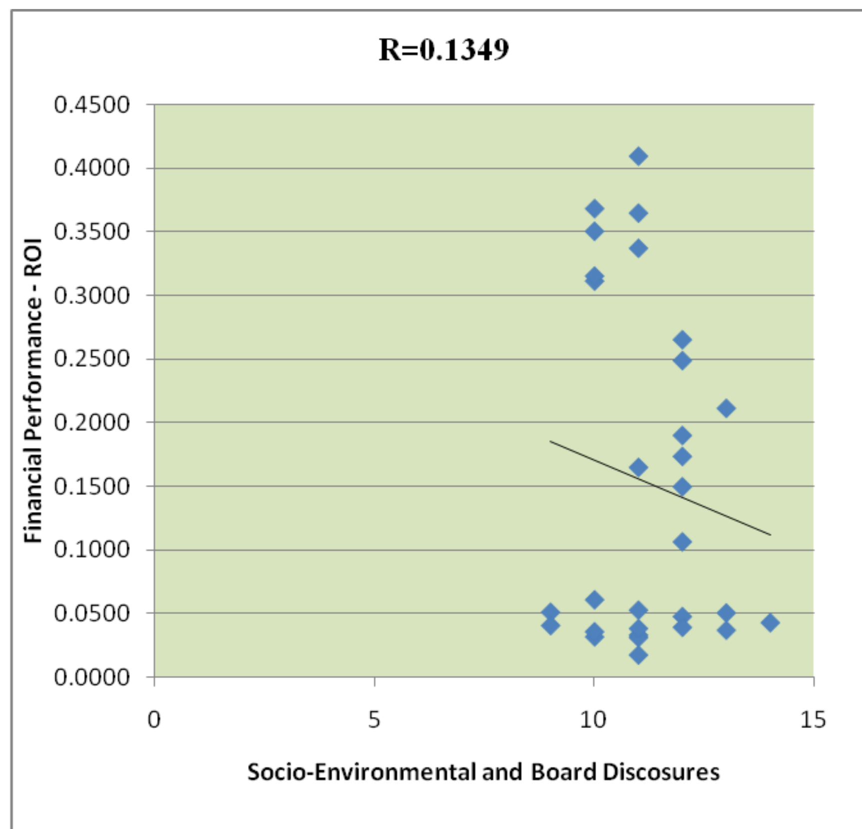


Figure 4.6: Socio-Environmental and Board Disclosures and ROI

4.4 Multiple Regression Analysis

This analysis involved a regression analysis on the dependent variable ROI against all the four predictor variables, namely:

X1= General Corporate and Strategic Information

X2= Financial Information

X3= Forward-looking Information

X4= Socio-Environmental and Board Disclosures

The multiple linear regression model was of the form:

$$y = 0.4660 + 0.0365x_1 - 0.1008x_2 + 0.0129x_3 - 0.0203x_4$$

A summary of the regression output is shown in Table 4.6 below.

Table 4.6: Summary of Multiple Regression Output

Variables	**Coefficients**		**Standard Error**
Intercept	β_0	0.4660	0.2484
General Corporate and Strategic Information	β_1	0.0365	0.0253
Financial Information	β_2	-0.1008	0.0277
Forward-looking Information	β_3	0.0129	0.0191
Socio-Environmental and Board Disclosures	β_4	-0.0203	0.0177
ROI	y	N/A	0.1107

Findings from the regression analysis depicted a coefficient of determination, R^2 of 0.3888 indicating that 38.88% of the variations in ROI are reduced by taking into account the predictor variables of voluntary disclosure. Also, a Pearson Product moment Correlation Coefficient, R, of 0.6235 was obtained implying that the model is a significant good fit since there is a strong relationship between ROI and the four predictor variables of voluntary disclosure i.e. General Corporate and Strategic Information, Financial Information, Forward-looking Information and Socio-Environmental and Board Disclosures. Table 4.7 summarizes these statistics.

