Relationship between Profitability and Voluntary Disclosure: A Case of Banks in Kenya

By

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Abstract

The purpose of this article was to examine the relationship between profitability and voluntary disclosure practices in the Kenyan banking sector. To measure the extent of disclosure, an un-weighted disclosure index consisting of 40 items was applied. The study employed ordinary least squares technique to analyse the data. On average, voluntary disclosure level of the Kenyan banks was found to be at 62.8%. Results show that profitability, listing status and size of the bank are positively and significantly associated with voluntary disclosure levels. In order to improve the general level of banks disclosure, there is a need for regulatory agencies in Kenya to strengthen compliance to the existing disclosure requirements.

***Key words**:* voluntary disclosure, profitability, bank size

JEL Classification: G21, G38

November, 2015

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Electronic copy available at: http://ssrn.com/abstract=2706027

1.0 Introduction

A number of investors and other market stakeholders have been dissatisfied with the amount and quality of mandatory information released in the companies' annual financial reports (Giacomo and Kamalesh, 2006). Accordingly, some of the companies have voluntarily release detailed information about their strategies, performance and plans of actions. Because mandatory disclosure no longer satisfies the investors' diversified needs, transparency has since become a major pillar of corporate governance at both local and international levels. The underpinning reason for the companies' willingness to provide more information to the public than the required mandatory amount is because scandals and corruptions (all over the world) have happened mainly due to insufficient disclosure.

Among the institutions that can cause wide ranging economic consequences if they collapse owing to information asymmetry or any other reasons are the banks. The burst of the United States bank's mortgages burble in 2007 for example, led to economic problem that dissipated to almost all countries in the world. The major reasons for the stalemate were the information gap and adverse selection of banks in mortgages issuing. Cognizant of such possibilities in the market, in 2006 the World Bank launched a voluntary disclosure program with an objective of preventing corruption and promoting healthier and competitive business practices. Specific countries also undertook steps to address information disclosure problem. In Kenya for instance, several structural and institutional reforms have been geared toward ensuring adequate/quality reporting, especially in the banking sector. Several regulatory institutions were introduced to enforce information disclosure, among others. Some of those institutions include Capital Market Authority, Centre for Corporate Governance, Institute of Certified Public Accountants, and Nairobi Stock Exchange.

The topic of voluntary disclosure in Kenya has generated discussions from various stakeholders (Barako *et al.*, 2006). A report by the World Bank (2001) indicated that, in Kenya there is a big gap between the required and the actual disclosure levels. Although the level of disclosure has since improved, the country still has a long way to go. For example, in the 2012 Transparency International Report, Kenya was ranked 154 out of the surveyed 183 countries.

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Voluntary disclosure is defined in the Financial Accounting Standard Board (FASB, 2000) of Kenya as release of information that is primarily outside of the financial statements that are not explicitly required by accounting rules or standards. This study, however, adopted a definition by Barako *et al.* (2006), who defined voluntary disclosure as "The discretionary release of financial and non-financial information through annual reports over and above the mandatory requirements, either with regard to the Kenyan company laws, professional accounting standards or any other relevant regulatory requirements".

Financial information generally helps stakeholders to evaluate the position and performance of the company, hence assisting the investors, user of the company's services and other stakeholders to make rational decisions. Improved disclosure not only assists in bridging the information asymmetry between management and the outsiders but also facilitates proper functioning of the financial markets and economic systems. On the other hand, adequate disclosure reduces cost of capital, increases liquidity, attracts new shareholders and builds reputation of the organization. When there is comprehensive, timely, informative and credible financial information disclosure, there is decrease in vulnerability to crises especially in the banking sector. Generally, outsiders view banks as opaque and thus a need for sufficient disclosure to reduce information asymmetry and to provide justifications of their long-term strategies and action plans.

In providing mandatory information all banks in Kenya follow a clear set of laws, regulations and accounting standard. However, the management remains with discretion to include any additional information in the annual report. Since voluntary disclosure details and deepens compulsory disclosure, what really matters is the benefits and the risks of voluntarily disclosing a lot of information to the public.

In the recent years competition among Kenyan banks has increased and voluntary disclosure of information has been adopted as a new strategy to attract non-banking finance at low cost. Profit is one of the factors considered when companies provide certain information to the public. Nonetheless, the extent to which profit influences disclosure in Kenyan banking sector is not well established. Also, there is limited empirical research on the extent to which bank specific

characteristics influences disclosure practices in the country. This study therefore uses Kenyan banks statistics of 2013 to investigates: (i) amount of voluntary disclosure in the annual financial reports; (ii) factors that affect voluntary disclosures levels in the annual financial reports; and (iii) whether there was any significant association between profit and the level of voluntary disclosure.

