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Abstract

The banking sector is featured and prioritized as one of the six key drivers of economic growth in Kenya's Vision 2030 as it plays a central role in mobilizing resources. The bank operations transparency and information disclosure are amongst the key elements of governance as lack of it can gradually weaken the trust of all parties in the bank's contracts. The specific objectives was to establish the effect of profitability on the quality of voluntary disclosure among Kenyan commercial banks. This study was guided by signalling theory. This study adopted positivistic philosophy and explanatory research design. The study period was between the years 2013- 2020 and 38 out of 41 commercial banks in Kenya licensed by the Central Bank of Kenya as at 2020 were selected as the sample using purposive sampling method. The data was extracted and compiled for evaluation from the financial statements using the document review guide. Descriptive and inferential statistics evaluated the data. