EFFECT OF VOLUNTARY DISCLOSURE ON COST OF EQUITY CAPITAL OF COMPANIES QUOTED AT NAIROBI SECURITIES EXCHANGE IN KENYA

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DECLARATION

I declare that this research proposal is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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I do hereby confirm that I have examined the master's proposal of

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ABSTRACT

Over the years there has been an increased trend towards application of corporate governance practice all over the world following major corporate scandals. The role of corporate disclosure practice has been of growing interest prompting for re-examination and scrutiny of policy on voluntary information disclosure. The objective of this is to determine the effect of voluntary disclosure on the Cost of Equity Capital of companies quoted at the Nairobi Securities Exchange. To achieve this, the study sought to examine the effect of forward-looking information, Corporate Social Responsibility information and Corporate Strategic information on the Cost of Equity Capital. The study was based on agency theory, capital need theory, signaling theory and stakeholder's theory. Descriptive research design was applied to attain the objectives of the study. The target population was companies currently listed in Nairobi Securities Exchange, however purposive sampling was used to select 20 companies from the NSE 20 share index.NSE is subdivided into 11 different sectors. Secondary data applied in the study was extracted from NSE handbooks, Capital Market Authority, annual reports and accounts of firms listed at NSE from a period of 5 years from 2012 to 2016. Data was analyzed using STATA. Results of the study indicated a positively insignificant relationship between voluntary disclosure of forward-looking, corporate social responsibility and strategic disclosure on the cost of equity capital. Additionally voluntary disclosure explained 9.28% on the variation in the cost of equity capital.

Keywords: Forward-Looking disclosure, Corporate Social Responsibility disclosure,

Strategic disclosure, Cost of Equity Capital.

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DEDICATION

This project is dedicated to my dear family for their love, encouragement and invaluable support.

May God bless you abundantly.

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LIST OF ABBREVIATIONS AND ACRONYMS

AIMS Alternative Investment Markets Segment

CEO Chief Executive Officer

CMA Capital Market Authority

COEC Cost of Equity Capital

CAPM Capital Asset Pricing Model

CSR Corporate Social Responsibility

DCI Disclosure Check Index

FISMS Fixed Income Securities Market Segment

FL Forward-Looking

IFRS International Financial Reporting Standards

ISA International Standards on Auditing

MIMS Main Investment Market Segment

NSE Nairobi Securities Exchange

OLS Ordinary Least Square

VIF Variance inflation factor

DEFINATION OF TERMS

Cost of Equity Capital: This is the return received by an investor expects from and investment in a business, it represent what the market expects as the compensations amount in exchange for owing stocks of a company (Beneda, 2003).

Forward-Looking Disclosure: Refers to information relating to both the current and future forecast and plans of a company to allow investors and stakeholders evaluate company's future performance (Hussainey, 2004).

Corporate Social Responsibility: Refers to the initiatives taken by an organization on the effects the organization has in the society it operates in (Carroll, 1999).

Strategic Disclosure: Refers to information outlining activities of a company in regards to vision and mission of the company, organization structure, company policies and procedures, description of the key business and marketing networks (Thompson and Strickland, 2003).

Corporate Governance: refers to structures, systems, processes, rules and procedures through which organizations are controlled and directed (Centre for corporate governance, 2015).

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Demand for information disclosure has been spurred by information asymmetry and agency conflict between management and external investors. Good corporate structure and principles are the foundation upon which trust of stakeholders is built. It is a philosophy and mechanism that involves putting in place better structures and processes upon which the affairs of a company are directed and managed to enhance long term shareholders value through transparency and accountability. Business operations and environment are changing fast, for example rapid technological changes, calling for regular review to the content and nature of reporting. Boesso and Kumar (2007) argued that inadequacy of traditional financial reporting has led investors and shareholders demand for additional information disclosure. Previous empirical studies on the relationship between cost of equity capital and voluntary disclosure have documented confusing results, study by Botosan and Plumlee (2000) found a positive relationship exists between voluntary disclosure and the cost of equity capital while the study by Gietzmann and Ireland (2005) found a negative association between voluntary disclosure and the cost of equity capital. Increased application of corporate governance all over the world has risen after major corporate scandals due to lack or improper corporate disclosure, this has resulted to investors and lenders lose confidence in the traditional financial reporting.

Adequate information disclosure creates transparency and sustains investors' confidence, stakeholders and the wider society. It also provides an opportunity for continuous improvement of business structure and processes. Inadequacy of traditional financial reporting has called for re-examination and scrutiny of the existing corporate disclosure thus spurring the need for expanding the existing disclosure policy. Being one key pillar of corporate governance, voluntary disclosure is considered as an external mechanism for

management control, tool for protecting shareholders and a tool for minimizing the agency costs resulting from information asymmetry between the management and shareholders. Botosan (2002) observed that those firms which disclose additional information in their annual reports enjoy the benefit of reduced cost of capital. The current growing wave towards increased corporate disclosure will transform the nature and content of annual reports.

Although the purpose of disclosure is to provide more and sufficient information to the various stakeholders, managers may choose not to disclose certain information in orders to protect firm's competitive advantage Kavitha and Nandagopal, (2011). Previous studies have revealed that public firms are careful about disclosing information that might lead to competitive disadvantages, example, information about technological innovations, strategic and specific operation data. The decision on the optimal level of disclosure is thus affected by the interplay between the costs and the benefits of disclosure.

1.2 Voluntary Disclosure

Elements of voluntary disclosure will be classified into three categories of information disclosure as forward-looking, corporate social responsibility and corporate strategic. Voluntary disclosure is regarded as an important economic tool that aids conveying information relating to firm performance to diverse market players in an industry with an aim of providing clear view about business's long term sustainability. Information disclosure conveys company's information to the owners, stakeholders and general public about the quality and value of the company Hamrouni et al., (2015). Voluntary disclosure is categorized into two, mandatory disclosure and voluntary disclosure covering all types of information, both of financial and non-financial in nature**.** Laws, regulations and accounting standards stipulate mandatory information disclosure whereas voluntary disclosure is the information reported beyond the statutory requirements. Voluntary disclosure is the free

option on the part of the company management to present financial and other and other non-financial information deemed pertinent to the decision making needs of annual reports users.

The extent and type of voluntary disclosure is dependent on the industry, size, governance structure, ownership structure and geographic region. Boesso and Kumar (2007) stated that one of the determinants that led to emergence of voluntary disclosure is financial reporting inadequacy as claimed by shareholders and investors. Investor's increased demand for openness and disclosure of information involving performance and strategies. Organizations gains some benefit by virtue of disclosing sustainably over and above the statutory required information. Li and McConomy established that firms with better financial conditions are likely to voluntary adopt the new International Financial Reporting Standards (IRFS) on environmental disclosure, hence become more profitable eventually reducing the cost of compliance. Spanheimer and Koch (2000) noted the primary motive for adopting informative accounting as the access to global funding, worldwide comparability of financial statements, increased transparency and pressure from capital markets. Companies which provide additional information disclosure minimizes the occurrence of information asymmetry between investors and manager. The benefits of disclosure are for example, increased share price will lower cost of capital resulting from a firm's full disclosure Nayak, (2012). Investors and creditors are better informed with a high level of disclosure making them understand the economic risk of the investment. Disclosure is generally done in the company annual report either through the statements or notes accompanying the statements.

Forward-looking information represents one form of corporate disclosure. It provides a confidence signaling power to the stakeholder in the management capability to foresee the future prospects of the business. According to Celik et al. (2006) forward-looking information assists to predict future of a company regarding the performance and strength of management. Management credibility is gained by accurately predicting company future

forecast over and over. Even though the shareholders frequently question the management about the future of the company, management cannot foretell what is going to happen but they observe market trends eventually present to shareholder explanations about company's future prospects. Those Companies that wish to access external sources of finance tend to voluntary disclose more information on forward-looking to enable them gain shareholders and investors confidence.

Corporate Social Responsibility (CSR) refers to the way companies integrates its social, environmental and economical activities into their value, culture, operations and strategies. Carroll, (1999) noted CSR as an evolving concept. Centre for corporate governance (2005) issued guidelines which encouraged companies to disclose information on CSR, ownership structure and board size (Barako, 2000). CSR efforts translate into improvements of firms' financial performance. Corporate social reporting disclosure enhances company reputation by gaining trust and support from the stakeholders. Additionally it helps assess congruence between the social value and social norms. CSR enables firms to access huge sum of finance that might be difficult to obtain.

In corporate practice, strategic information disclosure is a preference that enables a company to be conspicuous from other firms in the same industry, at the same time it helps stakeholders to monitor and evaluate company's performance Santema et.al.2005; Hermanlin and Weisbach,2012. Strategic information disclosed relate to firm's current business strategies, their effects and how its competitive advantage is achieved. Strategic information disclosure is mutually exclusive and subjective in nature. It takes into account both global business environment and global trends. It involves making and implementing decisions which have long-term impact on a company with an aim of achieving business success. Strategic information constitutes a key component of relating historical information to the prospective cashflow forecast. It disclose the interconnectivity between company strategy and

its capital revealing how they were to create value in short term, medium term as well as long term. Effective strategic information should be clear and focused. Benefits of corporate strategic information disclosure includes reduced cost of external financing, improved decision making and acts as a control against management exercising their personal interest Armstrong, Guay and Weber 2010.