Table 4.7: Multiple Regression Statistics

Model	**Multiple**	**R**	**Adjusted R**	**Standard**	**Degrees of**	**Observations**

	R	Squared	Squared	Error	Freedom	
Multiple Linear	0.6235	0.3888	-3.4312	0.1107	25	30

The reliability of the above model is supported by the ANOVA Table 4.8 below. Using the ANOVA table shown below, a significance test for the slope β_0 conducted at a 5% level of significance revealed an f-statistic of 3.9758. This value was greater than the F-critical value 2.76 obtained from the F distribution table hence leading to the rejection of the null hypothesis meaning there is a significant relationship between ROI and the four predictor variables of the study.

Table 4.8: ANOVA Table

Cause of Variation	Df	SS	MS	F	Significance F
Regression	25	0.1948	0.0078	3.9758	2.76
Residual	4	0.3063	0.0767		
Total	29	0.5011	0.0845		

4.5 Discussion

The primary objective of this study was to explore the relationship between voluntary disclosure and financial performance of selected companies quoted at the NSE. Specific objectives were also formulated to test the effect of each of the individual predictor variables of voluntary disclosure on ROI. An analysis on the effect of the individual predictor variables on ROI indicated mixed results. Through the use of Univariate regression analysis, findings revealed that a coefficient of determination R^2 of 0.048 was obtained when General Corporate and Strategic Information was regressed against ROI. This means that only 4.8% of the variations in the predictor variable were explained by variations in ROI.

The data set obtained on regressing Financial Information and ROI depicted a correlation coefficient of 0.5633 indicating that there was a negative linear relationship between the two variables and that only 31.73% of the variations in Financial Information could be explained by variations in ROI as evidenced by the coefficient of Determination R^2 of 0.3173. Socio-Environmental and Board disclosures depicted a weak negative linear relationship with ROI evidenced by Pearson's Product Moment coefficient of correlation of 0.2191 whereas Forward-looking information depicted a weak positive linear relation with correlation coefficient of 0.0984.

Further, a multivariate regression analysis on the combined model indicated that the four predictor variables put together established a strong linear relationship with financial performance measure, ROI, as shown by a Pearson Product Moment correlation coefficient of 0.6235 hence meeting the primary objective. The test on the slope of the multiple linear regression model additionally confirmed the significance of this relationship.

By adopting a descriptive study approach, Cerf (1961) who investigated the relationship between voluntary disclosure of information and its level of profitability noted that there exists a positive link between the two variables. Verrecchia and Weber (2006) also found a positive connection between profitability and voluntary disclosure. On the other hand, Asava (2012), who used the same approach coupled with content analysis, examined the effect of voluntary disclosure on stock returns of companies listed at the NSE from 2008-2012. Her findings revealed that there was no relationship between voluntary disclosure and stock returns for both the individual predictor variables and the combined model.

This study analyzed 10 companies at the NSE 20 share index and findings were consistent with studies from past researchers like Ahmed and Courtis (1999). In their meta-analysis study of the relationship between profitability and voluntary disclosures, they found out that the results using financial performance measures are rather mixed and conflicting making it difficult to

come up with satisfactory conclusions. Findings from this study proved that the relationship between the individual predictor variables with ROI produced mixed results.

This study is also consistent with a research done by Kristandl and Bontis (2007) whereby different voluntary disclosure items produced different results such that there was a negative relationship between cost of equity capital and the level of forward-looking information and a positive relationship between cost of equity capital and the level of historical information.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a summary of the findings obtained in Chapter four above on the relationship between voluntary disclosure and financial performance of companies quoted at the Nairobi Securities Exchange. The chapter also presents conclusions, limitations and recommendations of the study.

5.2 Summary of Findings

This study sought out to examine empirically the relationship between voluntary disclosure and financial performance of selected companies quoted at the Nairobi Securities Exchange from the year 2011 to 2013. To achieve this objective, the researcher identified the items voluntarily disclosed by 10 companies chosen from the NSE 20 share index based on market capitalization as at Quarter 4 of 2013. The researcher also approached the study is two ways; conducting a univariate analysis to evaluate the effect of each of the individual predictor variables of voluntary disclosure on Return on Investment to meet the specific objectives and conducting a multivariate analysis to find out the effect of the combined model to meet the primary objective.

