Community Involvement Disclosure and Financial Performance of Firms Listed At Nairobi Securities Exchange, Kenya

Karambu Kiende Gatimbu* & Henry Kimathi Mukaria**

*University of Embu, Department of Business and Economics, Embu, KENYA.
E-Mail: kiendegatts[dot]gmail[dot]com
**Chuka University, Department of Business Administration, Chuka, KENYA.
E-Mail: henrykimathi[dot]gmail[dot]com

Abstract—Community Involvement Disclosure entails disclosing the social conscious aspect of company activities. The main objective of this paper is to determine the effect of Community Involvement disclosure on financial performance of NSE listed firms in Kenya. This study made use of panel data from the annual reports and financial statements of listed companies at the Nairobi Securities Exchange. Content analysis of sampled listed companies’ annual reports was undertaken to examine Community Involvement disclosure practices. A checklist of Community Involvement disclosure items and categories was developed and Community Involvement disclosure indices computed. Target population of the study was 61 listed companies. The sample size was 32 listed companies. ANCOVA regression model was used to determine the casual relationship between Community Involvement disclosure and financial performance. Moderating variables were size and leverage. Findings reveal that community disclosure with P-value <0.05 has a positive significant difference in the mean financial performance. Size and leverage have no significant moderation. The study recommends that firms should engage in CID because it leads to increased financial performance. The purpose of the study is to help both private and public companies to realize the need of establishing CID for achievement of the competitive advantage and improved performance. Furthermore, this study advances the emerging field of CID in the stock market industry.

Keywords—Community Involvement; Disclosure; Financial Performance; Kenya; NSE.

Abbreviations—Analysis of Covariance (ANCOVA); Community Involvement Disclosure (CID); Nairobi Securities Exchange (NSE); Total Disclosure (TD).

I. INTRODUCTION AND BACKGROUND

The World Business Council for Sustainable Developments [1] sees CSR as the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large.

Today, CSR has become complex and requires organizations to adopt a broader view of its responsibilities that includes not only stockholders, but many other constituents as well, including employees, suppliers, customers, the local community, local, state, and County governments, environmental groups, and other special interest groups. Collectively, all these various groups that are directly or indirectly affected by the actions of the organization. The concept of CSR is underpinned by the idea that corporations can no longer act as isolated economic entities operating in detachment from broader society [Mermod & Idowu, 14]. There has been an increasing need for information by various stakeholders and hence transparency in the company’s reporting.

The listed firms at the NSE undertake various community service activities in attempt to pay back to the society and enhance their social capital. The firms extensive corporate social responsibilities can display elaborate relationship of community involvement and firm performance. According to Olweny & Kimani [9] the NSE is a major component of the financial sector and helps contribute towards economic growth through diversification, mobilizing idle savings and availing them to companies for optimal utilization and hence an ideal study context.

1.1. Community Involvement Disclosure

This traditional contract between business and society has changed over the years because of the addition of new social value responsibilities placed upon business. Some of these new social value responsibilities include: stricter compliance
with local, state, federal, and international laws; social problems; human values; health care; pollution; quality of life; equal employment opportunities; sexual harassment; elimination of poverty; child care and elderly care; support of the arts and universities; and many others [Samy et al., 6].

In a study conducted by Samy et al., [6] of motivations by business for community involvement revealed that Australian businesses were experiencing a positive transition in expectations of its social role, but part of the reason was that this social role contributes to the continuing health and growth of business. The study pointed out that 75 percent of the companies surveyed favored community involvement. The involvement was a way to maintain trust, support and legitimacy with the community, government and employees. It was observed by Ishmail & Sira [13] that community involvement disclosure theme topped the list among sustainability disclosures in Kenya. This involves such disclosures as; Donations of cash, products or employees services to support established community activities, events, organizations, education and the arts (includes declarations of sponsorship); internship programs for students; Sponsoring public health projects; Aiding medical research; Sponsoring educational conferences, seminars or art exhibits; Funding scholarship programs or activities. Other special community related activities include, opening the company’s facilities to the public; supporting national pride/government sponsored campaigns e.g. the HIV/AIDS, Polio campaign; supporting the development of local industries or community programs or activities.

There are several benefits of CSR for companies among others: to maintain and boost the company's reputation and brand image, get a social license to operate, reduce the risk of the company's business, expand access to resources for business operations, opening up wider market opportunities, reduce costs associated environmental impacts, improving relationships with stakeholders, increase employee morale and productivity, and the chances of getting an award. Various reasons for the company in conducting a voluntary CSR disclosure is to comply with existing regulations, gain competitive advantage through the implementation of CSR, the loan contract provisions and meet public expectations, thus legitimizing the actions of firms.

1.2. Community Involvement Disclosure and Financial Performance

Financial performance is the general measure of how well a firm uses its resources to generate profits. It was measured using accounting measures of profitability. ROE was used as the measure of financial performance. Panel data was used to smoothen the effects of manipulation and disparate accounting policies. A study was conducted by Daniel Kipkiron Tarus [16] on the relationship between CSR and firm performance in Kenya, using a sample of 352 firm-years during the period 2005–2012. Results indicate a positive significant relationship between community CSR and firm performance.