1.3 Cost of Equity Capital

Cost of equity capital is a key and significant element of decision making. It is important to manage cost of equity capital and its costs effectively. Both internal and external factors influence the cost of equity capital and other corporate financial performance. A company manipulates cost of equity capital by adjusting its internal factors, it cannot influence external factors such as inflation rate, interest rates etc. Cost of equity is what an investor expects to receive from his investment in a business. It represent compensation amount expected from the market in exchange for owing stocks of a company, it consist of dividends and capital gains. From an investor's perspective, cost of equity capital is the return an investor expects for a share of stock he keeps in his portfolio. The required rate of return by investors is influenced by factors such as the size and risk growth. When making decisions which affect the firm, Cost of equity plays a crucial role because it affects the discount rate at which expected future cashflows are evaluated. In achieving an effective strategic decision making and performance evaluation, the cost of equity should be estimated with accuracy.

According to Beneda (2003) the cost of equity is a vital base of comparing investment opportunities. Investors use the concept of cost of equity as an investment opportunity in a company. Cost of equity is one of the methods used to evaluate investment decisions, example capital budgeting analysis, choice of capital structure and firm valuation. Large firms are associated with low cost of capital when compared with the small firms since they are in a better position to raise funds from

external sources on favorable terms. Equity capital plays a fundamental role in the development of a firm due to its advantages when compared to other financing forms. The cost of equity capital is an important component with significant input in calculating the cost of capital Cotner and Fletcher (2000). It is detrimental to apply less appropriate model to estimate cost of capital, this can result to either underestimation or overestimation. Underestimation may result in value destructive investments while overestimation may lead to rejection of promising investment opportunities.

The cost of equity capital is a key indicator of operations in the financial markets and is used by managers and financial resource providers. Clear financial statements reduce uncertainties associated with shareholders' equity leading to decrease in the cost of equity while incomplete and unclear financial statements increases uncertainty hence causing information risk to shareholders who hence demand higher return. The cost of equity capital is of importance in two folds: securities valuation models are based on the cost of equity capital and without cost of equity capital it is impractible to invest company money as it is difficult to determine capital structure hence unable to determine investment priority Ahmend, (2007). Managers being agents of the shareholders try to minimize the cost of equity hence maximizing shareholders wealth at the same time improving the value of the company. In most financial decisions, cost of equity is an effective determinant factor. Cost of equity is used in capital budgeting decisions, setting optimal structure and working capital management.

Implementing corporate governance practice, the high cost of equity capital problem is overcome. The higher the level of voluntary disclosure the lower the investor uncertainty, with low dividend stream would decrease the cost of equity capital because of reduced risk premium expected by the investors. Low risk premium demanded by investors translate into a lower cost of equity capital of firms. Voluntary disclosure reduces the cost of equity capital in

two ways which are based on better stock market liquidity and on reduced non diversification of estimated risk. Increased voluntary disclosure minimizes investors uncertainty hence attracting long term investments. Determinants of the cost of equity capital can be categorized into two: variables measured on accounting information only (accounting based) and variables measured on relations between market data and accounting data (market based).Investors use earning information to calculate the level of the cost of equity capital. The cost of equity for a firm is computed by adding up the risk free rate and premium for exposure to systematic risk.

1.4 Nairobi Securities Exchange

The Nairobi Securities Exchange offers a trading platform for both the local and international investors looking to gain exposure to Kenya and Africa's economic growth. NSE plays a critical role in growth of Kenyan economy by encouraging investment and saving by serving both the local and international companies' access cost-effective capital. NSE is regulated by the Capital Markets Authority of Kenya. CMA approves public listing and at the same time fostering investor's confidence ensuring compliance of trading rules, regulations and requirements with market integrity is sustained in order to guarantee orderly, fair and efficient markets (CMA, 2016). CMA retains investor's confidence by ensuring rules, regulations and requirements for trade are complied with and market integrity is maintained. CMA also plays an important responsibility of mobilization and distribution of capital resources in the economy to provide incentives for long term investment (NSE, 2016)

In Kenya, listed firms are supposed to produce quarterly, half yearly and audited annual reports. Financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) and audited with guidance of International Standards on Auditing (ISA). The performance of the NSE is an indication as to whether the investors

have trust in the safety of their investment, trading goes down significantly with low investor's confidence.

NSE is categorized into three different market segments namely the Main Investment Market (MIMS) the Alternative Investment Markets (AIMS) and the Fixed Income Securities Market Segment (FISMS).According to Capital Market Authority (2017) as at December 2017, listed companies at the NSE were 64, categorized into 11 sector namely Agricultural sector, Automobiles and Accessories sector, Banking sector, Commercial and Service sector, Construction and Allied sector Energy and Petroleum sector, Insurance sector, Investment sector Manufacturing and Allied sector, Telecommunication and Technology sector lastly the Growth and Enterprise Market Segment sector. Banking sector is the largest sector represented with 18% of the total firms listed at the NSE, second is commercial and Services sector and Manufacturing and Allied with 15% each, Agricultural sector which is one of the country major economic sector is represented by 11% of the total firms quoted. Telecommunication and Technology and Growth and Enterprises Market sectors were the lowest each with 2% of the total firm's quoted. Through NSE, disclosures have had an impact on how investors trade, when the level of disclosure is high, investors confidence increases hence higher level of trading. The CMA guideline encourages firms to disclose more information directors and management remuneration (CMA, 2016).

1.5 Statement of the Problem

Inherent shortcomings of traditional financial reporting have prompted development of voluntary disclosure models. Voluntary information disclosure creates transparency which sustains confidence of investors, stakeholders and the wider society on how best management is performing. Corporate governance is currently an area broadly being researched on by many scholars, this is due to the significance of corporate disclosure and increased application of corporate governance practices all over the world. This study targets one pillar

of corporate governance, namely voluntary disclosure. Disclosed information provides a signal with an aim of revealing the state of a company to the investors for consideration in investment activities. Information plays an important and vital role in reporting. Disclosed information should be understandable, complete, accurate, timely and reliable (Fahdiansyah, 2013). Information is useful if it is relevant and is considered by stakeholder in decision making and at the same time gives confidence to investors.

Annual reports are important tools in communicating essential information about a company's both financial and non-financial information (Barako, 2007).The key drivers of corporate value in critical areas of the business are not reported under the traditional accounting model, as such theorist and researchers have begun to develop models for additional voluntary information disclosure. The concept of voluntary disclosure has been of growing interest given the needs to keep with the clients expectations. Investors and clients have challenged management on the need to provide more than what is required by the law and regulations. In Kenya, investors get essential information regarding trading activities of listed firms through annual reports and bulleting from CMA.

Study done by Lopes and Alencar (2008) investigated the relation between disclosure and cost of capital, researcher found that the increased levels of disclosure results in lower cost of capital for firms with inferior growth opportunities while firms with superior growth opportunities adopts better voluntary disclosure practice. Botosan and Plumlee (2002) investigated the relationship between the cost of capital and annual report disclosure, timely disclosure and investor's relation disclosure and found a negative relation to annual report disclosure, positive associated with timely disclosure and no relation with investor relations disclosure. Richard and welker (2001) showed a negative relationship between voluntary disclosures and cost of equity capital using direct approach. However these studies were done in developed economies with limited studies done in the context of developing countries

these studies tested the relationship between voluntary disclosure and several aspects for example profitability and stock liquidity

Studies done in Kenyan context include study by Mwangi and Mwiti (2015) investigating the impact of voluntary disclosure on stock performance, found a positive relationship between voluntary disclosure and market stock performance, exchange rate, interest rate and rate of inflation. Mutiva (2015) examined the effect of voluntary disclosures on financial performance of firms quoted at NSE and found mixed and conflicting results, Lopokoiyit (2012) investigated the effect of the corporate governance practices on share prices of firms quoted at NSE, the study established a direct relationship between voluntary disclosure and company performance. A study Asava (2012) investigated the effect of voluntary disclosure on stock returns of listed companies, her study reveals that there was no correlation between voluntary disclosure and stock returns. Barako (2007) in his study of determinants of voluntary disclosure in Kenyan listed company's annual reports observed that the level of disclosure is significantly affected by board disclosure, foreign ownership and firm size.

However previous literature conducted globally and locally lean more on factors that influence the extent of voluntary disclosure with few on the effect of voluntary disclosure on the cost of equity capital, motivation for this research was developed by the fact that majority of past research have given conflicting arguments creating a dilemma that necessitates further research on the effect of voluntary disclosure on the cost equity capital of firms in Kenya. Therefore the study intends to establish whether voluntary disclosure has any effect on the cost of equity for firms quoted at NSE.

1.6 Objectives of the study

The general objective of this study was to examine the effect of voluntary disclosure on the cost of equity capital of firms listed at NSE. The specific objectives of the research study were:

i). To establish the effect of voluntary disclosure of forward-looking information on the cost equity capital of firms listed in NSE.

ii). To determine the effect of voluntary disclosure of corporate social responsibility information on the cost of equity capital of firms listed in NSE.

iii). To determine the effect of voluntary disclosure of strategic information on the cost of equity capital of firms listed in NSE.

1.7 Hypothesis of the study

This study was guided by the following hypothesis.

Ho_1 : Forward-looking information disclosure has no significant effect on the cost of equity capital of firms listed in NSE.

Ho_2: Corporate social responsibility information disclosure has no significant effect on the cost of equity capital of firms listed in NSE.

Ho_3: Strategic information disclosure has no significant effect on the cost of equity capital of firms listed in NSE.

1.8 Significance of the study

Voluntary disclosures provide a further way for investors to evaluate a firm's performance. The study is aimed to facilitate the investor to make superior investment decisions and better capital allocations. It will also emphasize on amplified transparency which reduces information asymmetry that may exist between the investors and the management team. This study will extend literature on voluntary disclosure to academicians. The study will also help

listed and unlisted companies in Kenya in understanding the role of voluntary disclosure in the management of their firms with aim to reduce cost of its equity capital.

