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Business Case for Corporate Transparency: Evidence from Kenya

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Abstract

With increasing trend of corporate scandals and corporate failure, stakeholders are demanding access to information, transparency and accountability. In response to these demands, corporate governance guidelines all over the world prescribe for corporate transparency and disclosure of information especially among public listed firms. Drawing from agency theory and stakeholder theory, we argue that corporate boards have a responsibility to disclose material information to stakeholders in order to facilitate decision making and hence improve firm performance. This study investigates business case of corporate transparency in Kenya. Applying Fixed Effects regression model on data from 42 listed firms in Nairobi Securities Exchange for the period 2005-2010, we found that indeed corporate transparency has a positive and significant effect on firm performance. The results have important policy implications on corporate disclosures in Kenya.

Keywords: Corporate Transparency, Accountability, Corporate Governance, Kenya.

1.0 Introduction

Researchers increasingly realize that the separation of ownership and management creates a cost to the firm. More importantly, the divergence of interests between the corporate agents and principals in today's corporate world is widening at an alarming rate. To mitigate this problem diverse theoretical perspectives as well as regulatory frameworks have been developed; for example, agency theory argues that corporations need to address divergent interest by checking the actions of management via monitoring and controls (Jensen and Meckling, 1976). Arising from this theoretical framework and the increasing rate of corporate collapse and scandals, various countries have enacted legislations to curb the agency problem.

Almost all legislations enacted in both developed and developing countries such as Sarbanes Oxley Act of 2002 in the US, Cadbury Report in the UK, Kings Report in South Africa, and Corporate Governance Guideline of 2002 in Kenya emphasizes the importance of corporate transparency as a pillar in addressing governance problems because it limits the managers' incentive to misbehave. These legislations are premised on the fact that scandals and corporate collapse occur because of information asymmetry among the agents and the owners as well as dishonesty on the part of the management. Researchers such as Verrecchia (1990) and Ang and Brau (2002) found that corporate transparency reduces asymmetric information thus resulting in enhanced firm performance. Others argue that corporate transparency reduces cost of capital (Botosan and Plumlee, 2002). While Datar *et al*., (1998) attribute corporate transparency to increased firm's liquidity level because of the confidence that capital providers will have on the firm. In support of this perspective Lang and Lundholm (1996) found that transparency increases access to the capital markets.

Although the importance of corporate transparency is not in dispute in the extant literature, research on the effect of corporate transparency and its resultant corporate outcome is scanty especially in Kenya. Indeed, most researches on corporate transparency have been conducted using data derived from western countries. We believe that developing economies have unique set of corporate value system that may not be in tandem with the western world. Given the differences in the level of legal and institutional development, there is need to look at whether corporate transparency has implications on firm performance in developing economies. Moreover, this study conceptualized transparency it four dimensions: financial transparency, governance transparency, social transparency, and risk transparency, in order to understand how the various aspects of corporate transparency affect firm performance.

2.0 Theory and Hypotheses Development

Several theoretical perspectives can be used to understand the relationship between corporate transparency and firm performance. First, agency theory developed by Jensen and Meckling (1976) presupposes that individuals are opportunistic, and that managers constantly aim to maximize their own self-interests. In such a scenario there is no guarantee that managers will act in the best interests of the owners, rather, there is temptation for managers to maximize their own self-interests at the expense of the owners. They argued that the divergence of interest erodes shareholder value because the managers pursue their utility maximization objective at the expense of firm value.

The theorists believe that the divergence of interests between the owners and the managers can be addressed by instituting mechanisms to align their interests by incurring costs such as monitoring and disclosures. Thus by disclosing all material information to the public, the managers have little opportunity to pursue their own interests (Farrer and Ramsay, 1998). For example, the corporate governance regulations require that compensation systems be disclosed in the financial reports and that any increase in executive pay must be supported with explanations. Similarly, managers may have incentives to pursue strategies that reduce their employment risk (Amihud and Lev, 1981), or increase firm size resulting in greater compensation (Baker *et al.,* 1988; Donaldson, 1984). Consequently, they may adopt non-profitable investments, even though the outcome is likely to be result in value reduction and particularly in the presence of free cash flow in the firm (Jensen, 1986).

