THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Accounting Disclosures and Firm Value of Commercial Banks Listed on the Nairobi Security Exchange, Kenya

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Abstract:
The financial health, sustainability and soundness of banks is a basic requirement for the depositors and equally important for the shareholders, employees, and the entire economy. Thus, regulators across the globe have made an effort to measure the financial wellbeing of banks by requiring them to disclose information about their operations. External factors including being stripped of licenses, deregulation, lack of information amongst the customers, homogeneity of the business, connectivity amongst the banking sector affect the performance of the bank which is reflected in their value. The collapse of three commercial banks over a short period of time focused the attention of regulator and policymakers on the disclosures by commercial banks in Kenya. Investors have also demanded greater transparency particularly for firms listed at the Nairobi Securities Exchange. Further, a review of the trends in the share prices of listed commercial banks and the information released indicates contradictions. An analysis shows that in some instances the share prices recorded show increases despite the company releasing negative information and/or vice-versa. This leads to the question of what is the relationship between disclosures on the firm value. The aim of the study was to determine the effect of accounting disclosure on the firm value of listed commercial banks in Kenya. The study was guided by four research objectives namely: to determine the effect of accounting practices disclosures, risk information disclosures, hedging strategies disclosures, and reserves disclosures on the firm value of listed commercial banks in Kenya. The value of the firm was measured using the market based measurement Tobin's Q. The study was anchored on the Decision Usefulness Theory, Signalling Theory, and Positive Accounting Theory. The disclosure items were measured using an accounting disclosure index, which is a checklist of different disclosure indicators included in the annual reports of the listed commercial banks. The accounting disclosure consisted of 25 items. The study adopted a causal research design. The study sampled all the listed commercial banks. The study established that accounting policies, risks, hedging strategies, and reserves had a positive and statically significant effect on firm value of commercial banks listed on the Nairobi Securities Exchange.

Keywords: *Hedging Strategies, Accounting Disclosures, Firm Value,Reserves, Risks, Tobin's Q*

1. Introduction and Background

Over the last few decades, there has been an increase in the use of International Financial Reporting Standards (IFRS) and its predecessor the International Accounting Standards (IAS) in major corporations across the globe (Alfraih & Alanezi, 2015). According to the International Accounting Standards Board (IASB) (2014) more than 130 countries have adopted the use of the IFRS. The principle objective of having IFRS is to ensure high-quality reporting standards by companies. However, over the same period, there has been an endless stream of corporate collapses and scandals that were attributed to poor accounting standards and disclosures (Yink, Jide, & Emmanuel, 2015). Some of the scandals included Enron, Xerox, Reliant Resources, Global Crossings, CUC International, Adelphia Communications, Waste Management, Rite Aid and World Com (Waweru, 2018). The Xerox and Enron scandal combined cost the economy of the United States more than $ 35 billion. These scandals have not been limited to the United States with numerous scandals being reported across the globe.

In Kenya, various companies have been involved in the misappropriation of funds including Simple Homes Holding Cooperatives, Haco Tiger Brands, Dubai Bank, Imperial Bank, Uchumi, CMC Holdings, Mumias Sugar and Kenya Airways (Guguyu.2015; Mwiti, 2017). Following the closure of Chase Bank in 2016, it emerged that more than Kshs. 16.6 billion had been lent to the bank insiders most of whom were the banks directors. This information had not been disclosed by the banks auditors despite it being a mandatory requirement (Herbling, 2016). This was particularly worrisome given that two other banks Dubai Bank and Imperial Bank had been closed due to similar irregularities. Indicating perhaps that the information disclosed being disclosed by entities in Kenya was not adequate or accurate. As the Kenyan government makes concerted efforts to implement its economic blue print dubbed Vision 2030, one of the key issues that needs to be addressed is building investor confidence in the economy. According to Mugwe (2012), the ranking of Kenya in the global competitive report is poorer than it should be due to the unethical behaviour of firms, strength of investor protection, integrity of auditing and reporting standards, and the protection of minority shareholders. Due to the numerous corporate scandals, the demand for corporate transparency in Kenya has arisen, particularly for firms listed at the Nairobi Security

Exchange (Mugwe, 2017). This is particularly important given that these firms have a wide range of regulators and auditors, but still manage to have scandals.