The research findings from the univariate analysis indicated mixed results. Analysis of the effect of General Corporate and Strategic information on ROI depicted a weak negative linear relationship with a correlation coefficient of 0.2191 implying a weak relationship between the two variables. Similarly, regression of Financial Information on ROI depicted a negative relationship with a coefficient of determination of 0.3173 implying that only 31.73% of the variations in ROI are explained by the variations in Financial Information. Regression of Socio-Environmental and Board disclosures scores with the ROI

also produced a weak negative relationship with a correlation coefficient of 0.1349 resulting in the acceptance of the alternative hypothesis that there is a link between the two variables. On the other hand, regression of forward looking information and resulted in a correlation coefficient of 0.0984 signifying a weak positive relationship between the two variables. In all cases above, the null hypotheses developed in the onset of the study were rejected.

Further, findings from the multivariate analysis of the combined model revealed a Coefficient of Determination R^2 of 0.3888 and a Pearson Product Moment Coefficient of correlation R of 0.6235, implying that there is a strong positive relationship between voluntary disclosure and financial performance measure ROI, hence achieving the primary research objective. As such, only 38.9% of the data points will appear on the linear plot indicating that 61.1% of the variations in ROI are reduced by taking into consideration other factors outside of the combined regression model.

5.3 Conclusions

The findings of this study revealed that there is a significant positive relationship between voluntary disclosure and financial performance measure, Return on Investment, for the companies quoted at the NSE, evidenced by the Pearson Product Moment Correlation Coefficient of 0.6235. As such, given the Coefficient of Determination of 0.3888, 38.9% of the variations in financial performance measure ROI can be explained by variations in voluntary disclosure whereas 61.1% of the variations in financial performance measure (Return on Investment) are explained by other factors outside of the multiple regression model developed.

The null hypotheses developed for each of the four predictor variables of the research $H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$ were rejected hence implying there exists a link between each of the four predictor variables and ROI. These predictor variables are General Corporate and Strategic Information, Financial Information, Forward-looking Information and Socio-Environmental and Board Disclosures. Literature review had earlier indicated that firms that

disclose more information voluntarily enjoy the benefits of cheaper funds from capital markets which consequently translate to higher investment returns, a position confirmed by the findings from this research.

5.4 Recommendations

This research report recommends that since the findings from the study indicate that there is significant relationship between voluntary disclosure and financial performance, managers in organizations should disclose information voluntarily not only for the purposes of obtaining cheaper capital but also because voluntary disclosure of information increases transparency and accountability in annual reporting. In particular, disclosure of Financial Information such as EPS, share price information, liquidity ratios, historical summary of financial statements and value added statements tends to increase the Return on Investments more significantly.

Additionally, since investors are more interested in the returns they get on investments they make, managers should make decisions that increase the earnings of a company. Also, given that voluntary disclosure comes with a cost, firms would do well to voluntarily disclose so as to 'signal' to potential investors and enjoy a positive reputation, thus maximizing firm value.

5.5 Limitations of the Study

The study sampled only 10 companies from the NSE 20 share index, representing 16% of the population of the study. This raises further uncertainty about the extent to which the results are generalizable owing to the fact that the sample may be small in an emerging market that is relatively volatile. If more companies were examined, the results could have been more representative. Also, the study analyzed reports for these companies for three years only. If the period was relatively longer, more conclusive results would probably have been realized.

Moreover, since measurement of voluntary disclosures is a subjective exercise, different researchers will definitely have different ratings of voluntary disclosure items. The voluntary disclosure index in this study consisted of 49 items grouped into four categories. The results would probably change if more or less items were included. Additionally, since there is no universal index that measures voluntary disclosure, researchers with different indices may obtain the same or different results given the same population of study.