Transparency of executive pay denies managers an opportunity to vary the pay structure, thus increase firm value. Short *et al.*, (1999) and Cheung and Chan (2004) support this view that the ultimate goal of corporate transparency is to monitor the management decision-making in order to ensure that their actions are in line with shareholders' interests, and to motivate managerial behavior towards enhancing the shareholders wealth maximization goal. In essence, increased transparency lowers the agency costs inherent in the separation of ownership from control (Williamson, 1985).

Secondly, legitimacy theory postulate that corporations engaged in social activities need to disclose so that they can justify their existence as well as legitimize their actions to the owners. The theory argue that corporations with multiple stakeholders need to maintain survival by addressing social problems because that way firms can built reputation, image and social capital. They are expected to disclose social responsibility information so that they can legitimize their behaviors to the stakeholders groups. The theory is based on the idea that a 'social contract' exists between business and society. Society allows business to exist and as such have expectations of how business is conducted. Thus in order to survive, a company must ensure that the activities are in accordance with the values and norms of the society.

Corporate transparency, is defined as the availability of firm-specific information to those outside publicly traded firms, and viewed as the joint output of multi-faceted systems whose components collectively produce, gather, validate and disseminate information to market participants (Bushman and Smith, 2003; Bushman *et al.,* 2004). According to business Publications such as Scandals in Business USA (2002) corporate transparency is about promoting fair, efficient and transparent administration of corporations to meet well defined organizational objectives, it is also about promoting systems and structure of cooperating and controlling corporations with a view of achieving long term strategic goals that satisfy the owners, suppliers, customers and financiers while compiling with the legal and regulatory business requirements.

Research indicates that transparent firms are anticipated to provide greater firm-specific information to outside investors and contribute to the efficient flow of scarce resources to promising investment opportunities (Bushman and Smith, 2003). Thus greater corporate transparency not only lowers information acquisition costs, but it also ameliorates problems related to information frictions that a firm is bound to face in the absence of corporate transparency practice.

Caprio and Honohans (2001) argue that investors are hesitant to invest in public enterprises because of failure to disclose material information. Indeed, investors require information on the firm in order to place a value on the firms' securities. Thus opacity or information asymmetry means that investors have less information to base their valuation of the firms' securities. Transparency mechanisms therefore require increased disclosure of corporate information in a manner that allows shareholders to be fully informed and thus make quality decisions. Bushman and Smith (2003) also support the same sentiment that availability of firm-specific information allows investors to monitor manager's decisions and ensure that resources are directed towards profitable projects in terms of growing firm's cash inflow.

2.1 Financial Transparency and Firm Performance

It is generally accepted that financial transparency is one of the fundamental goals of financial reporting system as it is a tenet of any corporate governance system. A good system of corporate governance requires a high level of disclosure of financial information to reduce information asymmetry between all parties and in making corporate insiders accountable for their action (Melis, 2004). The financial reporting system represents the main mechanism to provide adequate financial information to shareholders. As such, financial reporting and disclosure can limit the top management's discretion to pursue their own interest and focus on maximizing shareholders wealth thus improving firm performance in the long run and value of company's stock at the stock market.

A major goal of financial disclosure is to supply outsiders with accurate information about financial position of organizations. More transparent accounting reduces information asymmetry and consequently mitigates adverse selection problems in capital choice. As a result it reduces cost of capital by lowering the liquidity premium that uninformed investors demand to protect themselves against adverse selection. Easley and O'Hara (2004) observe that an increase in liquidity and a lower cost of capital are beneficial in enhancing firm performance.

Firms strategizing on market expansion through mergers and acquisitions should adopt financial transparency as their strategic tool. Jensen (1986) argues that such firms use benefits of high transparency of their financial information to attract acquisitions thus receiving higher number of bids and more importantly improve on their capacity to negotiate competitive premiums, with the assumption that investors are risk averse and they are aware of information asymmetry problem.

Johnson *et al.,* (2000) argues that concentrated equity ownership can be bad for the governance of the firm because it gives the largest shareholders too much discretionary powers to use firm resources in ways that serve their own interests. Financial disclosure relating to share ownership is important to minority shareholders who have the right of protecting their investment against "tunneling" problem. This is because large shareholders mostly act on their own interest thus exposing the firm and the small investors to risk of losing control to speculators.