A study was conducted by Ponnu & Okoth [5] investigating CSR disclosure practices among listed firms in Kenya. Results reveal that CSR disclosure received modest attention and theme most commonly disclosed was community involvement. The sample size was 54 listed companies. Chi square test results indicate that there is no difference in level of disclosure between various industry groupings at 5% level of significance. The results also reveal firm’s financial status (liquidity, revenue, and profitability) has no significant influence on CSR. On themes of disclosure, more information, was reported on community involvement only limited number of companies disclosed information concerned with environment and Human Resources.

A study conducted by Ishmail & Sira [13] on Social Accounting Practices among Kenyan Firms: An Empirical Study of Companies Quoted at Nairobi Securities Exchange. The population of the study was fifty seven companies quoted in NSE and longitudinal study was carried from 2008-2010. Census method was used to collect data. Secondary data was collected from published annual financial statement of all listed companies. Content analysis and descriptive analysis was used in analyzing data. It was established in the year 2008, companies practicing social accounting were 72%, while 2009 were 75% and in 2010 were 81%. It was also established that community involvement and environment themes was leading in practice of social accounting. Finally, it was established that companies prefer non-monetary form over monetary form of presentation and also they prefer using separate location to using chairman’s report in annual reports.

The study conducted by Kipruto Daniel [15] intended to determine the effect of corporate social responsibility on financial performance of commercial banks in Kenya. Secondary data from the year 2009 to 2013 was used for analysis. Data was obtained banks audited financial statements, websites, publications and annual reports. Out of the 44 commercial banks studied, only eight provided the necessary and complete data that was appropriate for the study. The study findings were that expenses on social course have an effect on financial performance of commercial banks in Kenya.

1.3. Legitimacy Theory

Legitimacy is described as the congruence between the values of the organization and those of the society within which the organization is operating. Firms will therefore voluntary disclose information to show they are in congruence with the society [Uwaloma, 11].

When there’s conflict between the two value systems, then the organization legitimate entity is under attack because the society may even boycott their products. To maintain their legitimacy, companies may voluntarily disclose social and environmental information [Aburaya, 12]. Breaches of the sustainability contract are equivalent to legitimacy gaps, which surface whenever public perception is that the activities of an organization are not congruent to society’s norms [Dragomir, 7].
Organizations therefore, make sustainability disclosures as an avenue to gain or maintain legitimacy. Community involvement disclosure, in particular, provides a means to justify the company’s continued existence [Aburaya, 12].

1.4. Stakeholder Theory

According to Deegan et al., [3], corporate stakeholders are people who can affect or are affected by corporate actions, policies and decisions. They include shareholders, suppliers, the government, employee’s customers, the media, the local community, and future generations. Stakeholder theory has two branches: ethical and managerial aspect [Deegan et al., 3]. Ethical branch views community involvement disclosures as responsibility driven. The wide variety of stakeholders have the right to access to company wide information, acknowledgment of this fact/right can lead to improved corporate financial performance. However, from a managerial perspective, corporate management tends to respond to the information demands of powerful stakeholders who are important to the firm’s survival. The provision of information will depend upon how powerful stakeholders are perceived to be and their expectations will affect corporate operations and disclosure policies. The theory views community involvement disclosure as an important means by which companies negotiate their stakeholder relationships [Stanton, 10].

1.5. Critical Review

Most empirical studies reviewed show that many scholars have been considering firm characteristics such as size, profitability, market characteristics such as market capitalization and other characteristics such as listing and industry type and their effect on sustainability disclosure. CID in many research studies is considered the dependent variable and it’s aggregated. The source of the connection between community involvement disclosure and financial performance has presented mixed results. Studies further conducted on effect of CID on financial performance yielded either a negative, neutral or positive association thus indicating inconsistent results. In addition, many studies have focused on developed markets as opposed to emerging markets where there has been an increase in adoption of the reporting practice.

II. METHODOLOGY

The study employed casual research design. The design is applicable because it reveals the cause and effect relationship between variables [Cooper & Schindler, 8]. The design was therefore employed to determine the effect of sustainability disclosure on financial performance of listed companies in Kenya. Purposive sampling was used to select only those companies that have been listed for the entire period of study (2009-2013) and whose annual reports were available at the Securities Exchange. Firms that did not meet this criteria were excluded. A checklist instrument outlining the criteria for identifying disclosures was designed in order to codify the community involvement information contained in the annual reports. An extensive review of prior studies was undertaken to develop a list of items that may be voluntarily disclosed by a firm. A disclosure index was developed to help measure the quantity and quality of community involvement disclosure. Three procedures were undertaken in order to develop the disclosure indices. First, a checklist of community involvement disclosure items was constructed as a measuring instrument by selecting the relevant informational items to be included in the checklist. Second, a coding process was carried out to assign each community involvement informational item in the annual report to one of the checklist items using predetermined decision rules. Third, quantity scores were calculated for each disclosure category from which disclosure indices were computed to permit further analysis. Through these procedures, both the validity and reliability were tested.

2.1. Moderating Variables

The company size and the level of Debt to Equity ratio moderates the relationship between community involvement disclosure and financial performance. These variables are pegged on Positive Accounting theory [Watts & Zimmerman, 2]. It was ascertained by Watts & Zimmerman [2] that the objective of positive accounting theory is to explain and predict accounting practice by managers. Watts & Zimmerman [2] identified three key hypotheses that have often been used in the PAT literature to explain and predict why firms’ would support or oppose a particular accounting method. These hypotheses are management compensation hypothesis (bonus plan hypothesis), the debt hypothesis (debt/equity hypothesis), and the political cost hypothesis.

2.2. Model Specification

\[
ROE_i = \beta_1 + \beta_2 \text{CSR index}_{2i} + \beta_3 \text{SIZE}_{3i} + \beta_4 \text{LEVERAGE}_{4i} + \mu_i
\]

The only consideration is whether or not a company discloses an item of community involvement information in its corporate annual report. If the total disclosure score exceeds the mean categorical disclosure rating in the annual report it took the value ‘1’ and 0 if otherwise. The total disclosure (TD) score for a company is additive as follows.

\[
TD = \sum_{i=1}^{n} di
\]

Where, TD= Total Disclosure,
\(di =A\) score of 1 if TD> mean disclosure rating
\(A\) score of 0 if otherwise.

III. RESULTS

3.1. Hypothesis

\(H_0\) There is no significant difference in the mean financial performance of NSE listed firms with high or low community involvement disclosure ratings

Therefore, the null hypothesis was rejected and this implied that there is a statistically significant relationship
between community involvement disclosure and financial performance. There is a significant difference in the mean financial performance of NSE listed firms with high community involvement disclosure ratings compared to those of low community involvement disclosure ratings. This is supported by Mohr & Webb [4] who claims that a high level of CSR results in customers’ intent of buying and that consumer are prepared to pay a significant percentage of the value of the product for specific ethical features. CSR is also attributed to customer loyalty which in the long run increases interests for the organization.

**H02 Firm Size and its liquidity have no moderating effect on the relationship between community involvement disclosure and financial performance.**

A moderator is a variable that specifies conditions under which a given predictor is related to an outcome. The moderator explains when a Dependent Variable and Independent Variable are related. Moderation implies an interaction effect, where introducing a moderating variable changes the direction or magnitude of the relationship between two variables. Size and leverage were hypothesized as moderating variables.

Table 1: Moderating Effect of Size and Leverage on Relationship between Community Involvement Disclosure and Financial Performance

<table>
<thead>
<tr>
<th>ANOVA</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>2352.552</td>
<td>1</td>
<td>2352.552</td>
<td>30.586</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>2307.448</td>
<td>30</td>
<td>76.915</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>4660.000</td>
<td>31</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Regression</td>
<td>2531.788</td>
<td>3</td>
<td>843.929</td>
<td>11.103</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>2128.212</td>
<td>28</td>
<td>76.008</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>4660.000</td>
<td>31</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: ROE-REVISED
b. Predictors: (Constant), community disclosure
c. Predictors: (Constant), community disclosure, TS Log, leverage

Table 1 indicates that model 1 is significant at 5% significance level without the interaction effect F (1, 30) = 30.586, p <0.000. Model 2 F (3, 28) = 11.103, p <0.000 was also significant at 5% significance level. Model 2 accounts for more variance change in the interaction between community involvement disclosure and financial performance. The R square change is 0.04 p = 0.322, indicating that there was potentially no significant moderation of size and leverage on the relationship between community involvement disclosure and financial performance at 5% significance level. The null hypothesis was accepted.

3.2. Discussion

The study found out that community involvement disclosure has a significant effect on financial performance. Drawing on legitimacy theory, firms that engage in community involvement disclosure are likely to improve their performance because of social approval. They remain legit in the eyes of their various stakeholders thus improving their bottom line in the long run due to brand image and identity. The results are consistent with Daniel Kipkiron Tarus [16] who found a positive significant relationship between community CSR and financial performance among listed firms in Kenya. The study found no significant moderation of size and leverage on level of community involvement disclosure. These results are in conformance with the findings of Ponnu & Okoth [5] which revealed that in Kenya, a firm’s financial status (for example liquidity, revenue and profitability) has no significant influence on its CSR disclosure.

**IV. SUGGESTIONS FOR FURTHER RESEARCH**

The author makes the following suggestions for further research in view of the limitations of this research;

i. Research should be conducted on non-listed firms which are dominant in Kenya as opposed to listed firms in order to have a large sample size and hence better predictability of the results.

ii. Future researchers should consider other forms of corporate communication apart from annual reports for instance, corporate websites, and stand-alone reports among others. Annual reports provided limited information.

**REFERENCES**


*Karambu Kiende Gatimbu* is a Part-time Lecturer in Finance and Accounting at University of Embu. She holds an MBA (Accounting) from Chuka University and Bachelor of Business Administration with IT Accounting major (1st class Honors) from Maseno University in Kenya. Research interest include social and environmental accounting.

*Henry Kimathi* is a Lecturer in Finance and Accounting at Chuka University. He has extensive experience in industry and university teaching.