1.9 Scope of the study

This study was carried on NSE 20 share index listed firms at the NSE. Data was analyzed for a period of 5 years from 2012 to 2016. In addition of three disclosure concepts were considered that is forward-looking disclosure, corporate social disclosure and strategic disclosure.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter introduces theories that explain the subject of voluntary disclosure and past empirical studies relating to the variables under the study.

2.2 Theoretical Review

Both reporting and disclosure are important tool used by companies to communicate with interest-related parties. Several theories have been documented to relate to voluntary disclosure. They are Agency theory, Capital Need theory, Signaling theory and Stakeholder theory. Literature review presents theories about the subject of voluntary disclosure.

2.2.1 Agency Theory

Agency theory was developed by Jensen and Meckling in 1976 who defined agency relationship as an agreement in which one or more persons delegate decision making authority to another person to perform some services on their behalf. Agency theory explores the relationship between principal and an agent. In the context of a company, the manager or the agent acts on behalf of the shareholder or the principal. Company owners empower managers to make decisions on their behalf. Shareholders do not actively participate in the management of their investments instead they engage managers to act on their behalf. This makes managers have information advantage hence creating incentive to maximize their own value as opposed to that of the shareholders. Scott (2012) stated that the application of agency theory is used to explain the conflict of interest between managers and investors. The agency dilemma arises due to interest conflict between the investors and management because their goals are not in agreement.

Agency theory is apprehensive with solving problems arising in the agency relationship: agency shareholder or the principal and those of the manager or the agent making it difficult for the principal to correctly assess and determine the value of decision made by the agent. Secondly, problem of risk sharing arising from diverse attitude of the principal and the agent towards risk, the problem is each tends to select a different action when the risk happens (Depoers, 2000).One way in which agency problem can be minimized is by means of contract, it helps in investors' interest in line with interest of the manager (Healy and Palepu, 2001). These agreements entail management to reveal relevant information to investors and other creditors. Accordingly the principal can confirm in the management complied with the contract agreement and asses if decisions are in line with their interest, monitoring managers by mean of contract comes with a cost at the expense of manager's compensation and in order to reduce any potential conflict, principals incur monitoring costs while agents incur bonding costs which guarantees the interest of the principal is prioritized. Agency costs are the total sum of monitoring costs, residual loss and bonding costs.

According to agency theory, disclosing information voluntary is viewed as a better mechanism of mitigating the agency problem between the agents and principals (Hawashe, 2014). Managers who posses private information concerning a firm are able to us information they posses to make plausible and reliable communication to interested parties to optimize the value of the firm (Barako, 2007), these disclosure may include investment opportunity and financing policy of a company, however managers who pursue their own interest may fail to make proper information disclosure. Managers increases the level of voluntary information which is expected to reduce the agency cost (Barako et al., 2006) and also to persuade the external users that the management are acting in best possible way (Watson et al., 2002).OCED (2004) states that a strong disclosure policy is one of the expected

monitoring forms that is useful as a basis of adequate information for investment decision making by investors.

2.2.2Capital Need Theory

The main aim of any company is to attract external finance to increase capital through either debt or equity, however companies are disclosing more information voluntary as a measures of minimizing costs of raising its capital. The capital need theory can aid in explaining the reason behind of voluntary information disclosure made by firms. Healy and Palepu (2001) pointed out that managers are motivated to disclosure more by decreasing information asymmetry predicament and eventually minimizing the cost of external financing. The capital need theory predicts that with increased voluntary disclosure investors' uncertainty is minimized which results in lowering company's cost of capital (Schuster and O'Connell, 2006). The theory suggests that voluntary disclosure help in achieving needs of a company to raise capital at a lower cost (Choi, 1973). This theory implies that company's managers are motivated to disclose more information to enable company raise capital on most favorable terms (Gray at al., 1995).

According to Botosan (1997) market liquidity is strengthened through increased information disclosure which decreases cost of equity capital either through reduced transactions cost or increased demand for company's share. To assist investors in share trading activities and in decreasing uncertainty surrounding firms' future performance it is highly preferred to disclosure more information (Hassan et al., 2011). According to capital need theory disclosing more information in annual reports attracts new investors who increases demand for company's shares. The higher the level of disclosure the higher is the share price. Voluntary information leads to improved decision making on capital allocation and better return assessment from firm's share. Comparing firms with higher growth opportunities with firms with lower growth opportunity, lager firm disclose more voluntarily.

Firms with higher growth opportunities are usually in need of external financial sourcing consequently their need to provide more voluntary disclosure is greater.

Study by Soltani (2000) noted that voluntary disclosure yield three types of effects in the capital markets namely improved share liquidity in the stock market, decreased cost of capital and finally additional financial analysts. Disclosure of company's information to the markets enables shareholders to accurately evaluate their investments opportunity thereby making correct investments decision. According to this theory greater disclosure in annual report reduces information asymmetry which exists between managers and shareholders, for a disclosing company, stock liquidity is improved at the same time lowering the cost of raising finance in the market.

Firm management always attempts to take on voluntary disclosure levels as similar firms in the industry. If it doesn't, the investors may interpret that the firm is trouncing news (Victoria et al., 2009). The capital needs theory predicts, increase in voluntary information disclosure by company's management will enable them to minimize the company's cost of capital through reduced shareholders uncertainty (Schuster and O'Connell, 2006).

2.2.3 Signaling Theory

According to Khlifi and Bouri, (2010) voluntary disclosure in annual reports is used by managers to send a specific signal to market participants. Signaling theory is a channel of communicating positive information about good managerial attributes (Connelly et al., 2014). According to Spence, (1973), signaling theory was developed to illuminate information asymmetry in the labour markets, it serve the purpose of informing investors and analyst about firms value, trustworthiness and quality. Information disclosure is considered as a useful signal to the market aimed at reducing information asymmetry that exists between investors and manager at the same time increasing firm's value (Alvarez et al., 2008). Companies will send certain information to shareholders showing that they are better than

similar companies in the market for the purposes of attracting new investment and at the same time enhancing favorable reputation.

It is perceived that those firms that perform better than other in the markets will provide a ‘signal’ to catch investors attention to distinguish themselves from others firms in the market. Ross (1997) asserts that managers prefer to disclose additional information to signal that they have better investment opportunities. Cai et al., (2007) stated that manager of higher quality firms adopt segment reporting in order to disclose risk return information of its activities while the managers of lower quality firms would not. On the other hand managers of high quality companies closes asymmetric information gap by using valuable quality signals but managers of less quality firms are not capable of mimicking. Additionally managers releases both financial and non-financial information signaling that their performance is most favorable for the stakeholders (Akhtaruddin and Hossian, 2008). Consequently firm’s management will have more incentive to disclosure positive and distinguishing qualities in order to maximize their own self-interest (Campbel et al., 2001).

In markets with information asymmetry, signaling is commonly used to reduce information asymmetry by the party with more information to other interested parties. Additionally a successful quality signal must provide a unique, testable and practical perspective under imperfect market condition. This confirms the true quality of a company. Signaling is acknowledged as a feasible strategy when the benefits from signaling outweigh benefits from other strategy for high quality company while for lower-quality company non-signaling strategy supplies greater payoff than signaling (Kimani and Rao, 2000).

Information disclosure falls between non disclosure and full disclosure, disclosure is used as a signal of improving a company reputation, attracting new investors and lowering costs of capita. Voluntary information discourse in annual reports acts a means of providing a ‘signal’ about firms’ performance that they are better (Campbell et al.,2001). Management of

high quality firms can distinguish themselves from lower quality firms via voluntary disclosure, similarly manager of an underperforming firm may disclose extra information to signal steps the firm is taking to improve on its performance. In same sense, signaling theory conceives voluntary information disclosure as a signaling mechanism by management to distinguish themselves from other mangers on achievements.

2.2.4 Stakeholders Theory

Relationships between a company and its stakeholders are critical sources of wealth. The ability to establish and maintain such relationship determines company's success and in helping it to survive (Post et al., 2002). Stakeholders' theory expands the spectrum of interested parties. The theory looks at how managers strike a balance between the interests of diverse stakeholders in order to ensure each constituency receives some degree of satisfaction. It has been recognized that companies exists within a society which means they are no longer instruments of shareholders alone, this makes them responsible to that same society. Accountability is required on the activities of a company which impacts on the environment. Jenson (2001) critique of the stakeholders theory, in his argument suggested that performance of a firm should be measured using the flow of information from management to lower ranks, interpersonal relation, working environment in addition consideration should also be on the gains to its stakeholders.

According to Branco and Rodrigues, (2006) good relationship between management and stakeholder, valuable company reputation is generated which is enabled by improving the level and quality of disclosure to stakeholders. There is a association between the power of any stakeholder group and the importance to the on-going success of an organization (Deegan, 2006). A company is regarded as part of the wider social system within which it operates and to be positively accountable to various stakeholders group for its strategic perspective (An et al., 2011). Stakeholder's looks at how management works towards

creating value and their responsibility in satisfying the interest of the company's stakeholders. Stakeholder's theory points outs parties with competing interest in the operations of the firm.