Companies with higher levels of financial transparency are characterized with high levels of asset utilization, for instance, such firms are capable of attracting more potential investors which result in increased capital base, and thus improve financial performance. It has also been found that firms that embrace financial transparency pay a lower price for funds. In addition to influencing the cost of capital, financial transparency reduces financial improprieties and scandals that occur due to opacity in financial transparency. Agency theorists argue that corporations need to monitor management by ensuring proper accounting disclosure and auditing (Jensen and Meckling, 1976) because it is believed that corporate frauds and scandals result in wealth reduction owing to the possibility of takeovers and corporate collapse. Firms that embrace high levels of financial transparency increase investor confidence as well as signal other stakeholders of the future of the firm. Thus signal is expected to be reflected on the market value of the firm. Thus we hypothesize that:

H1: Financial transparency has a positive and significant effect on firm performance

2.2 Governance Transparency and Firm Performance

Governance transparency deals with the disclosure of relevant information about decision making processes, procedures, and the functioning of the firm. Corporate governance transparency is a formal system of accountability of senior management to its shareholders, and describes the network of formal and informal relations that is aimed at creation of a more transparent corporation with the goal of improving long term performance of the firm and also increasing its shareholder value (Bushman *et al.,* 2004).

Governance transparency is the disclosure of information on organizations' legitimacy of corporate power, corporate accountability, to whom and for what the corporation is responsible and by what standards is the organization to be governed and by whom (Bhat *et al.,* 2006). Drawing from agency theory, Jensen and Meckling (1976) observed that public corporations have two parties: the owner (principal) and the agent (manager). The theory further observes that both parties are utility maximizers who are expected to pursue self-interest. In other words, the managers may resort to the pursuit of their own parochial interest as opposed to the owners' interest and so the owners ought to monitor management. Thus one of the monitoring mechanisms is the disclosure of governance related information to diverse stakeholders.

It is widely recognized that corporate governance is critical in many countries (Shleifer and Vishny, 2000; Denis and McConell, 2003) because studies have shown a correlation between the governance systems and firm performance (Gompers *et al.,* 2003). Millestein and MacAvoy (1998) argues that governance transparency protects shareholders by providing timely and relevant corporate governance information such as composition and competence of the board, frequency of meetings, compensation plans, among others. Adequate and timely information about corporate performance enables investors to make informed buy-and-sell decisions and thereby helps the market reflect the value of a corporation under present management (Patel *et al.,* 2002).

Governance transparency is important for increasing investor confidence and improving market liquidity (Donaldson, 2003). With so many recent regulations focusing on corporate governance and the recent stock listing standards imposed there is a widely held view that better governance transparency results in better firm performance. Leblanc and Gilles (2003) found most measures of governance transparency to be associated with firm performance. Thus we state the following hypothesis:

H2: Governance transparency has a positive and significant effect on firm performance

2.3 Social Transparency and Firm Performance

Drawing from previous research, social responsibility transparency carries an aura of legitimacy (Neu *et al.,* 1998). Legitimacy theory posits that firms accept to justify their existence in the society by legitimizing their activities. In other words, corporations respond to public pressure by addressing social problems and so the company attempts to maintain survival by disclosing social responsibility activities and in the process legitimize their activities.

Numerous studies have investigated the link between corporate social responsibility and financial performance through a theoretical as well as an empirical lens. In particular, research rooted in neoclassical economics argued that social responsibility unnecessarily raises a firm's costs, putting the firm in a position of competitive disadvantage vis-à-vis its competitors. Jensen (2002) predominantly based on agency theory argue that firms employing valuable firm resources to engage in social responsibility result in significant managerial benefits rather than financial benefits to the firm's shareholders (Brammer and Millington, 2008).

Studies conducted by Lang and Lundholm (1993) support the view that social transparency has firm performance implication. For instance, in a cross-sectional analysis of the transparency policies of firms, they found that disclosure ratings are positively associated with firm's performance. On the other hand, Welker (1995) found a negative relationship between the AIMR rankings and firms' bid-ask spreads. Prior studies have examined whether firms that provide more extensive disclosures benefit by achieving a lower cost of capital thus considerable influence on their general firm performance.