2. Statement of the Problem

Following the closure of Chase Bank in 2016 by the CBK, it emerged that more than Kshs. 16.6 billion had been lent to the bank insiders most of whom were the banks directors. This information had not been disclosed by the banks auditors despite it being a mandatory requirement (Herbling, 2016). This was particularly worrisome given that two other banks Dubai Bank and Imperial Bank had been closed by CBK due to similar irregularities. Indicating, that the information being disclosed by entities in Kenya was not adequate or accurate. The collapse of the three commercial banks over a short period of time focused the attention of regulator and policymakers on the disclosures. Investors have also demanded greater transparency particularly for firms listed at the Nairobi Securities Exchange (Mugwe, 2017).

Further, a review of the trends in the share prices of listed commercial banks and the information released indicates contradictions. An analysis shows that in some instances the share prices recorded show increases despite the company releasing negative information and/or vice-versa. Financial literature suggests that increased levels and frequencies of disclosures reduce the degree of information asymmetries which is reflected in the firm value (Cormier, Ledoux & Aerts, 2010). However, the literature does not indicate the degree to which the information should reflect in the firm value which is often indicated by the share price. This leads to the question of what is the relationship between disclosures on the firm value.

Research has been conducted to investigate the effect of various accounting disclosures on the financial performance of firms. However the findings have not been consistent across the globe. In Kenya, numerous studies have been undertaken to evaluate the effects of various aspects of accounting disclosures on financial performance. Matengo (2008) carried out a study on the relationship between corporate governance and financial performance of banking industry in Kenya and found that transparency significantly affected financial performance while disclosure did not show any significant relationship. Mboya and Wachudi (2009) also carried out a study on the effect of board diversity on the performance of commercial banks in Kenya and found that boards of commercial banks are male-dominated and that board diversity has no effect on the performance of commercial banks in Kenya. The studies focused on the financial performance and did not look at the firm value. This study purposed to fill the research gap by evaluating the effect of accounting disclosures on firm value.

3. Objectives

- To determine the effect of accounting policies disclosures on the firm value of listed commercial banks in Kenya.
- To evaluate the effect of risk information disclosures on the firm value of listed commercial banks in Kenya.
- To assess the effect of hedging strategies disclosures on the firm value of listed commercial banks in Kenya.
- To investigate the effect of reserves disclosure on the firm value of listed commercial banks in Kenya.

4. Significance of the Study

The findings of this study are important to various parties. The regulatory authorities will be able to determine the manner in which various categories of accounting disclosures affect the firm value of listed firms. The findings of the study also enlighten the shareholders of the factors to consider when developing investment strategies. Similarly, the management of the firms will get knowledge of how various decisions affect the firm'svalue. This insight will be useful when formulating strategies and determining what to communicate.A review of literature indicates that most of the studies done focus mostly on the capital structure of the firm and its impact on financial performance. This study expands the knowledge base by focusing on accounting disclosure and firm value.This study contributes to increasing the understanding of the underlying factors that affect firm value. Academics will be able to use the findings of the study as a basis for further studies

5. **Review of Literature**

5.1. Theoretical Review

5.1.1. Decision Usefulness Theory

This theory is attributed to a committee of the American Accounting Association (AAA) which was charged in 1966 with the responsibility of developing a statement of basic accounting theory (ASOBAT) (Williams & Ravenscroff, n.d.). The most important consideration for the selection by the committee, of any given accounting measurement method, would be its usefulness to the various categories of accounting information users. The usefulness is determined by the predictive ability of the accounting information given. The more accurate the predictive value of the accounting information the more useful the information. The committee defined usefulness as determined by the user. However, the committee did not expressly define the users of accounting data (Young, 2006).