Survival of any company depends on trust built on the relationship between a management and stakeholders. This can be achieved through improved and effective information disclosure (Svendsen et al., 2001). According to Gray and Owen (1987), stakeholder's exercises a substantial amount of control over organizations resources by making managers obliged to supply them with the required information that may help them in decision making. Guthrie et al (2006) stated that management is presumed to undertake activities deemed necessary by their stakeholder and gives feedback on those activities to the stakeholders. Companies provide disclosure voluntary to satisfy various stakeholders' interests. Company expects good stakeholder's relation to be beneficial in developing its reputation by differentiating it from competitors (Gray and Bebbington, 2001). Among the economics objectives of any organization is to maximize stakeholder's value which is achieved through efficient operational process. For any company to continue operate in its optimal operational capacity, support of stakeholder's is crucial. Existence of any company is threatened by withdrawal of stakeholders. For this reason management should choose to disclose information voluntary which enables stakeholder to make better informed investment, financial and social responsibility decisions.

2.3Empirical Review

This section reviews the literature related to the specific objectives that a firm need to voluntarily disclosure, namely forward-looking information disclosure, corporate social responsibility information disclosure and strategic information discourse.

2.3.1Forward-Looking Information Disclosure and the Cost of Equity Capital

Study by Kristandl and Bontis (2007 investigated the relationship between the cost of equity and forward-looking disclosure, historical disclosure and investor's relations disclosure. The study was done using OLS regression on a sample of 95 listed companies from Austria, Germany, Sweden and Denmark, they found there is a negative relationship between the level of forward-looking information and the cost of equity capital.

A study by Beattie et al. (2004) examined voluntary narrative section of 1999 annual reports of 11 UK firms active in the food industry found that of all text units 13% has a forward-looking time orientation and most forward-looking information is about activities and plans on how to meet broad objectives and business strategies. Li, 2010, assessed the content of 30,000forward looking sentences across 12 content categories. Most of them contain information about operations, productions and general business. Additionally Aljfri and Hussainey (2007) indentified the drivers of forward-looking information disclosure in the context of the United Arab Emirates in reference to five companies explanatory characteristics, the study adopted quantitative research approach based on counting number considering with forward-looking phrase and dividing it against the number of total disclosure sentence. The reveled a positively significant relationship between the level forward-looking information disclosure and the degree of finance leverage while the relationship with profitability measure was negative

In a study by Uyar abd Kilic (2012) to determine the extent of forward-looking information disclosure on manufacturing companies of listed Instabul Stock Exchange in Turkey. The analysis involved seven variables namely profitability forecast, market share forecast, sales forecast, cashflow forecast, capital expenditure, new investment forecast and share price estimation . The study was done on 131 manufacturing companies for the year 2010. Data was collected by analyzing narration section of annual reports where descriptive

statistics and content analysis was used to measure the extent of forward-looking information disclosure. The study found that firm size and auditor size are significant determinants of forward-looking information disclosure while profitability, leverage, ownership structure, independent directors and listing age are insignificant determinants. The result also indicated that new investment forecast as the most disclosed item while share price estimation as the less disclosed items. The result also revealed that firm size as an important determinant of forward-looking information disclosure where large firms tend to disclose more information when compared to smaller firms.

Celik, Ecer and Karabacak (2012) in their study examined factors influencing disclosure of forward-looking information in annual reports of firms listed in Instanbul Stock Exchange. The proposed factors consist of the industry size, Institutional investors and Intangible on annual reports. The methodology of the study adopted was content analysis done by examining and analyzing 2004 annual reports of 233 listed firms to determine the extent of influence. Annual report was chosen since these reports represent main source of information disclosed voluntary on forward-looking information. The resulted reveled that more than half of firms under the study disclosed information relating to forward-looking information on earning though without be specifically disclosing the point of estimates and does not provide quantitative earnings. The study found that the total forward-looking information disclosure is positively associated with the size and foreign offers and negatively related to ownership structure, profitability, level of foreign investment and proportional of institutional investors. Additionally the study also revealed that more is disclosed by firms operating in services and finance sector when compared manufacturing sector. It was noted ownership structure and financial performance are determinant factors affecting the disclosure of forward-looking information.

2.3.2 Corporate Social Responsibility Voluntary Disclosure and Cost of Equity Capital

A study by Hossain and Hammami (2009) purported that financial results released are the bases' performance with those of similar firms in the same industry by examining trends over time. Financial analysis involves use of mathematical techniques, understanding and appreciating business strategies and future prospects through examination of financial reports. Financial ratios play a key role in financial management. The extent to which a firm uses debt financing is called financial leverage. Also Botosan and Plumlee (2002) investigated the association between cost of equity capital and annual reports disclosure, timely disclosure (quarterly or other published reports) and investors relation disclosure, they found a negative relationship of the annual reports disclosure, their research found that the cost of equity capital is positively related timely reporting action which could be attributed to the fact that timely disclosure increases the volatility of the share price by attracting transient investors who trade aggressively on short term earning , however they did not find the relationship between the cost of equity financing and investor relations disclosures.

In evaluating the relationship between information asymmetry and financing methods (debt and equity financing) of firms listed on the Tehran Stock Exchange from year 2003 to 2010, Mahdi, Vahab and Hamin (2015), found that there no significant relationship between information and debt financing though information asymmetry is positively associated with debt financing, however there was a positive significant relationship between information asymmetry and equity financing. The study was done using secondary dataset of 61 firms. Debt and equity financing methods were adopted. Data was extracted from financial statements of sample firms and analyzed in excel and STATA.

Another study by Mangena, Jing and Tauringana (2016) investigated whether Intellectual capital and financial disclosure jointly affects the firms cost of capital for 125 UK firms listed at the London Stock Exchange (LSE) representing firms across industries from

March 2004 to February 2015, data for measuring disclosure are drawn from annual reports. They used descriptive approach as their study methodology. The study found that IC disclosure is negatively associated with the cost of equity capital, the relationship between financial disclosure and cost of equity capital is magnified when combined with the IC disclosures. It was also observed that the IC and financial disclosure interacts on the effects of the cost of equity capital, the analysis of this interactions demonstrates that the effect of financial on the cost of equity capital is augmented for firm characterized by medium level of IC disclosure.

In their study, Francis, Nanda and Olsson, (2002) investigating the association among voluntary disclosure, earning quality and cost of capital. The study was done in Chicago, USA on 677 firms' annual reports and 10-K filings in the fiscal year 2001 using self constructed index of coded items. It was noted that firms with good earning quality have more expansive voluntary disclosure than firms with poor earning quality, on unconditional tests, it was found that more voluntary disclosure is associated with lost cost of capital, however on complementary relationship between disclosure and earning quality it was noted that the disclosure effect on the cost of capital is substantially reduced or disappear completely.

In their study Goncalves et al. 2012, analyzed the association between the level of social disclosure and the cost of equity in public limited firms in Brazil on 83 listed companies in Sao Paulo Stock, Brazil for a period of five from 2005 to 2009. The methodology used was regression analysis on an index of 13 indictors from 83 listed companies tested using panel data with cross-sectional fixed effects. The study found that there is a negative the level social disclosure and the cost of equity capital. The result also fund that that Brazilian Stock Market has a semi strong market efficiency. Cormieret al. 2009 investigated the effect of substitution on social and environmental information disclosure in

minimizing the information asymmetry between management and investors. The study was done in Toronto Stock Exchange on a sample of 137 observations of web disclosure for the year 2005on non-financial. The study provided an integration analysis of firms' social and environmental disclosure strategy.

Additionally, Wang et al., (2013) investigated the effects of corporate social responsibility performance on the cost of equity capital globally. The study was done in five different continents. The methodology used was descriptive statistics done on a sample of 11,055 firm-year observation from 35 countries from a period nine years from 2002 to 2010.The study concluded that firms with better corporate social disclosure are significant in reducing the cost of equity capital. The study also provided the implication for regulators and policy makers when setting social reporting standards where institutional and cultural factors affecting management social reporting behavior. The result also suggested that significant difference exists in CSR in different region due to various environmental, culture and religion.

2.3.3Strategic Information Voluntary Disclosure and Cost of Equity Capital

In their study Hashim, Nawari and Salin (2014) examined the determinants of strategic information disclosure. The aim of their study was to observe practices of online strategies information disclosure to determine factors the influence information disclosure using a sample of 165 Malaysian listed firms. Data was collected for the year 2010 and multiple liner regression was used to analyze the relationship between the following variables board meeting, size, population of independent non executive directors, CEO duality and Institutional shareholding. The study revealed only the board size has a positive significant impact on volume of strategic information disclosure on the internet while other variables frequency of the board meeting proportion of independent non executive director, CEO duality and institutional shareholding have no significance association with the volume of

strategic information disclosure on the internet. On average the study found listed firms prefer to disclose average amount of strategic information disclosure on the internet.

Krause (2012) studied the basic characteristic of strategic and firm value in the Czech Republic. Characteristics include in the study includes focus on the future, risk allocation of resources and participation of top managers. The aim of the study was to formulate the basic characteristics and strategic management principles. Questionnaire was used as data collection method. Discriminate research method was used to analyze data. A sample of approximately 1,500 firms was used in the study. The study found that, higher value is created by firms with strategy compared to firms without any strategy. Firms which exercise external and internal factors create higher value than firms without these factors while firms with good compliance of resources create higher value unlike firms without. At the same time higher level of innovation activity create higher value for owner than firms with lower level of innovation activities.

According to Baimukhamedova and Luchaninova (2017) who examined the relationship between corporate strategic disclosure and the cost of equity capital on a sample of 37 largest and most liquid listed at Kazakhstan Stock Exchange for period 2008 to 2014, the study used multiple linear regression models. The findings indicated that firms with higher level of financial transparency are related with significantly lower cost of equity capital. The results shown that firm on the Kazakhstan Market reduces their cost of equity capital by increasing the level of voluntary disclosure. Moreover Stanwick (1998) investigated the relationship between strategic disclosure and organizational size, financial performance and environmental performance. The aim of the study was to evaluate the relationship between social performance and environmental performance of the organization. Data was was collected from 1987 to 1992 and descriptive design was used. Corporate reputation index was constructed. The findings were that social performance was indeed

affected by the size of the firm, the financial performance of the firm and amount of pollution emissions released by the firms.