2.0 Financial Reporting and Disclosure Regulation in Kenya

Kenya is currently the largest economy in East Africa, and is considered as an economic hub for both trade and finance in the region. The country's economy has been growing consistently from 2000 (CBK[1], 2012). In 2014, Kenya documented a great improvement in terms of socio-economic development and that led the World Bank to recognize the country as one of the emerging middle income countries in the world.

Kenyan financial sector is largely dominated by banks and so the process of financial intermediation depends heavily on banks. This means the survival and development of almost all key sectors in the country virtually relies on banks stability and efficiency. Kenya has a total number of 44 banks, out of which 3 are owned by the government; 28 are owned by the domestic private investors; and 13 are under foreign ownership (CBK, 2012). As of December 2013 there were 11 listed banks in the Nairobi Stock Exchange (NSE). All banks in Kenya are monitored by CBK and regulated under the Companies Act, Banking Act and Central Bank Act.

Kenya Companies Act (2012) cap. 486, is the principle legislation that governs corporate disclosure of companies. This Act gives the general outline and minimum requirement of financial accounting and reporting by all registered companies. The Act also addresses disclosure of issues about accounts and audits, annual returns, registers and inspections, general meetings and Board of Directors.

The Banking Act (2010) bestows legal powers to the regulatory authority and overrides any obligations of secrecy or disclosure imposed by any other laws. Based on this Act, the CBK issues prudential regulation guidelines with the major objective of enhancing market discipline and maintaining a stable and efficient banking system. Those guidelines have greatly enhanced

[1] CBK is abbreviation of Central Bank of Kenya.

the depth of reporting in banking sector by giving framework of transparency, disclosure and controls for good corporate governance.

The baking Act (2010) and the companies Act (2012) provide limited details on information disclosure and as a result, financial and non-financial reporting and regulation in Kenya are complemented by other institutional laws. These institutions have played a key role not only in clarifying issues about corporate governance but also in ensuring supervision and enforcement of the same (Lishenga, Mbaka, 2012).

The Centre for Corporate Governance is the premium institute that drives corporate governance reforms in Kenya. It assists in promoting high standards of corporations and institutions through, education and training, institutional capacity building, research and development, advocacy, and communication, monitoring and evaluation. The centre developed voluntary code which emphasized on non-financial reporting especially on matters pertaining to corporate social responsibility, structure and composition of the Board.

The Capital Markets Authority (CMA) is an independent government regulation agency which provides legal and regulatory framework for the functioning of the capital markets in Kenya. CMA works with the NSE in issuing rules and guidelines to be observed by the publicly listed companies in pursuit of good corporate governance and enhancement of comprehensive and timely disclosure. An institution should comply with all the stipulated guidelines or explain the reasons for non-disclosure, and also indicate steps to be taken to achieve the required compliance.

Other institutions contributing to strengthening of corporate governance and disclosure practices include: Institute of Certified Public Accountants (ICPAK), The Law Society of Kenya, the Association of Kenya Stock Brokers and the Association of Practitioners in Advertising. All these institutions not only work together to promote disclosure practices but also take part in the Statutory Discipline Committee which adjudicates over cases involving non-compliance.

3.0 Theoretical Perspective and Literature Review

In banks like in most other institutions there is agency problem in two dimensions: between the management and shareholders; and between the banks and their respective clients/public. Agency problem occurs where the principal authorizes an agent to perform some service on his/her behalf but an agent performs such a function in his/her own interest at the expense of the principal (Jensen & Meckling, 1976). The major goal of any organizations is to maximize returns to the shareholders (principals). Usually managers (agents) are entrusted with responsibility to achieve this goal. However, because people are not philanthropic, agents do not constantly act in the interest of the principals, and therefore resulting to conflicting interests. Because managers can access more information than the shareholders, agency relationship often leads to information asymmetry thereby creating conflicts between the two parties. Similarly, because firms/banks may want to make abnormal profits, they do take advantages of misinformation on the side of their clients to benefit from price differentials or interest margins. This information issue, which is founded on agency theory is one of the critical concerns influencing studies of this nature about the banking industry.