This shortfall was rectified by the Jenkins Committee of the AICPA which identified the different users of accounting information and identified their information needs (Young, 2006). The Financial Accounting and Standards Board (FASB) and the International Accounting Standards Board (IASB) further increased the definition of the accounting users. The framework format resembled that provided by ASOBAT by identifying the objectives of financial reporting (SFAC No. 1) and specifying the characteristics of accounting information in order to fulfill the identified objectives (SFAC No. 2)

(Freedman, 2015) However, the framework narrows the classes of users and the decisions for which accounting information was to be used. According to the framework, financial reporting should provide information that is useful to current and potential future investors and creditors and other users. The information should specify the amount, timing, and uncertainty of prospective cash flows. This theory is relevant to this study as it indicates the usefulness of financial disclosures contained in financial reports.

5.1.2. Signalling Theory

This theory came into being in the 1970s through the works of Arrow (1972) and Spence (1973). The works of Spence (1973) were geared at overcoming the limitation of the classical theory, particularly those related to the hypothesis of the perfect competition (Bini, Dainelli, & Giunta, 2011). According to Spence (1973) in the workforce market, the unemployed person who is seeking to attain employment sends a signal to the market. The unemployed person seeks to keep their talents, skills, and qualification in the public eye in order to prevail. According to this train of thought, financial economists posit that the most profitable companies have something to gain by signalling their competitive advantage through frequent and better communication (Connelly, Certo, Ireland, & Reutzel, 2011).

The signalling theory indicates that the corporate disclosures can solve the information asymmetry between the internal stakeholders and external stakeholders (Kothari, Li, & Short, 2009). Thus, disclosure may result in increased demand for the firm's shares and a rise in the price of the shares given that the disclosures should essentially reveal the firm's value (Hussainey & Walker, 2009). According to Leuz and Wysocki (2008) and Beyer, Cohen, Lys, and Walther (2010) information rich conditions increase the value of the firm this is due to the diminishing in mispricing. The signalling theory is relevant to this study as it shows the association between information through disclosures and the firm value.

5.1.3. Positive Accounting Theory

This theory emerged in the late 1960s and was refined and promulgated by Watts (1978) and Zimmerman (1986) working at the Willian E. Simon School of Business Administration at the University of Rochester (Deegan, 2009). This theory is complementary to the Agency Theory. The Positive Accounting Theory is formulated on the discrepancy between the interests of the shareholders and other users of the firm's financial statements and the managers (Setyorini & Ishak, 2012). This theory follows the neo-classical economic theory. This means that it is based on the principle of self-interest commonly referred to as opportunistic behaviour which is the basis of all economic activity.

Positive accounting theory is associated with the contractual view of the firm. The firm in this theory consists of a nexus of contracts and accounting is the tool used to facilitate the formation and implementation of contracts. The accounting methods evolve overtime to mitigate contracting costs that are established by ex-ante agreements amongst the contracting entities. For instance, this theory advocates for conservatism in accounting which essentially requires a lower/higher standard of verification to recognise losses/gains (Deegan, 2007). The contracts include managerial compensation contracts and lender debt contracts. According to Setyorimi and Ishak (2012) in the absence of conservatism, the managers of the firm may formulate compensation packages that pay based on current reports but which may later be found to be unwarranted (Zakaria, 2011).

The accounting and management practices of the firm are thus attentive issues for all corporate stakeholders. The management utilises their judgment in financial reporting and formulating transactions that change financial reports that either give a wrong picture to stakeholders about the financial performance of the firm or to influence the contractual outcomes that depend on the financial reports (Yip, Cahan, & Van Staden, 2011). These actions decrease the quality of the financial statements. Profitability and firm value are directly related to the contracts and actions of managers. The managers manipulate the accounting disclosures to suit their needs.