Consistent with stakeholder theory, Molenkamp (2005) argues that social transparency benefits the firm through improved corporate relationship and initiative towards its stakeholders; as a result corporations gain long term benefits. For example, if the firm engages in social responsibility activities and discloses them in the financial statements, stakeholders who may have benefited from the activities and those who may have seen them in the financial reports are likely to have a high esteem on the company. It is also been found that the financial community pays greater attention to the companies performing well in social and environmental transparency fields, thus giving a competitive advantage to firms that are considered socially friendly who in the end achieve both short-term and long-term corporate financial performance objectives.

According to Davis (1975) increase in social transparency brings forth company's social influence. When a company is unable disclose its social activities in the form of tax payment, employment, provision of quality products, among others it may result in a loss of social power which is a necessary ingredient in bargaining for customers in the market. Stakeholders more often than not are unaware of the firm's social activities. In most cases they have no access to relevant information concerning such social activities and so social transparency should be availed to enable them understand and contribute towards organizational social goals.

Lyon and Maxwell (2006) argue that social transparency plays an important role in not only informing stakeholders on the firm's social activities but also has a long term advantage of championing for customer loyalty as well as enhancing reputation and corporate image. This is considered as a powerful strategy in ensuring constant firm performance and an opportunity for the firm to contribute solutions to social problems. By engaging in social activities, firms may be rewarded indirectly through tax allowances and support of other stakeholders. Thus disclosure of social responsible activities is poised to enhance firms' reputation and stakeholder goodwill. We therefore hypothesize that:

H3: Social transparency has a positive and significant effect on firm performance

2.4 Risk Transparency and Firm Performance

Although much of the existing literature on transparency and disclosure deals with governance and social transparency, a new stream of research is emerging that attempts to investigate risk transparency. Several scholars argue that risk disclosure is an integral part of the business disclosure because it provides greater transparency and enhances investors' confidence (Solomon *et al.,* 2000; Iatridis, 2008). Risk transparency is defined as the disclosure in the financial statements of general, specific, and potential circumstances and events that may cause corporations assets and/or liabilities' value to fluctuate (Hassan, 2008). In particular, it involves the inclusion in the financial statements of information about managers' estimates, judgments, and non-financial information about corporations' plans, strategy, and other operational, economic, political and financial risks (Hassan, 2009).

Risk transparency is an important governance mechanism because it builds investor confidence in management of the firm. It gives assurance to the shareholders and other stakeholders on the firm's ability to meet its financial obligations as and when they fall due either in favorable or unfavorable economic condition. Research has found that disclosure of risk-related information improves the corporations' image and informs the stakeholders of the management ability to manage risks (Iatridis, 2008). Agency theorists argue that agency problems are more common when firms' decisions and operations are opaque (Jensen and Meckling, 1976), particularly when the firm is operating in a risky environment. Thus high levels of risk transparency would reduce agency costs and consequently enhance firm performance. In support of this view, Linsmeier *et al.,* (2002) observed that risk transparency has a positive correlation to stock prices because such transparency informs shareholders well in advance of the inherent risks and the mitigating mechanisms. In tandem with stakeholder theory, corporations with higher levels of risk is expected to disclose more amount of risk related information because the managers are willing to explain the causes of high risk and re-assure the stakeholders that they are prepared to address them (Abraham and Cox, 2007). This explanation of how efficiently managers are in managing the risk has the effect of increasing stakeholder confidence and thus value in the firm.

Another perspective in the accounting literature is that disclosure of information in the financial statements lowers the cost of capital (Dye, 2001). In support of this view, Verrechia (2001) argue that disclosure of risk related information reduces the information asymmetry component of the cost of capital, that is, a factor used by investors to discount firm equity. Thus firms with above average performance use transparency to favorably distinguish themselves from other firms, thereby increasing demand for their securities and lowering the cost of capital (Gelb and Strawser, 2001). This reduction in the cost of capital enhances firm performance. Accordingly, the following hypothesis is tested:

H4: Risk transparency has a positive and significant effect on firm performance.

3.0 Methods and Data

3.1 Data Sources

We used data derived from firms listed in Nairobi Securities Market (NSE) for the period between 2006 and 2010 irrespective of its industry or market segment. Secondary data was used and was collected using content analysis mainly from firms' annual reports and NSE bulletins.

3.1 Measurement of Variables

Independent variables: We obtained a list of corporate transparency items. Once the list of items was identified, each annual report was extensively examined to determine the presence or absence of the items disclosure. Hence, if the firm disclosed the item it received one, otherwise it received zero. This produced a disclosure score of each annual report, which was calculated for each firm by actual number of items disclosed. This procedure is known as the un-weighted approach and has been used in previous research. We therefore used the un-weighted disclosure index method following the procedure set by Cooke (1992) as follows:

$$CTD = \frac{\sum d_j}{d_j = 1}$$

Where; CTD= corporate transparency disclosure

d_j = 1 if item is disclosed

$\sum d_j$ = sum of variable disclosure

0 = If item is not disclosed

η = Number of items

The corporate transparency disclosure index was derived by computing the ratio of actual scores awarded to the maximum score attainable by that firm. various components of corporate transparency such as financial transparency, governance transparency, social transparency, and risk transparency was computed as independent variables.

Dependent variable: Firm performance was measured using return on asset ratio. It is defined as total revenue divided by total assets. ROA was measured as the ratio of Earnings before Interest and Taxes to Total Assets (EBIT/TA). This measure of firm performance has been used by Kato & Long (2006).

Control Variables: Possible confounding factors that affect the firm performance were controlled. For example, *board size* and measured as the total number of members in the board (Ruigrok, 2006; Zhang and Rajagopalan, 2010). Many studies have used this measure of counting the number of individuals serving on board of directors (Kaymak and Bektas, 2008). This variable was controlled because research indicate that large boards tend to be constrained firms strategic actions (Hambrick *et al.,* 1996) and stifles members participation in decision making because of insufficient time for individual directors to speak up (Golden and Zajac, 2001). *Independent directors,* herein referred as the percentage of seats held by outside directors were controlled. Studies have showed that boards with higher proportion of outside directors increase firm value (Rosenstein and Wyatt, 1990).

Tenure of Directors was measured based on the mean number of years board members have spent with a firm. To take into account board members who have served for less than one year, the study utilized the approach used by Kaymak and Bektas (2008) to calculate tenure on monthly basis, which was then converted into yearly equivalents. Board tenure was controlled because long tenure is associated with wealth of experience that enhances firm performance (Datta and Rajagopalan, 1998). However, research has also found that long tenure is related to status quo (Hambrick *et al.,* 1993), a feature detrimental firms that are in dynamic environments. Audit committee was measured as a dichotomous variable '1' if the audit committee exists in the firm, otherwise '0'.

3.2 Model Estimation

We used Fixed Effects regression method to test the hypotheses. The panel regression model used in this study is given as follows:

$$y_{it} = \alpha_{it} + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + \beta_4 x_{4it} + \varepsilon_{it}$$

Where: y =firm performance measured by Return on Asset (ROA); α = constant; $\beta_1 \ldots \beta_4$= the slope which represents the degree in which firm performance changes as the independent variable change by one unit variables; x_1= Financial transparency; x_2= Governance transparency; x_3=Social transparency; x_4= Risk transparency; ε = error term; t = measure of time; i = number of firm observation.

4.0 Results

4.1 Descriptive Statistics

Table 1 presents descriptive statistics of the study variables. The results reveal that the average board size in the sample is 9 members with a maximum of 17 board members. Independent directors had mean score of 0.7462, implying that on an average 75 percent of the board members are independent directors. It was also found that 34.67 percent of the firms in the study had audit committee. The average mean for board tenure is 5 years with some directors having been in the board for over 15 years. The study indicates that on an average, firms in the sample are transparent with means above 50 percent.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Board Size	225	1	17	8.9422	2.96275
Independent Committee	225	0.03	0.99	0.7462	0.20873
Internal Audit Committee	225	0	1	0.3467	0.47697
Board Tenure	225	0	15.04	5.0066	2.59041
ROA	225	-0.6	4.17	0.3796	0.62593
Financial Transparency	225	0.1	1.43	0.589	0.24139
Governance Transparency	225	0.2	6	0.698	0.42737
Social Transparency	225	0	1	0.4817	0.23581
Risk Transparency	225	0	1	0.6427	0.29025

4.2 Robustness Tests

Various robustness diagnostic procedures were performed to assess the validity of the regression results. First, at 1.97, the Durbin Watson statistic did not indicate that residuals were auto correlated. Second, a plot of residuals and statistical test by use of Kolmogorov-Smirnof test (see Hair *et al.,* 2010) revealed that all variables are normally distributed around zero. Finally, Variance Inflation Factor (VIF) procedures did not suggest presence of multicolliearity. Similarly, we computed Pearson correlation coefficients between the independent variables. The results show that the correlations between the independent variables are small. In fact the correlations are between .10-.37. Thus collinearity does not seem to bias the regression results.