According to Barako *et al.* (2006) Voluntary disclosure can be used as one of the means of mitigating the agency problem. Managers should voluntarily disclose more non-mandatory information to not only reduce the information asymmetry but also to convince the shareholders that their actions are in accordance with the company's objectives (Watson *et al*, 2002). Reliable and sincere communication to the market can also be used by the managers as a way of reducing agency cost and increasing confidence thereby optimizing the value of the firm.

Agents know that there is lack of full trust in what they do and so in attempt to alleviate the agency problem, they do signal their actions for smooth continuation. Signalling theory explains it that a signal can be an action or an arrangement used by firms in sending positive indications to the public about the company's products and image in general. Companies have detailed information about the kind of services they offer and the quality of their products than the market participants. As such, information asymmetry makes a reason for investors and market

participants to form a broad perception about the image, the quality of the products and the overall value of the firm (Morris, 1987).

To prevent this information asymmetry, voluntary disclosure has been used as one of the means of providing signals to the market. Based on the performance, managers want to distinguish their firms from others and hence voluntarily disclosure provides positive information to the stakeholders so as to attract more investments and to widen clientele-base as a way to enhance corporate value (Álvarez *et al*., 2008). The main emphasis of the signalling theory is that companies should release their positive information so as to convey the constructive managerial attributes to the public. Nevertheless, signalling is only a good strategy if the benefits accrued from giving such signals outweighs the benefits of any other different strategy.

When attracting external capital, companies aim to acquire debt or equity at a low cost. The capital need theory explains that managers are motivated to release extra information so as to get capital at the lowest possible cost. Increased voluntary disclosure helps managers to lower the cost of acquiring capital by reducing investor uncertainty surrounding the company's future performance. It has also been argued that disclosure of financial information improves the company's reliability in the market (Schuster and O'Connell, 2006; Cooke, 1989b). Even so, sometimes managers withhold information to hinder the market participants from effectively monitoring the company, and also claiming for the adequate cost of capital to be paid (Karamanou and Vafeas, 2005).

The highlighted theories attempt to explain reasons why firms voluntarily disclose information. Applying these in isolation may not offer a satisfactory basis for voluntary information disclosure. Integrating these theories can provide a better understanding of the concept of voluntary corporate disclosure from different perspectives in banks and even in other institutions.

The literature shows that past studies have linked voluntary corporate disclosure to various bank specific-variables. Voluntary disclosure has been related to the size of the bank, profitability, leverage, liquidity, corporate governance, board composition, existence of audit committees and

stakeholder's concentration, among others. Until now the results from various researches suggest conflicting relationship between banks performance and voluntary corporate disclosure.

In Kenya, Barako *et al.* (2006) conducted a 10 year period panel data analysis on the association between corporate governance practices and voluntary disclosures in the annual reports of 43 listed companies. To approximate the determinants of voluntary corporate disclosure, the study applied a pooled ordinary least square (OLS) with panel-corrected standard errors (PCSEs). Results indicated that profitability, liquidity and leadership structure were insignificant in explaining corporate disclosure practices in Kenya. In contrast, there was a positive and significant connection between the levels of voluntary disclosure and variables such as presence of the audit committee, ownership type, firm size and leverage. However, the findings reported a negative relationship between shareholders concentration and voluntary corporate disclosure levels. Although this study was extensive, it focused only to the listed companies. Our current study unlike that of Barako *et al.* (2006) it takes into consideration both listed and unlisted banks. The reason is that, in principle, both listed and unlisted corporations have the same ultimate core objective of profit/value maximization and thus they may not need to be viewed as unique and different in central characteristics.

Kahl *et al* (1981) studied disclosure levels of 70 banks which were selected from 18 countries. The study concluded a positive relationship between the profit and size of the banks with the levels of voluntary disclosure. This finding necessitates investigation of these variables for Kenyan banks as it may have implication to mergers and acquisition policy.

Mandatory and voluntary disclosure of 38 listed banks in India, and its relationship with the company size, profitability, and audit was studied by Hossain (2008). The study also investigated the level of disclosure index, which contained 184 information items extracted from both mandatory and voluntary information. Dichotomous approach was used in scoring items. The findings from the ordinary least square (OLS) regression model indicated that the size, profitability and the Board composition of banks are significant in determining banks disclosure patterns. Nonetheless, variables such as age and complexity of the business were insignificant. The study was based on the sampled data that was restricted to the listed banks only.