5.6 Suggestions for Further Research

Given that researchers are increasingly exploring the concept of voluntary disclosure, this study recommends that the period of analysis be increased to say 6 to 8 years so as to find out the long run effect of voluntary disclosure on financial performance.

Also, future researchers may try and center their analysis on firms in specific industries at the NSE like Banking, Agricultural or Construction and Allied to find out if similar results are obtained since different industries respond differently to information disclosures.

Moreover, if the relationship between voluntary disclosure and financial information was investigated as soon as the annual reports were released, probably the outcomes would be more effective in predicting the relationship.

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APPENDICES

APPENDIX A: Voluntary Disclosure Checklist

	General Corporate and strategic information	Disclosed ('1'), Not Disclosed ('0')
1	Historical background of the company	
2	Corporate, business and marketing strategies	
3	Mission and vision statements	
4	Description of major goods and services	
5	Market analysis i.e. market share, market growth	
6	Corporate goals and objectives	
7	Corporate governance	
8	Organization structure	
9	Identification of major competitors	
10	Regional economic and political stability	
11	Effect of business strategies on current performance	
12	Industry competitive analysis	
	Socio-Environmental and Board disclosures	
13	Corporate social responsibility statement	
14	Environmental policy	
15	Environmental activities undertaken	
16	Involvement in community projects	
17	Categories of employees by age, gender and qualifications	
18	Reasons for changes in employee numbers	
19	Disclosure of welfare policy of workers	
20	Work place safety policies	
21	Redundancy policies	
22	Information about employee turnover, absenteeism and strikes	
23	Names of directors	
24	Ages of directors	
25	Professional qualifications of directors	
26	Directors shareholding	
27	Board of Directors meetings held and their attendance	
28	Senior management responsibilities	
	Financial Information	
29	Summary of financial statements for the last three years or over	
30	Brief description and analysis of financial position	
31	Share price information i.e. market price, par value	
32	Earnings per share	
33	Return on equity	
34	Debt to equity ratio	
35	Value added statements	
36	Supplementary inflation adjusted financial statements	
37	Liquidity ratios	
38	Return on assets	
	Forward-Looking Information	
39	Investments forecasts	
40	Effect of business strategies on future performance of the company	
41	Information about new product and service development	
42	Research and development expenditure	
43	Advertising and publicity expenditures	
44	Planning and capital expenditures	
45	Sales forecasts	
46	Cash flow forecast	
47	Profit forecast	
48	Information on dividend policy	
49	Risk management policy for future investments	
	TOTAL	

Source: Researcher (2014)

APPENDIX B: Top 10 Companies by Market Capitalization in Kshs Billion for Q4/2013

Listed Companies	Oct/2013	Nov/2013	Dec/2013	Q4/2013 Average
SAFCOM	378.34	432.39	434.48	415.07
EABL	252.26	257.00	229.32	246.19
KCB	144.73	143.24	141.00	142.99
EQUITY	131.45	131.45	113.86	125.59
BARCLAYS	101.30	95.05	95.60	97.32
STAN-CHART	93.68	97.69	93.98	95.12
BAMBURI	77.67	76.22	76.22	76.71
CO-OP	74.81	77.11	74.39	75.44
NMG	60.14	60.33	59.20	59.89
BAT(K)	57.40	57.90	60.00	58.43
Top 10 Co.s Mkt Cap.	1,371.78	1,428.38	1,378.05	
End-month total Mkt. Cap	1,873.66	1,975.00	1,920.72	
Mkt Concentration	73.22%	72.32%	71.75%	

Source: NSE(2013)

APPENDIX C: Financial Performance, ROI (y) and Voluntary Disclosure Item (x_n)