4.3 Correlation Results

Results of Pearson Product Moment of correlation reveal significant correlation among the study variables. Table 2 shows that ROA is significantly related to all the study variables except board tenure. Most importantly, all the independent variables relating to corporate transparency are positive and significantly related to firm performance. For instance the relationship between governance transparency and firm performance is positive and significant (r=0.512, p <0.01), financial transparency was also positively and significantly correlated to firm performance (r=0.355, $p < = 0.01$), social transparency and risk transparency had positive and significance association with firm performance (r=0.254; 0.232, $p < 0.000$) respectively. Other correlation results are indicated in Table 2 below.

Table 2: Correlation Results

Variable	ROA	Financial Transp.	Govern. Transp.	Social Transp.	Risk Transp.	Board size	Independent Directors	Board Tenure	Audit Committee
ROA	1								
Financial Transparency	.355**	1							
Governance Transparency	.512**	.086	1						
Social Transparency	.254**	.255**	.048	1					
Risk Transparency	.231**	.112†	.091	.109	1				
Board Size	.347**	.153*	.087	.281**	.127†	1			
Independent Directors	-.310**	-.013	.051	.107	.052	.049	1		
Board Tenure	-.040	-.077	.025	-.059	-.155*	-.084	.085	1	
Audit Committee	-.189**	-.013	-.047	-.059	.118†	-.096	.154*	-.014	1

*†Correlation is significant at 10 percent; * significant at 5 percent; ** significant at 1 percent*

4.4 Regression Results

Regression results are presented in Model 1 and Model 2. Model 1 presents the results for all the control variables. While results in Model 2 presents the results for the full model. The results in Model 1 indicate that board size has a significant and positive relationship with firm performance. This indicates that as board size increase firm performance also increase. However, board independence and the presence of audit committee is found to have a negative and significant effect on firm performance. These results however seem to contradict the existing theory that independent directors monitor management and as a result improve firm performance (Rosenstein and Wyatt, 1990). Similarly, some theorist argue that independent directors bring a bundle of resources such as networks to the firm (Hillman *et al.,* 2000) resulting in improved firm value. This notwithstanding, independent directors may lack the necessary time because of work overload and lack of firm specific information which may be useful in enhancing quality decision making.

Results in Model 2 are used to test the hypotheses. Hypothesis 1 postulates that financial transparency has a positive and significant effect on firm performance. Results on Table 3 shows that financial transparency has a positive and significant effect on firm performance (coefficient estimate β= 0.586 with a p value of 0.000) and hence the hypothesis is supported. Hypothesis 2 hypothesized that governance transparency has a positive and significant effect on firm performance. Results supports the predictions (β= 0. 689 with a p -value =0.000).

Hypothesis 3 predicted that social transparency had a positive and significant effect on firm performance. Again the results support the hypothesis ($\beta_{=}$ 0.330, p-value=0.009. Hypothesis 4 postulated that risk transparency had a positive and significant effect on firm performance. The results indicate a coefficient of β= 0.370 with p value of 0.000. Hence the results support hypothesis 4.

Table 3: Regression Results

Variable	Model 1	Model 2
Intercept	.442 (.187)*	.434 (.170) **
Board size	.075 (.013)**	.048 (.010) **
Independent Directors	-.936 (.180)**	-1.07 (.134) **
Audit Committee	-.140 (.079)†	-.137 (.059) *
Board Tenure	.003 (.014)	.012 (.011)
Financial Transparency		.586 (.118) **
Governance Transparency		.689 (.065)**
Social Transparency		.330 (.125) **
Risk transparency		.370 (.100) **
R square	.239	.595
Adjusted R square	.225	.578
F	17.264**	34.98 **

*Values in Parentheses are standard errors. † indicate the variable is significant at 10 percent; * indicate the variable is significant at 5 percent; and ** indicate the variable is significant at 1 percent.*