Another similar research was done in Ashanti region of Ghana by Agyei-Mensah (2012). The study investigated influences of bank-specific characteristics on the extent of voluntary disclosure in the 2009 annual reports of 21 listed banks. Agyei-Mensah also used a dichotomous method in scoring 27 information items for voluntary disclosure. The findings from OLS regression models show that as profit – approximated by Return on Capital Employed (ROCE) – increases, disclosure level also rises. Other variables tested including debt equity ratio, liquidity, bank size and audited firm size, which were reported to have insignificant relationships with the disclosure patterns in Ghana.

A most recent study by Chokri & Raoudha (2013) has examined determinants of voluntary corporate disclosure in the annual reports of listed banks in Tunisia. They sampled 10 listed banks for the period 2000-2011. Using the prais-winsen regression model, the results show that size of the Board, block-holder ownership and state ownership have a negative effect to the levels of disclosures. However, bank profitability, size and proportion of foreign ownership are positively and significantly associated with the voluntary disclosure levels. In contrast, the proportion of board independence, Auditors reputation and CEO duality does not influence patterns of voluntary disclosures as variables investigated in this study.

Contrary to the findings of the discussed studies, results from some other studies conclude that profit does not influence the extent of disclosure in firms. For instance, Hamid (2004) assessed social disclosure levels of 48 banks in Malaysia for the year 1999. The study focused on the following variables; firm size, financial performance (measured by ROE and ROA), age of business, listing status, and company profile. Using multiple regression models, an insignificant relationship between profitability and information disclosure was reported. Nevertheless, it was also revealed that the level of information disclosure increases as the firm size, listing status and age of business increase. Some other studies done in different countries also concluded that profitability does not necessarily have a significant influence on the level of voluntary disclosure. These include, *inter alia*: Brammer and Pavelin (2006); Akhtaruddin (2005); and Mohammed *et al*. (2009) for UK, Bangladesh and Qatar, respectively.

Variables and Hypotheses

The main variables in our study are voluntary corporate disclosures and banks performance. Banks profitability was defined as return on Asset (ROA) approximated by net income divided by the total assets. Previous studies have reported conflicting results on the impact of profitability on voluntary disclosure levels. Some studies found that profitability is influential to the firm's voluntary disclosure levels, while some others, including the study that was done in Kenya (Barako *et al*, 2006) conclude that profit has no significant relationship with disclosure levels.

Adopting the signalling theory we should, nonetheless, expect significant positive relationship between voluntary disclosure and bank profitability. Based on this theoretical view we formulate our main hypotheses as follows:

H_1: The higher the profitability of a bank, the higher the level of voluntary disclosure.

Control Variable

Review of prior studies indicated that apart from profit, there are other variables that affect disclosure levels, (see Ahmed & Nicholls, 1994; Wallace & Naser, 1995; and Barako *et al*, 2006). As a result, variables such as the age of the bank, liquidity ratio, listing status and firm size were selected and included in our model as control variables. The proxies used in estimation of these variables and their expected signs are represented in Table 1.

Age of the bank (*AGE*): the age of the bank is hypothesized to have positive and significant influence on disclosure level (see Owusu-Ansah 1998 and 2005). This is mainly because, old banks are more exposed to the market competition and they have the skills as well as the ability to organize and supply extra information through annual reports. Age is defined as the number of years the bank operated in the market since it was first established in Kenya until 2013.

Liquidity status (*LQDP*): institutions and market stakeholders use liquidity ratio not only to gauge the status of companies but also to predict and assess bankruptcy (Wallace and Naser; 1995). Liquidity ratio has also been used to gauge whether companies are able to clear their outstanding commitments when they fall due. Therefore, a firm is expected to honour its current obligations with its current assets without liquidating fixed or long-term financial assets. From

the prior studies, (see. Alsaeed, 2006), liquidity is hypothesized to have positive effect on the extent of disclosure (e.g. Alsaeed, 2006).

Listing status (*LISTS*): apart from complying with the listing requirements, listed banks tend to disclose more information to boost the investors' confidence so as to attract large number of investors. In addition, listed banks are normally subjected to extra disclosure requirements and they face tougher penalties in case of non-disclosure than their counterpart (unlisted) banks. In Kenya for example, failure to disclose enough information of any listed company faces a risk of being suspended from the Nairobi Stock Exchange. Empirical evidence suggests that listing status has a positive and significant association with voluntary disclosure scores (see Wallace *et al.,* 1994; Inchausti, 1997; Hamid, 2004). The listing status (LISTS) variable is a dummy which we coded as:

1 = for a bank listed in the NSE; and

0 = for a bank not listed in the NSE.

The size of the bank (*SIZE*): larger banks are more likely to provide extra information to the public because agency cost increases with the firm size (Chow and Wong-Boren, 1987). That is also likely because bigger banks tend to have lower average cost of collecting and disseminating information (Hossain *et al*., 1995). Accordingly, studies have confirmed that there is a positive and significant relationship between the company size and the level of voluntary corporate disclosure (see Hossain *et al*., 1995; Wallace *et al*. 1994; Wallace and Naser, 1995; Owusu-Ansah, 1998; Ho and Wong, 2001; Barako *et al*. 2006). This means, the size of the bank whose proxy is usually the natural logarithm of the total assets is expected to be positively related with the extent of voluntary corporate disclosure.

Table 1: Variables, their measurements and hypothesized sign

Independent Variable	**Expected sign**	**Operational definitions**
Test Variable Profitability(ROA)	+ or –	ROA defined as a ratio of net profit to total assets
Control Variable Age of the bank (AGE)	+	Number of years the bank has been operational since its incorporation up to 2013
Liquidity(LQDP)	+	Ratio of current asset to current liabilities
Listing status (LISTS)	+	Dummy variable with the score of "1" if the bank is listed and a score of "0" if not listed
Size of the bank	+	Log of total assets

4.0 Methodology and Data Source

As of December 2013, Kenya had a total of 43 commercial banks, out of which 11 were listed in the Nairobi Stock Exchange. The study sample contained 31 banks; 11 listed in the NSE and 20 randomly selected unlisted banks. The data was extracted from commercial banks' annual reports for the 2013.

Selection and scoring of the Disclosure Index

The approach used in selection of the index items was adopted from the standard approaches used in previous studies. After extensive literature review, 40 items were identified as essential and possible to be voluntarily disclosed through the bank's annual financial reports. The identified disclosure items were all placed under four categories as shown in Appendix A.

Researchers have generally been using two different indexes; the weighted, and the un-weighted index in measuring the level of disclosure. Literature suggests that the use of these two different approaches makes very little or no important difference in the findings. In the weighted index approach, as adopted by Barrett (1977) and Marston (1986), the selected items are assigned scores above zero but less than one. The value of zero is assigned to any information item not disclosed. A weight and a score given to any item depends highly on significance attached to that item by the researcher. The un-weighted disclosure index, was adopted by the current study, it is also referred to as the dichotomous procedure. In this approach, a question is on whether a firm discloses an information item or not. All items in the constructed disclosure index are treated as equally important to the users. For any item that is disclosed in the company's annual financial report, a score of "1" is awarded. In case of non-disclosed, then the item is assigned a score of "0". This method has been widely used by researchers such as Cooke (1991&1992), Wallace *et al*. (1994), Hossain *et al*. (1994) and Hossain (2000 &2001).

Total Voluntary Disclosure Scores **(***TVDS***)** for every bank per year was calculated as:

$$TVDS = \sum_{i=1}^{40} (d_i) .$$

Therefore, *Percentage Voluntary Disclosure Score* (*PVDS*) = (*TVDS*/40) *100

Where, *TVDS* = Total Voluntary Disclosure Score for individual bank.

d = 1 if item d_i is disclosed in bank's annual reports, and

d = 0 if item d_i is not disclosed in annual reports.

The following multivariate OLS model was applied to assess how commercial bank attributes impact the level of disclosure practices in Kenya.

$$PVCD = \beta_0 + \beta_1 PRFT + \beta_2 AGE + \beta_3 LQDP + \beta_4 LISTS + \beta_5 SIZE + \epsilon.$$

Where:

PVCD = Percentage Voluntary Disclosure Score

PRFT = Banks' Profitability

AGE = Banks' age

LQDP = Liquidity position of the bank

LISTS = Listing status, dummy variables

SIZE = Size of the bank

β = Regression model coefficients (parameters).

β_0 = Constant or intercept

ε = Error term.

5.0 Results and Discussions

5.1 Descriptive statistics

Table 2a shows descriptive statistics of the variables included in the model. The mean of voluntary corporate disclosure (VCD) is 62.78%. That is, on average banks disclose 25 items out of the 40 items included in the disclosure index. These results also show that disclosure levels among the banks are relatively high with a maximum total score of 97.5% (i.e. a total of 39 out of 40 items) while a minimum score of 34.7% (i.e. a total of 14 out of 40 items).

Table 2a: Descriptive statistics

Variable	*Obs.*	*Mean*	*Std. Dev.*	*Min.*	*Max.*
VCD	31	62.78	18.09	34.67	97.5
ROA	31	2.25	1.5	-1.88	4.78
*SIZE**	31	86.6	98.1	5.77	391
LQDP	31	40.42	11.35	23	75.2
AGE	31	37.94	29.79	7	119
LISTS	31	0.35	0.48	0	1

*Figures in billion Kenyan shilling.

On the other hand, Table 2b elaborates VCD practices in bank's annual reports. The table presents analysis of the banks whose disclosure scores are within some particular ranges. In 2013, three banks (9.7%) had disclosure scores of less than 40%. Likewise, 20 banks disclosed between 41% and 70% of information causing the mean of VCD in Kenya to be 62.8%. Only 8 banks voluntarily release over 70% of their information through annual reports. This implies that even if disclosure levels were above the average, commercial banks in Kenya would still have a need to willingly release more information to the public.

Table 2b: Voluntary Disclosure Scores

% VCD	*Number of banks*	*Percent*
31-40	3	9.7
41-50	7	22.6
51-60	7	22.6
61-70	6	19.4
71-80	3	9.7
81-90	1	3.2
91-100	4	12.8
Total	**31**	**100**

ROA ranges from – 1.9 to 4.8 with average of 2.3% and a standard deviation of 1.5 which shows a wide variation from this average. Size of the bank, as approximated by total assets, varies from a low value of Ksh. 5.8 billion to a high value of Ksh. 391 billion and an average of Ksh. 86.6 billion. Age of the bank and liquidity ratio had mean of 37.9 and 40.4, respectively.

Descriptive statistics of the binary variable, (listing status) show that out of 31 banks, 35.5 % (i.e. 11 banks) are listed in the NSE while 64.5% (i.e. 20 banks) are not listed.

Table 2c: Listing Status

Variable	***Banks***	***Percent***
Listing status		
Not listed	20	64.52
Listed	11	35.48
Total	**31**	**100**

Diagnostic tests

Here we did diagnostic tests of the included variables as presented and described before the regression analysis.

Table 3: Pearson Correlation Coefficient

	VCD	***ROA***	***AGE***	***LQDP***	***LISTS***	***SIZE***
VCD	1.0000					
ROA	0.5813**	1.0000				
	0.0017					
AGE	0.3797*	0.4277	1.0000			
	0.0351	0.0560				
LQDP	-0.1554	0.2124	0.1351	1.0000		
	0.4040	0.1652	0.4688			
LISTS	0.8097**	0.5024*	0.4778**	-0.1859	1.0000	
	0.0000	0.196	0.0066	0.3167		
SIZE	0.7692**	0.5024*	0.4778**	0.0611	0.7623**	1.0000
	0.0000	0.0131	0.0027	0.7441	0.0000	

** and * imply correlation is significant at level 10% level and 5% level, respectively

Table 3 shows that some variables, notably: return on assets; age of the bank; size; and listing status are positively and significantly related to voluntary disclosure. However, there is a correlation between some of the regressors. For instance, ROA is correlated with listing status (r = 0.5024) and size (r = 0.5820) at 0.5 level of significance. Also, the variable age is positively and significantly correlated with listing status. The highest correlation reported is between listing status and bank size (r = 0.7623). This correlation could be a signal of multicollinearity problem. If not corrected, multicollinearity results to wrong and biased results of the estimated model. Therefore, it was important to check for this problem before performing the OLS regression analysis. Using Variation Inflation Factor (VIF) to test for multicollinearity problem, the results gave a general average of 2.15. For multicollinearity to be present, the regressors must produce a

VIF value of more than 10. This means multicollinearity is not present between the explanatory variables and hence, the research findings can be interpreted with confidence.

Table 4: Multicollinearity test results (VIF)

Variable	***VIF***	***1/VIF***	***COMMENT***
Listing status	3.24	0.308477	No Multicollinearity present
Size	3.21	0.311219	No multicollinearity present
ROA	1.55	0.643755	No multicollinearity present
Age	1.47	0.678461	No multicollinearity present
Liquidity	1.27	0.790029	No multicollinearity present
Mean VIF	2.15		

Normality test, heteroskedasticity test, and Ramsey reset test for the model specification were conducted to make sure that the basic ordinary least squares (OLS) assumptions are not been violated.