5.2. Empirical Review

Uyar and Kilic (2012) conducted a study to investigate whether or not listed Turkish companies' voluntary disclosure practices are value-relevant in the capital market. The study sampled 129 manufacturing companies. The study collected data from the annual reports of the sample companies. The dependent variable in the study was the ratio of the market value to book value and the natural logarithm of market value to book value of equity six months after the year ended. The disclosures were collected using a disclosure checklist consisting of 96 items. The study established that the impact of disclosures on the firm value was determined by the amount of disclosure. The more the disclosures, the higher their impact on the firm's value. That study was conducted in Turkey, this study was conducted in the Kenyan context.

Lishenga and Mbaka (2015) conducted a study to evaluate the relationship between compliance with corporate governance disclosure code and firm performance in Kenya. The researchers developed the Kenya Corporate Governance Index (KCGI) which was computed from forty-five binary and objective questions all focusing on publicly available secondary data. Each positive answer in the study was awarded one point thus the final scores ranged from 0-45. The index was based on four dimensions of corporate governance quality namely disclosure; board composition and functioning; ethics and conflicts of interest; and shareholder rights. Firm performance was measured using simplified version of Tobin's Q (Market Equity / Book Equity), Return on Assets (Earnings before interest and taxes divided by book value of assets), and Return on Equity (ROE). That study established that there was a positive relationship between corporate governance practices and all the measures of firm performance. That study took a broad view of corporate governance. This study focused more on accounting disclosures so as to give definitive results.

Maghzom (2016) examined the value relevance of risk disclosures in Saudi listed banks. In the study, data was collected for the period 2009-2013. The disclosure information was collected by manual content analysis. Other data was collected from DataStream and Bloomberg. The study data was analyzed using Ordinary Least Squares (OLS) approach. In

the study risk disclosure of all the banks was measured using accounting policies, financial risks, derivatives hedging, general risk information, financial instruments, reserves, segment information, business risk, and compliance with regulations. The results of the study indicated that there was no association between the levels of voluntary risk disclosure and firm value which was measured using the market to book value at the end of the year (MTBV). The study also used the accounting based measure return on assets (ROA). That study found that the association between ROA and risk disclosure levels was positive and significant.

Nyamongo (2017) conducted a study to investigate the relationship between voluntary disclosure and value of listed insurance companies in Kenya. The study adopted a casual research design. Data was collected from the annual financial statements of the listed insurance companies. The dependent variable of the study firm value was measured using Tobin's Q. The independent variables of the study were investment policy, financial disclosure, non-financial disclosure, and governance disclosure. The disclosure information was collected using a disclosure index.The data was analysed using Analysis of Variance Approach (ANOVA). The study established that voluntary disclosure had a positive and statistically significant effect on the firm value of listed insurance companies in Kenya. These findings contradict those of M'ithiria, Musyoki, and Shawa (2017). The contradictions in findings could be attributed to the different methodologies used. This study aimed to fill the research gap left by that study by examining the effect of accounting disclosure on firm value of listed commercial banks in Kenya.

M'ithiria, Musyoki, and Shawa (2017) conducted a study to evaluate the relationship between firm value and disclosure practices of firms listed at the Nairobi Securities Exchange. The study sampled 39 of the 61 firms listed on the NSE during the period 2003-2013. The study collected two types of data, financial data and disclosure practices data. The financial data collected included data that was used to compute firm value, firm size, risk, growth prospects and leverage. The disclosure information consisted of governance variables that included the degree of transparency in the annual reports issued to stakeholders, and the quality of data presented. The dependent variable of the study firm value was measured using Tobin's Q. The study constructed a disclosure index. The study established that there was a negative relationship and significant relationship between disclosure practices at the upper quartiles of the firm value distribution. That study is relevant to this study as it provides the framework for measurement of disclosures. However, that study has various research gaps as the disclosures taken into consideration were few. This study included a wide range of accounting disclosures.

6. **Research Method**

The research design is the methodology used to show how the objectives of the study were fulfilled (Sekaran, 2010). The study adopted the causal research design which is similar to the approach used by Oso and Onen (2009) and Nyamongo (2017). This research design was thought to be suitable for the study as the study intends to establish if alterations in the independent variables cause changes in the dependent variables. In this case whether a change in accounting disclosures led to changes in the firm value of commercial banks listed on the Nairobi Securities Exchange (NSE). In this study, the target population are the commercial banks listed on the Nairobi Securities Exchange. These commercial banks are listed in Table 3.1.were Barclays Bank, Stanbic Holdings Plc, I& M Holdings, Diamond Trust Bank Kenya, HF Group Limited, National Bank of Kenya Ltd, NIC Group Plc, Standard Chartered Bank Ltd,Equity Group, Cooperative Bank, and KCB Group.

The study was collect data from the audited annual financial reports for the eleven commercial banks listed on the NSE. The study collected cross-sectional data from the individual banks. Additionally, the study collected time series data covering the period 2010-2017. The data was collected from the websites of the individual banks. In the study firm value was measured using Tobin's Q. This measure was chosen after an extensive review of literature (Henry, 2008; Ficici & Aybar, 2012; Ammann, Oesch & Schmid, 2011; Krafft, Qu, Quatraro, & Ravix, 2013). Tobin's Q will be calculated as follows:

$$\frac{Market\ Value\ of\ Equity}{Book\ Value\ of\ Equity}$$

Following the model developed by Arvidsson (2003) and used by Hassan (2009), Hassan, Romilly, Giorgioni, and Power (2009), Aras, Arbars, and Kutlu (2010), Nekhili, Boubaker, and Lakhal (2012), Abdullah and Hassan (2013), Al-Shammari (2014), and Nekhili, Hussain, Chefti and Tchuigoua (2015), an accounting disclosure index, which is a checklist of different disclosure indicators included in the annual reports of the listed commercial banks was developed. The accounting disclosure index has a total of 25 items that the according to literature are published in the annual reports of commercial banks. The items are divided into four categories: accounting policies, risk information, hedging strategies, and reserves. The researcher used an un-weighted disclosure index. Research in the field of accounting uses both weighted (some items are given more importance than others) and un-weighted. The un-weighted index is used as the findings of this study will not be targeted or focused at a specific group of users (Nekhili, Boubaker & Lakhal, 2012). The study addresses all the users of the financial reports. The contents present in each of the financial reports of the listed commercial banks in Kenya were compared to the items listed in Appendix I. A dichotomous model was coded as 1 if the item is disclosed or 0 otherwise (Hassan, 2009; Hassan, Romilly, Giorgioni, & Power, 2009; Aras, Arbars, &Kutlu, 2010; Nekhili, Boubaker,&Lakhal, 2012; Abdullah &Hassan, 2013; Al-Shammari, 2014; Nekhili, Hussain, Chefti & Tchuigoua, 2015). The total score is given as

$$TD = \sum_{i=1}^{n} d_i$$

Where d=1 if the item is disclosed; d=0 if the item is not disclosed; n= number of items,

The total score for each bank is 25. The component of the total score is given in Table 1

Disclosure	Number of Items
Accounting Policies	10
Risks	7
Hedging Strategies	5
Reserves	3
Total	**25**

Table 1: Disclosure Index
Source: Researcher (2018)

The study provided descriptive statistics of the study data. The descriptions were presented in form of percentages, means, sums, and standard deviations. The effect of accounting disclosures on the firm value of listed commercial banks in Kenya was determined by the use of a multivariate regression model. The study utilized the regression model used by Al-Maghzom (2016)

$$FV = \beta_0 + \beta_1 AP_1 + RS_2 X_2 + HS_3 X_3 + RE_4 X_4 + \varepsilon \ldots\ldots 1$$

Where FV is the firm value, β_0 is the intercept, $\beta_1 - \beta_4$ are the regression coefficients, AP_1 denotes Accounting Policy Disclosures, RS_2 denotes Risk Information Disclosures, HS_3 denotes Hedging Strategies Disclosures, RE_4 denotes Reserves Disclosures

7. Study Findings

Using Firm value as the dependent value, the study set to determine the relationship between accounting policy, risk, hedging strategies, and reserve. The regression was conducted using FGLS approach. The findings are summarised in Table 2.

FV	Coef.	Std. Err.	z	P>|z|
AP	0.006	1.033	0.620	0.037
RS	0.001	1.649	0.570	0.007
HS	0.003	2.089	1.210	0.000
RE	0.001	1.481	0.680	0.005
Constant	1.529	0.645	2.370	0.018

Table 2: FGLS Results
Source: Study Data (2019)

The findings summarised in Table 2 indicate that accounting policies have a positive and statistically significant effect on firm value as implied by β= 0.006 and p-value 0.037. The findings indicate that a unit increase in accounting policy will result in a 0.006 unit increase in the firm value. These findings confirm the findings of Uyar and Kilic (2012) and Lishenga and Mbuka (2015). The researchers established that accounting policy disclosures have a positive and statistically significant effect on performance. However, the extent of the impact was greater in the study by Uyar and Kilic (2012), and Lishenga and Mbuka (2015).

The results indicate that risk has a positive and statistically significant effect on firm value. The findings indicate that a unit increase in risk disclosure will result in a 0.001 unit increase in the firm value of listed commercial banks in Kenya. These findings contradict the findings of Maghzou (2016) who established that there was no relationship between risk disclosure and firm value of listed commercial banks in Saudi Arabia. According to the Maghzou (2016), there was deep-rooted secrecy amongst Saudi Arabian firms. Hence, the theoretical underpinnings put forward in corporate finance theory with regard to disclosure and performance was violated.

The coefficient for hedging strategies was established to be 0.003 with p-value 0.000. This implies that an increase in use of hedging strategies will result in a 0.003 unit increase in firm value. The findings summarised in Table 1 indicate that reserves has a positive and statistically significant effect on firm performance as implied by β = 0.001 and p-value 0.005. The findings suggest that a unit increase in reporting on reserves will result in a 0.001 unit increase in firm value. These findings confirm the findings of Nyamongo (2017) that there is a positive association between hedging strategy disclosures and firm value. The hedging strategies indicate low levels of volatility. These suggest less information asymmetries reduces the chances in volatility and risks to firms' earnings. The findings summarised in Table 2 imply that equation 1 can be written as

$$FV = 1.529 + 0.006 AP_1 + 0.001 X_2 + 0.003 X_3 + 0.001 X_4 \ldots\ldots 2$$

8. Conclusions

The study established that accounting disclosures have a positive and statistically significant effect on firm value. The study concludes that the communication decisions of the firm have an effect of influencing investors' expectations which ultimately results in the improvement of the market value of the firm. Of the four accounting standards evaluated, the study found that the largest effect was due to the accounting policy. The study concludes that the most important disclosure for investors is the accounting policies being used by the firm.

The study established that risk disclosures have a positive and statistically significant effect on firm value. These findings led the researcher to conclude that risk and risk management strategies are relevant to the investors. Risk information minimises the risk of adverse selection perceived by investors.

The study established that there is a positive and statistically significant relationship between the hedging strategies and firm performance of listed commercial banks in Kenya. These findings are similar to previous studies that found that there is a positive association between hedging strategies disclosures and firm value. The study thus concludes that the disclosure of hedging strategies is significant to the market participants at the NSE, investors place premium on hedging disclosures.

9. Recommendations

The findings of the study show that there is a positive and significant relationship between the level of disclosure and the value of the firm. The study recommends that the Nairobi Securities Exchange should enhance and ensure adequate compliance with accounting disclosure requirements as this improves the performance of the firm. Secondly, the study recommends that the government should regulate listed commercial banks through disclosures in order to increase the amount of information available. The findings suggest that the higher the number of disclosures the better the firm performance. This might help to reduce the number of commercial banks in Kenya that experience financial distress or require statutory management.

10. Suggestions for Future Studies

A study should be done to compare the relationship between financial disclosure and performance of all the commercial banks in Kenya. Additionally, future studies should be expanded to include firms in other countries. This will expand the knowledge base and allow for comparison.

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