COMPANY	YEAR	y	x_1	x_2	x_3	x_4
SAFARICOM	**2011**	0.1650	8	3	5	11
	2012	0.1498	8	3	6	12
	2013	0.1901	8	4	7	12
EABL	**2011**	0.2653	7	4	7	12
	2012	0.3372	10	5	7	11
	2013	0.2114	9	4	7	13
KCB	**2011**	0.0332	9	6	5	11
	2012	0.0408	7	4	7	9
	2013	0.0359	10	6	7	10
EQUITY	**2011**	0.0512	10	6	5	9
	2012	0.0507	10	6	5	13
	2013	0.0478	9	5	7	12
BARCLAYS	**2011**	0.0313	8	5	5	11
	2012	0.0610	8	5	6	10
	2013	0.0371	10	5	5	13
STAN-CHART	**2011**	0.0176	7	4	4	11
	2012	0.0528	8	5	4	11
	2013	0.0430	9	5	7	14
BAMBURI	**2011**	0.1736	10	5	4	12
	2012	0.2489	10	5	5	12
	2013	0.1065	11	5	5	12
	2011	0.0319	10	6	7	10

CO-OP	**2012**	0.0384	10	6	5	11
	2013	0.0394	9	4	5	10
NMG	**2011**	0.3114	8	4	5	10
	2012	0.3505	8	4	4	10
	2013	0.3153	8	4	5	10
BAT (K)	**2011**	0.3683	9	4	6	10
	2012	0.4095	8	4	7	11
	2013	0.3649	8	4	6	11
TOTAL		4.5798	264	143	171	336

Source: Researcher (2014)

APPENDIX D: Companies Listed at the NSE as at 1st January 2014

AGRICULTURAL	**COMMERCIAL & SERVICES**	Liberty Kenya Holdings Ltd
Eaagads Ltd	Express Kenya Ltd	Pan African Insurance Holding Ltd
Kakuzi Ltd	Hutchings Biemer Ltd	Jubilee Holdings Ltd
Kapchorua Tea Co. Ltd	Kenya Airways Ltd	Kenya Re Insurance Corporation Ltd
The Limuru Tea Co. Ltd	Longhorn Kenya Ltd	**INVESTMENT**
Rea Vipingo Plantations Ltd	Nation Media Group Ltd	Centum Investment Co Ltd
Sasini Ltd	Scangroup Ltd	Olympia Capital Holdings Ltd
Williamson Tea Kenya Ltd	Standard Group Ltd	Trans-Century Ltd
AUTOMOBILE & ACCESSORIES	TPS Eastern Africa Ltd	**MANUFACTURING & ALLIED**
Car &General (K) Ltd	Uchumi Supermarket Ltd	A. Baumann & Co. Ltd
CMC Holdings Ltd	**CONSTRUCTION & ALLIED**	B.O.C Kenya Ltd
Marshalls(E.A.) Ltd	ARM Cement Ltd	British American Tobacco Kenya Ltd
Sameer Africa Ltd	Bamburi Cement Ltd	Carbacid Investment Ltd
BANKING	Crown Paints Kenya Ltd	East African Breweries Ltd
Barclays Bank of Kenya Ltd	E.A. Cables Ltd	Eveready East Africa Ltd
CFC Stanbic of Kenya Holdings Ltd	E.A. Portland Cement Co. Ltd	Kenya Orchards Ltd
Diamond Trust Bank Kenya Ltd	**ENERGY & PETROLEUM**	Mumias Sugar Co Ltd
Equity Bank Ltd	KenGen Co. Ltd	Unga Group Ltd

Housing Finance Co .Kenya	KenolKobil Ltd	**TELECOMMUNICATION & TECHNOLOGY**
I &M Holdings Ltd	Kenya Power & Lighting Co. Ltd	Safaricom Ltd
Kenya Commercial Bank Ltd	Umeme Ltd	**GROWTH ENTERPRISE MARKET SEGMENT (GEMS)**
National Bank of Kenya Ltd	Total Kenya Ltd	Home Afrika Ltd
NIC Bank Ltd	**INSURANCE**	
Standard Chartered Bank Kenya Ltd	British American Investment Co. Ltd	
The Co-operative Bank of Kenya Ltd	CIC Insurance Group Ltd	

Source: NSE (2014)