The normality test of Shapiro-Wilk was used to check for the normality of the error term. With a *z* value of 0.7788 we concluded that the error term is normally distributed. Heteroskedasticity test was done using Breusch-Pagan test. Results show a *p* value of 0.8634, which is greater than the critical value of 0.05, implying heteroskedasticity is not present and therefore the residuals of the model are homoscedastic. Finally, a Ramsey reset test was conducted to identify any mis-specification errors like omission of important explanatory variables. If the model is correctly specified, then no additional independent variables should be significant. Results from the test reported an F-statistics of 0.6311 which is greater than the critical value of 0.05. This means it is not necessary to increase the number of the regressors to this specification and there is no non-linearity problem in the model. In view of these results, the estimates from the regression analysis will be unbiased.

5.2 Regression results

The goodness-of-fit of the regression model shows that a large proportion of the variation in voluntary disclosure can be explained by the variations of the set of included explanatory variables.

Table 5a: Goodness-of-fit statistics

MODEL	*F(5,25)*	*Prob > F*	*R-square*	*Adjusted square*	*R*	*MSE*
1	15.71	0.0000	0.7585	0.71102		9.74

R-squared of 0.7585 was obtained and F-value of 15.71, which is significant at 1% level. The difference between R-squared and adjusted R-squared is not that big, and to minimize errors that could cause bias in estimations we used OLS model with robust standardized error. We present and discuss the results based on the tested hypotheses.

Table 5b: OLS regression results with robust standard error

VCD	*Coef.*	*Robust SE*	*T*	*P>t*	*[95% Conf.*	*Interval]*
_CONS	-66.01406	48.26638	-1.37	0.184	-165.4205	33.3924
ROA	3.00521	1.265911	2.37	0.026	0.3980213	5.6124
AGE	-0.596926	0.0715943	-0.83	0.412	-0.207143	0.087759
LQDP	-0.2006	0.1538475	-1.3	0.204	0.517457	0.116252
LISTS	15.64529	5.378741	2.91	0.008	4.567565	26.72301
SIZE	5.18542	2.045814	2.53	0.018	0.9719856	9.398853

Hypothesis (H1): Profitability of the commercial bank

Referring to Table 5b we conclude that profitability (with *ROA* as its proxy) is relevant in explaining the level of voluntary disclosure in the Kenyan banking sector. These results affirm the alternative hypothesis that more profitable banks release significantly more information through their annual reports than the less profitable ones. Thus, banks profitability is an essential factor

that should be considered when deciding the variation and the extent of voluntary disclosure in the banking sector in Kenya.

These results are consistent with both the signalling and agency theories. Referring to the signalling theory, we can infer that managers from profitable banks release more information through their annual reports so as to signal market confidence thereby cultivating their reputation and avoiding the market undervaluation of the value of the firm (Inchausti, 1997). Conversely, managers from under-performing companies choose to reveal lesser information in the annual financial reports so as to conceal their poor performance.

From the agency theory, we can deduce that profitable banks voluntarily release extra information in their annual reports so as to reduce the agency cost and convince both the shareholders and other users of financial information that they are maximizing the value of the company. Similar results were also reported by Akhtaruddin *et al*. (2008), Owusu-Ansah (1998) and Hossain and Reaz (2007). Nevertheless, they contradict the findings of Barako *et al*. (2006). In examining the determinants of voluntary disclosure in Kenya, Barako *et al*. (2006*)* reported an insignificant relationship between the two.

Contrary to the predicted sign, *Age* of the bank seems to have no effect on voluntary disclosure in in Kenyan banks. As a result, the level of voluntary disclosure is not affected by the number of years the bank has been in operation. Similar results were reported by Akhtaruddin (2005), Alsaeed (2006), Hossain and Reaz (2007) and Hossain (2008).

In line with the findings of Owusu-Ansah (2005), Alsaeed (2006) and Barako *et al*. (2006), regression results indicate that there is a negative and insignificant relationship between banks liquidity and annual voluntary disclosure levels. This means that banks liquidity status does not influence the levels of voluntary disclosure to an important level.

The sign and the coefficient of the variable “listing status” is positive and significant at 5%. These results show that listed banks disclose more information than unlisted ones. We can argue that apart from complying with the listing requirements, listed banks in Kenya voluntarily

disclose more information to increase the investors' confidence thereby reducing the cost of acquiring capital. In addition, these banks do normally enjoy trainings and incentives which motivate them to disclose more information than their unlisted counterparts. This result coincides with that of Wallace *et al*. (1994), Hossain *et al.(*1995), Inchausti (1997) and Abdul (2004).