Study by Thakor (2013) analyzed firm specific determinants and organizational outcomes of corporate information voluntary disclosure using a sample 70 listed companies in the Netherlands for a period from 2003 to 2008. The study used quantitative research method. The study found significant effect of industry profitability, dual listing, ranking and listing age on voluntary corporate strategic information disclosure. The study also revealed stock liquidity and corporate reputation are influenced significantly by voluntary disclosure of strategic No significant effect was found for volatility of stock.

According to Agca and Onder (2007) who examined factors affecting voluntary disclosure of 51 firms listed in Istanbul Stock Exchange in Turkey. The study used Ordinary Least Square (OLS) statistical method to analyze the impact of firm size, leverage, auditor, ownership structure, profitability and multi nationality on voluntary disclosure. The result found the profitability and firm size have significant effect for strategic information disclosure, while Auditor and firm size have significant effect on the financial information disclosure, leverage has significant effect for non-financial information model. Auditor, profitability and firm size have significant effect on the total disclosure model. The overall results revealed that firms which are listed in Istanbul Stock Exchange are hesitant to disclose information voluntary to the public.

Ferreira and Rezende (2007) examined voluntary disclosure of information about corporate strategies. In the study a model was developed where managers choose whether to disclose their strategic plans only to internal partners or to even external partners Results of the study revealed that management will voluntary disclosure its private information to encourage partners to agree to invest in certain specific investment directions. Public announcements of strategic information enhances credibility because management are

concerned about their reputation and thirdly corporate strategic information voluntary disclosure creates value due to positive effects on partners incentives.

2.4 Conceptual Framework

Mugenda and Mugenda, (2013), Conceptual framework is the diagrammatic presentation of independent and dependent variables showing the connection between them. Forward-looking disclosure, corporate strategic disclosure and Strategic disclosure are the independent and the cost of equity capital as the dependent variable. The study seeks to examine the relationship between these variables as schematically presented in Figure 2.1 below.

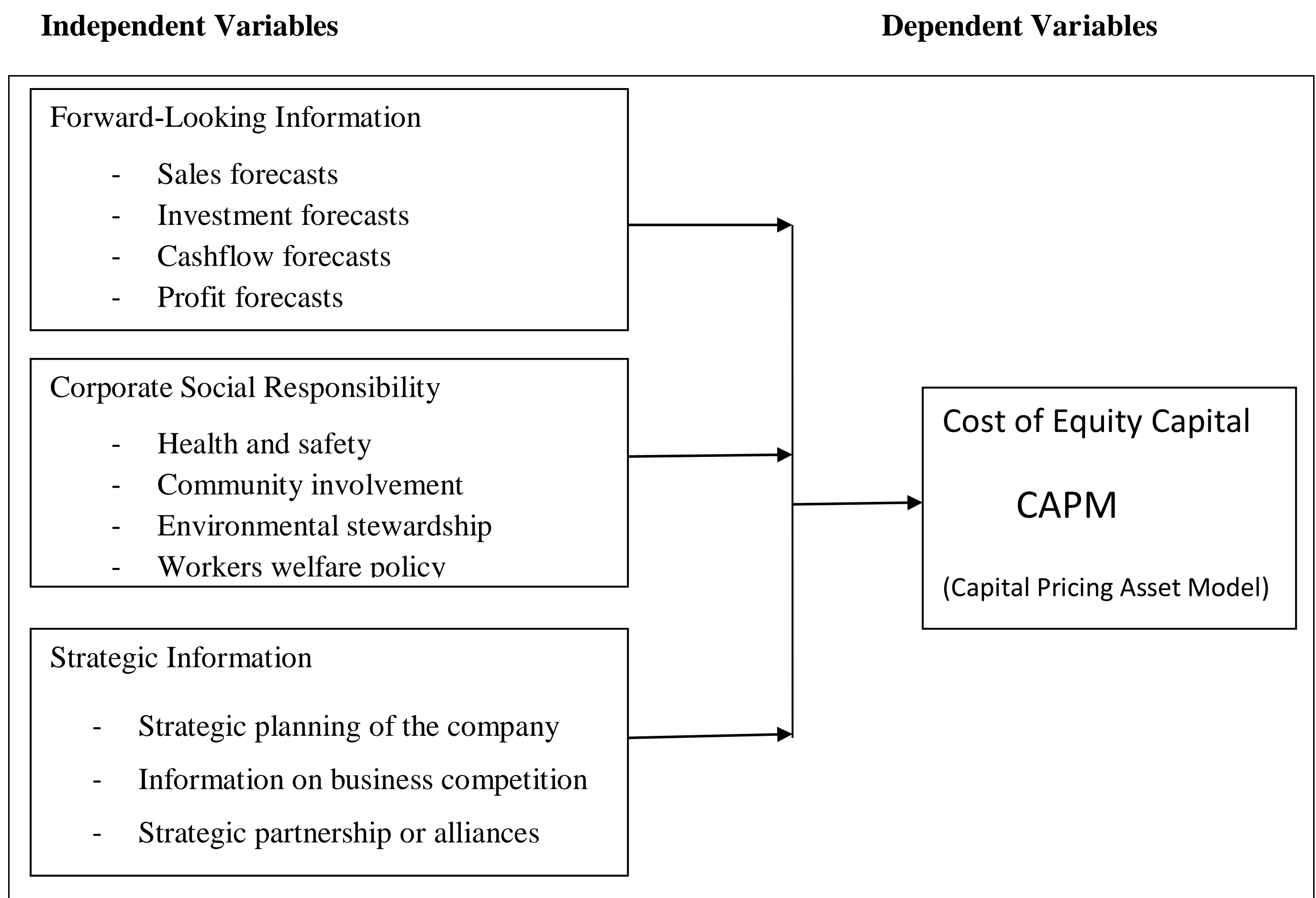

Figure 2.1: Conceptual Framework

2.5Operationalization of Variables

The study will operationalize the effect of voluntary disclosure on the cost of equity capital of NSE 20 share index. The independent variables are forward-looking disclosure, corporate social disclosure strategic disclosure while dependent variable is the cost of equity capital Table 2.1 highlights how the variables will be measure and analyzed.

Variables	Category	Operationalization and Measurement	Scale
Forward-Looking Information X_1	Independent Variables	Sales forecasts	Continuous
		Cashflow forecast	
		Research and development	
		Investment forecasts	
		Profits forecasts	
		Planning and capital expenditure	
		Advertising and publicity expenditure	
		Information on dividend policy	
Corporate Social Responsibility X_2	Independent Variable	Work place health and safety policy	Continuous
		Community involvement	
		Environmental stewardship	
		Workers welfare policy	
		Environmental policy	
		Business ethics	
		Social activities	
		Training and development	
Strategic Information X_3	Independent Variable	Statement of the vision, mission, objective and other relevant philosophy.	Continuous
		Strategic planning of the firm (to get involved with various ventures).	
		Annual planning of the company	
		Information on business competition	
		Information on associated risk (economy, financial, technical and operations)	
		Company's strategic position in respective sector (declared as a leading company or main player in the industry)	
		Strategic partnership or alliances	
		Information on production methods	
Cost of Equity Capital (Y)	Dependent Variable	CAPM – risk free rate - Beta of the company - Expected market return	Continuous

TABLE 2.1: Operationalization of Variables

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that was applied in the study. This chapter presents details of the research design employed, target population, sampling procedure and determination of the sample size, instruments for data collection and data analysis.

3.2 Research Design

Research design is the framework the researcher intends to follow. It outlines the nature and pattern that guides the research Makerere University, (2011). Ogula (2005) describe a research design as a plan, structure and strategy which gives a guideline of how to obtain answers to research questions and control variance. In this study descriptive research design was adopted, Saunders, Lwesi and THornhill (2013) observed this design is appropriate if it shows the characteristics and association between variables without affecting the environments. The choice of descriptive was motivated by the fact that it involves gathering data, observing and describing the behavior of the data without influencing it in any way (Bryman, 2000). The design was appropriate in the study since it sought to establish the effect of voluntary disclosure on the cost of equity capital.

3.3 Target Population

Mugenda and Mugenda (2009) define a population as sum of all the items under consideration. Ngechu (2004) defines population as a set of people, services, events or organization to be investigated. The target population for this study consisted of NSE 20 share index (Appendix I) of firms listed in NSE as at 31st December 2017 (NSE, 2017).

3.4 Sample Size and Sampling Procedure

A sample is sub-group of the target population chosen by the researcher to represent other members of the target population (Amin, 2004). Sampling involves processes, techniques and procedures of choosing a subset from a target population to participate in the study. Oso and Onen, (2009) stated that there are two main ways of selecting study sample from the target population, probability and non-probability sampling technique. In this study purposive sampling technique was applied to select companies to be included in the study. Kothari (2004) stated that in purposive sampling technique an element is selected through subjectively defined method where the researcher personal judgments play an important role An optimal sample size is one which meets requirements of representativeness and reliability. The study considered a sample of 20 firms from NSE 20 share index selected based on a weighted market performance in the year 2017 (NSE, 2017). The study was conducted for 5 year period.