5.0 Discussions and Conclusions

This study explores how corporate transparency affects firm performance. In our analysis of firms listed in the securities exchange in Kenya, we found corporate transparency accounting for a significant variance in firm performance. First, the results are consistent with our belief that financial transparency has a positive effect on firm performance. This expectation is based on the argument that transparency mitigates against divergence of interests and secondly it reduces agency costs (Fama and Jensen, 1983; Jensen and Meckling, 1976). Jensen (1986) further argue that financially transparent firms attract acquisitions thus receive higher number of bids and more importantly improve on their capacity to negotiate competitive premiums, with the assumption that investors are risk averse and they are aware of information asymmetry problem. Easley and O'Hara (2004) argue that an increase in liquidity and a lower cost of capital are beneficial to the firm on ensuring increase of firm performance.

Secondly as highlighted by Melis (2004), a good system of corporate governance requires a good level of disclosure and adequate information to reduce information asymmetries between all parties in making corporate insiders accountable for their action. The financial reporting system represents the main mechanism to provide adequate financial information to shareholders. As such, financial reporting and disclosure can limit the top management's discretion to pursue their own interest and focus on maximizing shareholders wealth thus improving firm performance in the long run and value of company's stock at the stock market this is in line with argument of agency theory since with reduced information asymmetry between principals and agents of the firm leads to reduction of related agency cost associated in promoting transparency in the firm. Thirdly these findings support a number of studies that have shown that financial transparency influence capital market considerations (Francis *et al.,* 2009).

Governance transparency was also found to have a positive effect on firm performance. Again we expected these results because the adoption of better governance transparency practices is intended to align the interests of the owners and management. This alignment of interest has an effect of increasing firm value because the shareholders have an opportunity to monitor management. Governance transparency enhances corporate accountability as well as boosts the reputation of the business in the eyes of stakeholders such as lenders and creditors (Leblanc and Gillies, 2003). Similarly, governance transparency increases investor confidence and thus improves share value (Donaldson, 2003). In line with the agency theory, governance transparency also reduces agency costs resulting in better firm performance. LeBlanc (2003) also found that most measures of good governance transparency are always in line with the firm's good performance hence this is consistent to his findings.

Our hypothesis that social transparency does affect firm performance is also consistent with previous research. For example, Molenkamp (2005) show that social transparency benefits the firm through the improvement of firm's relationship to its stakeholders. Most importantly, social disclosure increase firms' reputation and social capital which are necessary for increased performance. The results concur with stakeholder theory that firms engage social responsibility research that show that corporate social responsibility result in increased firm performance. Specifically, instrumental facet of the stakeholder theory argues that firms paying attention to stakeholder management are comparatively successful and thus outperform firms without stakeholder orientation (Donaldson and Preston, 1995).

We found risk transparency to have a positive effect on firm performance. Again we expected the results and are consistent with extant literature. First, risk transparency provides investors with the future outlook of the firm particularly when the firm has a clear strategy on how to mitigate the risks. Secondly, a clear articulation of the future risk profiles of the firm influences the nature of the capital structure of the firm, thus determines the cost of capital (Dow and Gorton, 1997; Cebenoyan and Strahan, 2004). And thirdly, a clear risk mitigation strategy communicates the quality of the firms' management. This enhances the confidence of the investors as well as other firms' stakeholders. Consequently, firm performance is expected to increase with increased risk disclosure.

Our results have important implications for understanding the importance of corporate transparency. While a lot of attention has been paid to developed economies, limited research has actually considered value implication of corporate transparency in Kenya. Our findings are consistent with the theoretical proposition that corporate transparency enhance firm value. Our study found that financial transparency, governance transparency, social transparency, and risk transparency have important implications to firm performance, and so management benefits from this study by increasing engagements in activities and structures that are designed to enhance firm value. We found governance transparency to have more effects on firm performance while social transparency had the least effects. Overall, corporate transparency in Kenya is an important predictor of firm performance.

Our study was not without limitations. First, we relied on archival data especially information contained in financial reports. We suggest that primary data may be useful in providing more insights rather than using proxies to measure corporate transparency. Secondly, we based our research on a sample of listed firms in Nairobi securities exchange. This restriction limits generalizability of the findings particularly because of the small number of firms listed in the market. Future research using different samples (e.g. private non-listed firms) may provide additional insights and add to the existing understanding of the issues explored in this study.

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