The variable *size* (as approximated by total assets) influence the level of voluntary disclosure of the Kenyan banks positively and significantly. This is consistent with the view that it is cheaper and less risky for larger banks to release extra information through their annual reports rather than the smaller banks to do so. It is also possible that smaller firms disclose less information for fear that full disclosure might jeopardize their competitive position. Looking into the previous researches, this finding is similar to that of Barako *et al.* (2006), Hossain & Reaz (2007) and Huafang & Jianguo (2007), although Chow and Wong (1987), and Agyei-Mensah (2012) reported insignificant relationship between the two.

Conclusions and Policy Recommendation

This study investigates the factors that determine voluntary disclosure of financial information in the Kenyan banks annual reports. Both listed and unlisted banks were include in the sample. The findings show that on average, banks disclose 63% of their information. This indicating that there is a room for quite reasonable improvement. Regulatory agencies have to therefore strengthen implementation of the already placed disclosure requirements in the country.

The findings confirmed the hypothesis that profitable banks disclose more financial information than the less profitable ones. This is because managers from the more profitable banks are motivated to release extra information so as to communicate their quality to investors (Meek *et al*., 1995). Managers from the less profitable banks need also to harness benefits of releasing adequate extra information to the public as they could signal their performance and growth if the pattern of relevant information is given over time.

The results also confirm that the listed banks voluntarily disclose more information through their annual reports than the unlisted banks. This is partly because Capital Markets Authority guidelines are only mandatory for the listed banks, while it is not compulsory for the unlisted

banks in Kenya to comply with those guidelines. This follows from the fact that listed banks in Kenya face variety of stiff penalties in case of non-disclosure. Besides these, incentives to adequate information disclosure are more directed towards the listed companies than the unlisted ones. In order to reduce this gap, steps should be taken to ensure that all banks comply with the set CMA guidelines regardless of their listing status. The focus should now be shifted to the unlisted banks which comprise the largest number of banks in Kenya.

The finding from this study further reveal that the size of a bank is an important variable in explaining variations of voluntary disclosure across all banks. This means that the big banks tend to willingly disclose more information through their annual reports than small banks. To improve general levels of banks disclosure in Kenya, regulatory bodies should sensitize small banks to enhance their voluntary disclosure levels.

Our research confirms the applicability of capital need theory, signalling theory and agency theory which were used as theoretical frameworks relevant to modelling disclosure of banks in Kenya. The study, does not only give more insight to disclosure issues in the Kenyan banking sector but also provides useful information to institutions and individuals who are interested in addressing the overall issues of voluntary disclosure in the country.

We are aware of some limitations to this study, which can be addressed in future researches. The current research used ROA as proxy in measuring profit. Other profit proxies such as return on equity can also be applied for robustness as results are compared. This study focused only on information released in the banks' annual reports. At the present, electronic/digital communication has increasingly been used as an effective communication to the market stakeholders, and so future studies may investigate the extent of voluntary corporate disclosure through the electronic type of reporting such as website and e-financial reporting.

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Appendix A: Voluntary Disclosure Checklist

Background of the Commercial Bank	
1	Brief narrative of the bank
2	Description of major services
3	Address of the bank/Telephone/Fax
4	Date and details of establishment
5	List of branches and their location
6	General outlook of business activities
Social Responsibility Information	
7	Sponsoring public health and sports
8	Information on donation and charitable activities
9	Supporting national pride and government sponsored campaigns
10	Information on social banking activities
Corporate Governance Information	
11	List of board members
12	Disclosure of information of board members qualification and experience
13	Duties of board members
14	List of senior manager (Not in the board)
15	Disclosures on managers qualifications and experience
16	Pictures of all board members
17	Pictures of all senior managers
18	Numbers of board meetings and attendance list
19	List of audit committee
Financial Ratios and other Statistical Information	
20	Brief discussions of the banks operating results
21	Five years performance at a glance
22	Graphical information of information
23	Return on assets
24	Return on equity
25	Liquidity ratio
26	Earnings per share
27	Capital adequacy ratio
28	Loan to deposit ratio
29	Total dividend
30	Dividend per share for the period
31	Number of branches extension during the fiscal year

32	Comparative income statements for two years
33	Comparative balance sheet for two years
34	Comparative cash flow statements for two years
Accounting Policies	
35	Disclosure of accounting standards and its uses
36	Accounting valuation of fixed assets(Fair value or historical cost)
37	Depreciation method used
38	Foreign currency transactions and different treatments
39	Treatment of tax
40	Treatment of contingent liabilities