3.5 Instrumentation and Data Collection

A researcher should develop data collection instruments which measure, observe or quantify data under investigation Creswell (2008).Secondary data was applied, according to Mugenda and Mugenda (2009), secondary data is data that is readily available having been collected in the past by other user other than the researcher for the purpose of the study, it is readily available, less complicated, easily accessible and less expensive. In spite of these benefits, secondary data is disadvantageous due to its likelihood for obsolesce thus the information to use was for a period of 5 years from 2012 to 2016 (see appendix II). This study used Disclosure Check Index (DCI) as the principal instrument for data collection of voluntary disclosure information. Similar approach was adopted in previous research by Buckland et al., (2002), Wangechi and Nasieuk, 2015, Nduta and Muturi, (2015). Data was extracted from NSE hand book, CMA libraries and audited annual reports from company's website because

they are credible attested documents with minimal biasness. Data was collected on twenty four (24) disclosure items then entered in check-in tables containing all variables under the study. DCI consisted of three categories: forward-looking information corporate social responsibility disclosure and strategic information disclosure To measure the amount of disclosure a binary coding was applied, the presence of disclosed item a score of one (1) was entered and zero score (0) when disclosure item was absent. The total score was computed as un-weighted score of sum of all disclosure items. The level of voluntary disclosure item was calculated as

$$\text{Level of Disclosure} = \frac{\text{Actual items disclosed}}{\text{Total possible items in the index}}$$

The dependent variable (cost of equity capital) was calculated using CAPM, this measure was adopted by Botosan 2000.Data of both of financial and non-financial in nature was considered.

3.6 Validity and Reliability

According Kombo and Tromp (2006), validity refers to how accurate and meaningful a test measures instruments is as intended. Validity is concerned with study's success. Construct validity was used to ensure validity of study instruments. The main aim of validation is to perform a measure of a construct on a number of tests which determines its relationship with other variables which are either no relation, positive relation or negative relation, Cronbach and Meehl, 1995. Voluntary disclosure was pre-test on a five randomly selected listed organizations to ensure the response rate was adequate and favorable.

Reliability is the extent of how a measure is consistent with research procedures will deliver the same results when given similar conditions. (Seale,2004). The re-test method was applied to test the reliability of the study instruments. A coefficient of 0.60 or more is considered

more reliable (Bartholomew, Henderson and Marcia, 2000). The reliability of the study instrument was 0.64 which is deemed reliable.

3.7 Data Analysis and Presentation

Data analysis involves data cleaning, coding and data analysis Kothari (2011).Microsoft Excel and STATA statistical packages were used to analyze the data. Data collected in the study was panel with 20 firms over 5years (2012-2016), application of panel data analysis model was required due to the fact that data collected was longitudinal and cross sectional nature.

Panel data analysis model has two options fixed effects model (FE) and random effect model (RE). Fixed effect model is suitable where some factors may influence independent variables and need to be controlled, it remove the influence of time invariant features to enhance assessment of the effects of independent valuable on the dependent variable. Random effect model is suitable where each group different characteristics may or may not relate with independent variable. Random effect is suitable where the difference among groups have an effect on response variable.

Hausman test was conducted to determine which of the two models (fixed and random) was appropriate (Hsiao et al.,2009). The most appropriate model for this was random effects model. Additional other tests were conducted which included correlation analysis to test strength of relationship, multicollinearity test, normality test, Breusch Pagan LM was conducted to determine use of either pooled or random effects model.

The model will have three independent variables (forward-looking informationX_1, corporate social responsibility disclosure,$X_2$and strategic disclosure X_3).

The equation for the random effects model is:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where: Y = the dependent variable (Cost of Equity Capital)

X_1 = the indepedent variable (forward – looking information)

X_2 = the independent variable (Corporate Social Responsibility)

X_3 = the independent variable (Strategic information)

β_1 = The coefficient of independent variables

ε= The error term

3.8 Diagnostic Tests

These are robust statistical tests performed to verify if the panel data met the underlying assumptions of OLS regression while removing problem associated with the data. In this study, panel data was used and the following tests carried out.

3.8.1 Multicollinearity Tests

Multicollinearity is an assumption of a linearly predicted relationship between independent variables creating bias in the model. The problem of Multicollinearity occurs when independent variables are highly correlated with each other with a correlation coefficient among the variables greater than 5.

3.8.2 Heteroscedasticity Tests

According to Brooks (2008), Heteroscedasticity is when the error in the panel data has a constant. The presence of heteroscedasticity is as a result of omitted variables which are not included in the explanatory variables but are absorbed by error term hence giving wrong results (Saastamoinen, A.2015). Several tests are used to test heteroscedasticity problem which include Breusch-Pagan Goldfrey test, White test among others. This study used Breusch-Pagan test to detect the presence of heteroscedasticity.

3.8.3 Hausman Tests

Hausamn tests are carried out to determine which model is the most appropriate between fixed effect model and random effect model. In this study the findings indicated that random effects model was the most suitable since the p value was greater than 0.05.

3.8.4 Correlation Analysis

This test was performed amongst the study variables to show the nature, extent and the association existing between them. This test explains the scale with which a variable varies dues to change in the other variable. Positive correlation means that variable moves in the same directions while negative correlation moves in the opposite direction.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

The chapter presents research outcomes and discussions of the study with the main objective to determine the effect of voluntary disclosure and the cost of equity capital of companies quoted at the Nairobi Securities Exchange. The study intended to find the effect of elements of voluntary disclosure and cost of equity capital. The independent variables were forward-looking disclosure, corporate social disclosure and strategic disclosure. The dependent variable was cost of equity capital. Data was analyzed using STATA statistical software from secondary data of 20 companies and NSE 20 share index were selected on the basis of market capitalization as at December 2017.

4.2 Research Findings

The section discusses the exploratory data results, descriptive statistical results, diagnostics tests followed by regression analysis results. The study then discusses the empirical results explaining the association between the various elements of voluntary disclosure and the cost of equity capital. Data is presented in tables and graphs

4.2.1 Exploratory Data Analysis

The exploration data analysis involves within firm analysis and between firm analyses. Trend plot tests were performed for within firms effects while the overlain plots was done for between the firm effects. Exploratory analyses were conducted on the dependent variable, the cost of equity capital, the results was summarize and presented using graphs.

Figure 4.1 below, shows there were changes in slopes on the cost of equity capital within the firm over time. Kengen showed a fluctuating trend, however the other 19 firms indicated unpredictable within firm's trend over time.

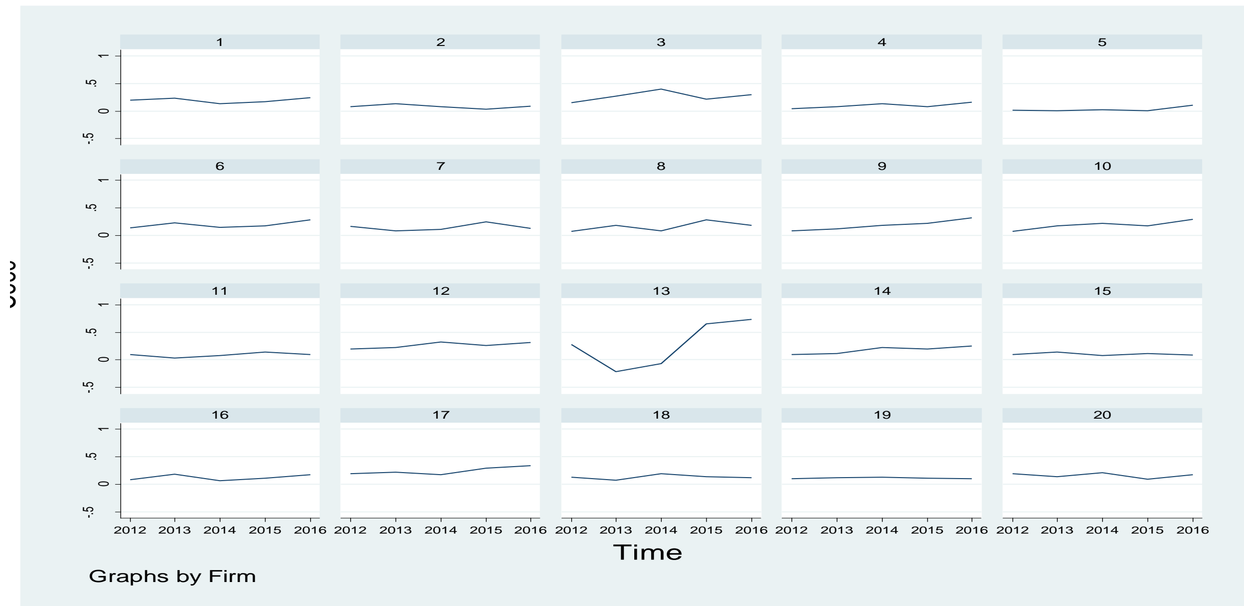

Figure 4.1 Trend Plot for Cost of Equity Capital

The graph presentation in below figure 4.2 shows the slopes changes on the cost of equity capital between the firms .Overlain plot help explain significance differences between and if the firms have different intercepts. Unpredicted trend patterns are observed between the firms over the five year period.

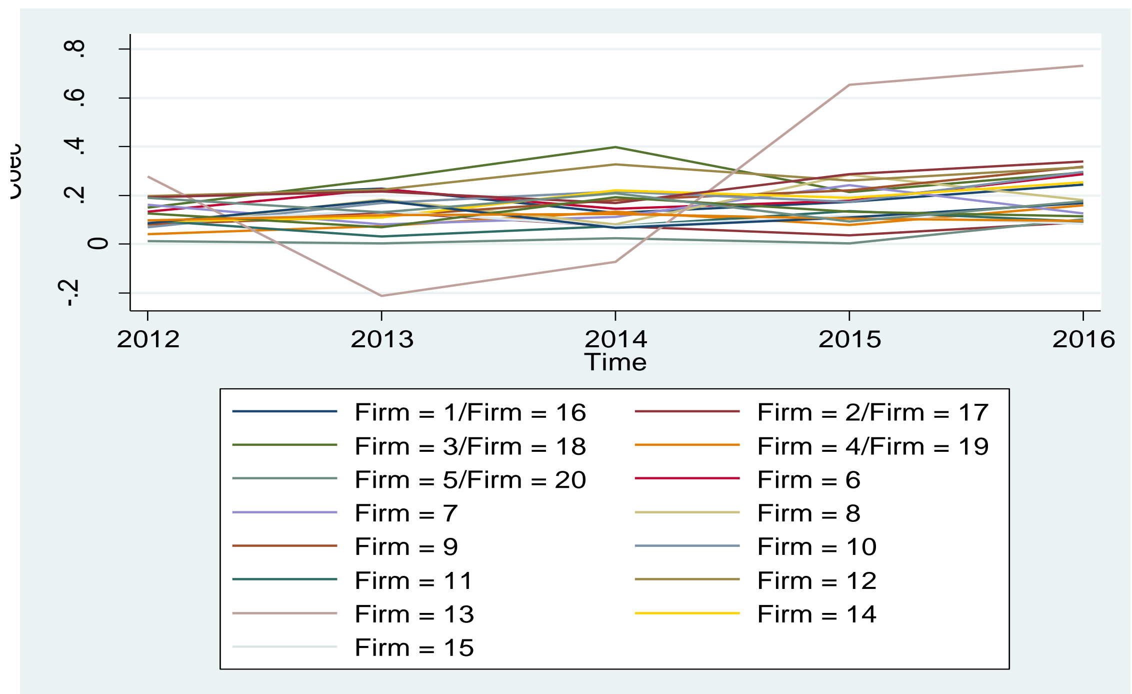

Figure 4.2 Overlain Plot for the cost of equity capital

4.3 Panel Data Descriptive Analysis

The study undertakes to establish the relationship that exists between various elements of voluntary disclosure and cost of equity capital of NSE 20 share index. Voluntary disclosure was obtained from annual reports for the period of five years 2012 to 2016, weighted using disclosure check index in Appendix II. Cost of equity was measured by CAPM.

The table 4.1 below presents descriptive analysis of the companies' under the study from the year 2012 to 2016. The table presents the mean value, standard deviation, minimum and maximum values. The dependent variable was the cost of equity while the independent variables are the forward-looking information disclosure, corporate social responsibility information disclosure and strategic information disclosure.

The average cost of equity capital for the firms over the 5 year period was 15.96% with a standard deviation of 11.96%. The maximum cost of equity capital was 73.11 while the minimum cost of equity capital was –21.14%. This shows some firms had a negative cost of equity capital over the 5 year period.

The average voluntary information on forward-looking disclosure was 40.23% with a standard deviations of 9.21%. The maximum forward-looking disclosure was 63% while the minimum was 24%. Which mean that at least listed firms under the study made forward-looking information disclosure.

The average corporate social responsibility information disclosure was 37.01%, standard deviation of 6.53%. The maximum CSR disclosure was 56.05% while the minimum CSR disclosure was 24.14%. This indicates that there was CSR voluntary information disclosure.

The average strategic voluntary information was 55.29% of the total disclosure with a standard deviation of 9.80%. The maximum disclosure was 86% while the minimum

disclosure was 31%, this means shows companies disclosed more of their strategic information

this

. xtsum

Variable		Mean	Std. Dev.	Min	Max	Observations	
Firm	overall	10.5	5.795331	1	20	N =	100
	between		5.91608	1	20	n =	20
	within		0	10.5	10.5	T =	5
Time	overall	2014	1.421338	2012	2016	N =	100
	between		0	2014	2014	n =	20
	within		1.421338	2012	2016	T =	5
Coec	overall	.159687	.1196346	-.2114	.7311	N =	100
	between		.0675712	.02946	.27588	n =	20
	within		.0996547	-.327593	.614907	T =	5
FL	overall	.4023	.0920897	.24	.63	N =	100
	between		.0457742	.33	.51	n =	20
	within		.0804357	.2503	.6363	T =	5
CSR	overall	.370112	.0652646	.2414	.5605	N =	100
	between		.0359266	.33262	.46506	n =	20
	within		.0549627	.202472	.540972	T =	5
Strate~c	overall	.5529	.0980342	.31	.86	N =	100
	between		.0775696	.392	.704	n =	20
	within		.0619416	.4309	.7089	T =	5

Table 4.1 Descriptive Analysis

4.4 Diagnostic Tests

This is a robust statistical tests performed to verify if the panel data used meets the underlying assumptions of ordinary least square and remove problem that exists in the panel data. Tests carried out included Multicollinearity, normality tests, correlation analysis, hausman tests and panel data regression analysis.

4.4.1 Multicollinearity test

Multicollinearity is an occurrence where one predictor variable in a multiple regression can be linearly predicted with a substantial degree of accuracy from others. This test helps indentify variables which are highly correlated hence causing the presence of collinearity. VIF which is greater than 5 shows presence of multicollinearity. In this study Independent

variables are assumed to have no correlation with each other since the mean VIF is 1.40 as shown in below table.

Variable	VIF	1/VIF
CSR	1.56	0.642609
FL	1.38	0.726427
Strategic	1.26	0.792186
Mean VIF	1.40	

Table 4.2 Multicollinearity test

4.4.2 Normality Test

Figure 4.3 below showed that the independent variables are normally distributed, variables are not normally distributed if the probability value is less than 0.05. The results in this study shows that the probability if more than 0.05

```
. sktest Coec FL CSR Strategic
```

Skewness/Kurtosis tests for Normality

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	joint adj chi2(2)	joint Prob>chi2
Coec	100	0.0000	0.0000	37.02	0.0000
FL	100	0.0769	0.2505	4.53	0.1039
CSR	100	0.0404	0.6421	4.50	0.1052
Strategic	100	0.5110	0.5047	0.89	0.6394

Table 4.3 Normality test

4.4.3 Correlation Analysis

In this study correlation analysis was used to examine the strength or weakness of the relationship between variables under investigation. The results were tabulated as shown in table 5 below. There was a positively but insignificant relationship between cost of equity capital and forward-looking information disclosure (rho=0.2414,p value=0.0156). Additionally the association between the cost of equity and CSR was positive and insignificant (rho=0.1670, p value=0.0967) finally there was a positive and insignificant association between the cost of equity capital and strategic information disclosure (rho=-

0.0607, p value 0.5483). Since none of the independent variable had a correlation coefficient greater than 0.8, there was no multicolliniarity.

```
. pwcorr Coec ForwardLooking CSR Strategic,sig star(0.05)
```

	Coec	Forwar~g	CSR	Strate~c
Coec	1.0000			
ForwardLoo~g	0.2414*	1.0000		
	0.0156			
CSR	0.1670	0.5157*	1.0000	
	0.0967	0.0000		
Strategic	-0.0607	0.0106	0.0795	1.0000
	0.5483	0.9167	0.4317	

Table 4.4 Correlation Analysis

4.4.4 Hausman Test

The study carried a Breuch-Pagan test to determine the appropriate model to use. Table 4.5 shows results for Hausman test. The value of prob>chi2 is 0.9133. The rule is if prob<0.05, reject Ho meaning use fixed effect model and if prob >0.05 accept the Ho and use random effect model. In this case results obtained indicated that the most appropriate model was random effects model and not fixed effect model since the p-value is greater than 5%.

```
. hausman fixed random
```

	Coefficients			
	(b) fixed	(B) random	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
FL	.1458621	.2461663	-.1003042	.1450161
CSR	.367001	.2583792	.1086219	.2095386
Strategic	.0921981	.0384742	.0537239	.1945402

```
                   b = consistent under Ho and Ha; obtained from xtreg
    B = inconsistent under Ha, efficient under Ho; obtained from xtreg

  Test:  Ho:  difference in coefficients not systematic

              chi2(3) = (b-B)'[(V_b-V_B)^(-1)](b-B)
                      =        0.53
            Prob>chi2 =      0.9133
```

Table 4.5 Hausman test

4.5 Panel Data Regression Analysis Results

In this study, Random effects model was fitted to examine the effect of voluntary information disclosure on the cost of equity capital among NSE 20share index firms. The findings in table 4.6 above indicated the model was insignificant in explaining the cost of equity capital (f =11.00,p < 0.05). The study established that the overall r-squared was 9.02% explains variability of independent variable in dependent variables, this mean 9.02% variation on the cost of equity capital can be explained by forward-looking information disclosure, corporate social responsibility information disclosure and strategic information disclosure while the remaining percentage can be accounted for by other factors not included in the model. The study indicates the within R-squared was 0.1168, in the model this explains 11.68% of change in the cost of equity capital within the NSE 20 share index firms, this indicates a better model. Additionally, the between R-squared was 0.0304, this indicates that the model explains 3.04% of the change in cost of equity capital between the NSE 20 share index firms. The results of random effect showed that forward-looking and corporate social responsibility and strategic information disclosure have a positive and insignificant effect on cost of equity capital. The chi square test was insignificant with a p-value of 1.17% is less than 5% which means that all coefficients are not equal to zero.

From the estimated results, it is clear probability values of forward-looking (12.8%), CSR (29.3%) and strategic (80.9%) are statistically insignificant to explain cost of equity capital because they have a probability of more than 5%.

In the model, forward-looking information voluntary disclosure had an insignificant positive effect on the cost of equity capital (β=0.2462, t=1.52, P>0.128). This finding indicates that a unit change in forward-looking information disclosure will cause an insignificant increase in the cost of equity capital by 0.2462 units. These results are in agreement with Celik, Ecer and Karabacak (2012) who examined factors influencing

disclosure of forward-looking information in annual reports of firms listed in Instanbul Stock Exchnage. The results of the findings revealed forward-looking information disclosure has positive association with the profitability.

Similarly, the effect of corporate social responsibility information disclosure on the cost of equity capital was positively insignificant (β = 0.2584, t = 1.05, p >0.293).The findings established that a unit change in corporate social responsibility information disclosure would have a positive effect on the cost of equity by 0.2584 units The findings was inconsistent with that of Botosan and Plumlee (2002), whose findings indicated that there was a negative relationship between corporate social disclosure and the cost of capital, additionally findings by Mahdi, Jing and Tauringna (2016), found a negative relation between disclosure and intellectual capital.

Further, the results indicate that strategic voluntary information disclosure have a positive but insignificant influence on the cost of equity capital (β=0.0385, t=0.24, p>0.809). These findings established that increase in strategic information disclosure would cause a positively insignificant effect. This can imply that a unit of change in the strategic information voluntary disclosure increases the firms cost of equity capital by 0.0385 units while holding other factors constant. The results were in disagreement with Baimukhamedova and Luchaninova (2017), who observed positively significant relationship between strategic disclosure and the cost of equity capital.

The model was fitted in the regression as below

$$\mathrm{Y} = -.0562 + 0.2462\mathrm{X}_1 + 0.2584\mathrm{X}_2 + 0.0385\mathrm{X}_3$$

Y = Cost of Equity Capital,

$\mathrm{X}_1 = \text{Forward} - \text{looking disclosure},$

$\mathrm{X}_2 = \text{Corporate Social responsibility disclosure}$

X_3 = Strategic Disclosure.

From the hypothesis formulated in chapter two it was concluded that, the null hypothesis, forward-looking information, (Ho_1) corporate social responsibility (Ho_2) and strategic information disclosure (Ho_3) failed to reject the null hypothesis, the variables were positively insignificant to explain the cost of equity capital.

```
. xtreg Coec FL CSR Strategic,re

Random-effects GLS regression                   Number of obs      =       100
Group variable: Firm                            Number of groups   =        20

R-sq:  within  = 0.1168                         Obs per group: min =         5
       between = 0.0304                                        avg =       5.0
       overall = 0.0902                                        max =         5

                                                Wald chi2(3)       =     11.00
corr(u_i, X)   = 0 (assumed)                    Prob > chi2        =    0.0117

------------------------------------------------------------------------------
        Coec |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
          FL |   .2461663   .1617024     1.52   0.128    -.0707646    .5630972
         CSR |   .2583792   .2456372     1.05   0.293    -.2230609    .7398192
   Strategic |   .0384742   .1593984     0.24   0.809    -.2739408    .3508893
       _cons |  -.0562474   .0807595    -0.70   0.486     -.214533    .1020383
-------------+----------------------------------------------------------------
     sigma_u |  .05403744
     sigma_e |  .10601615
         rho |  .20622559   (fraction of variance due to u_i)
------------------------------------------------------------------------------
```

Table 4.6 Panel Data Analysis

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The Chapter provides a summary of the findings obtained in chapter four above on the effects of voluntary disclosure and the cost of equity capital of firms quoted at the Nairobi Securities Exchange. The chapter presents the summary, conclusion and recommendations of the study.

5.2 Research Findings

The study adopted descriptive research design and panel data was extracted from NSE handbook, annual reports and accounts of NSE 20 share index between 2012-2016. Hausman tests was used to determine the most appropriate model between pooled effect model, fixed effects model and random effect model. The results revealed the most appropriate model to adopt was the random effect model.

Voluntary disclosure of information is becoming an integral part of the company's annual reports and is crucial to decision makers. This study established the voluntary disclosure was at relatively moderate level. As a corporate governance practice listed companies are mandated to disclosure mandatory and voluntary information to stakeholders, CMA outlines certain requirements for listed companies.

The study established that 9.02% of variation in the cost of equity capital can be explained by forward-looking disclosure, corporate social disclosure and strategic disclosure while the remaining percentage can be explained by other factors excluded in the model.

The results of this study found a positive but insignificant relationship between forward-looking voluntary information disclosure and the cost of equity capital since the p-value of 12.8% is greater than 5%. This means there is need for listed firms to improve on

their level of voluntary disclosure in relation to forward-looking information i.e. sales forecasts, investment forecasts, research and development expenditure and planning and capital expenditure. By disclosing more information voluntarily is viewed a mechanism of mitigation the agency problem which in turn reduces the agency costs. The findings are inconsistent with the findings of Ah

Secondly, the study depicts positively insignificant influence of corporate social responsibility voluntary information disclosure on the cost of equity capital, it has a p-value of 29.3% which is greater than 5% which is the recommended rate. This means listed companies should increase disclosure and reporting of their CSR information i.e. community involvement, environmental stewardship, environmental policy, workers welfare policy and workplace health and safety policy. By voluntarily disclosing more information on CSR acts a 'signal' to stakeholders who determines company's success by expanding the spectrum of interested parties.

Finally, the study found out there is a positively insignificant association between strategic information voluntary disclosure on the cost of equity capital amongst 20 share index, the p-value of 80.9% is greater than 5%. This means disclosure of strategic information voluntary disclosure i.e. strategic planning, strategic partnership annual planning and information on business partnership influences positively the cost of equity capital. Strategic information disclosure is mutually exclusive and subjective in nature, this expose companies to their competitors.

5.3 Recommendation

Over the years, corporate governance is gaining awareness from investors, public and government. Based on the study findings and conclusion, the study recommends that quoted firms should continuously increase their voluntary disclosure levels.

Secondly, it was noted more disclosure was on strategic voluntary disclosure compared to corporate social responsibility voluntary disclosure and forward-looking voluntary disclosure. Corporate governance should be in all practices and disclosure levels should not be restricted to annual reports only as the annual reports may not disclose all the information that investors may require to aid in decision making

Similarly, the purpose of voluntary disclosure is to inform the public about operations of a company in return the management hope that stakeholders will act in favor of the company while the company gain some benefits by virtue of providing more disclosures. Disclosure could be made periodically.

Finally, efforts should be made to create a harmonized measure for voluntary disclosure as to provide more accurate analysis because some items outlined on the voluntary disclosure index may not provide as much information necessary for disclosure while items omitted from disclosure may provide more and necessary information form disclosure.

5.4 Limitations of the study

The study relied on a self constructed index to measure the amounts of disclosure. Though objectivity was ensured, the subjective measurement of voluntary disclosure through assigning an index by the researcher would affect the findings since different researcher will give different ratings. Additionally if a different researcher was to use variables that are different than those used in the index for this research, the results would be different.

The findings of this research only focused on the association between voluntary disclosure and the cost of equity capital ignoring any other factor that could impact on the cost of equity capital. In addition the study focused on five years, nevertheless a longer study period is expected to provide more generalizable findings.

5.5 Recommendations for Further Studies

This study investigated the effect of voluntary information disclosure of NSE 20 share index for the period 2012 to 2016, based on NSE handbook and annual reports, a longer study period and for all the 64 firms listed at NSE is expected to provide more stable and generalized findings. In addition, further research can also investigate constructs associated with voluntary disclosure such on reaction of the market following disclosure. Further, future research should be conducted to establish factors that influence the level of voluntary disclosure in firm's annual reports.

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APPENDICES

Appendix I Sample of listed companies at Nairobi Securities Exchange

1	ARM CEMENT LTD
2	BAMBURI CEMENT LTD
3	BARCLAYS BANK KENYA
4	BRITAM KENYA INSURANCE LTD
5	BRITISH AMERICAN TOBACCO LTD
6	CENTUM INVESTMENT CO.LTD
7	CFC STANBIC HOLDINGS
8	CO-OPERATIVE BANK OF KENYA
9	EAST AFRICAN BREWERIES LTD
10	EQUITY BANK
11	KENGEN CO. LTD
12	KENOL KOBIL LTD
13	KENYA AIRWAYS LTD
14	KENYA COMMERCIAL BANK
15	KENYA POWER & LIGHTING CO. LTD
16	NATION MEDIA GROUP LTD
17	SAFARICOM LTD
18	SASINI LTD
19	STANDARD CHARTERED KENYA
20	WPP SCANGROUP LTD

Appendix II: Voluntary Disclosure checklist

	Disclosure Check Index	2012	2013	2014	2015	2016
	Information relating to Forward-Looking Disclosure (X_1)					
1	Sales forecasts					
2	Cash flow forecast					
3	Research and development expenditure					
4	Investment forecasts					
5	Profit forecast					
6	Information on dividend policy					
7	Advertising and publicity expenditures					
8	Planning and capital expenditure					
	Information relating to Corporate Social Responsibility Disclosure (X_2)					
9	Work place health and safety policy					
10	Community Involvement					
11	Environmental stewardship					
12	Workers welfare policy					
13	Environmental policy					
14	Business ethics					
15	Social activities					
16	Training and development					
	Information relating Corporate Strategic Disclosure (X_3)					
17	Statement of the vision, mission, objective and other relevant philosophy.					
18	Strategic planning of the company (to get involved with various ventures)					
19	Annual planning of the company					
20	Information on business competition					
21	Information on associated risk (economy, financial, technical and operation))					
22	Company's strategic position in respective sector (declared as a leading company or main player in the industry)					
23	Strategic partnership or alliances s					
24	Information on production methods					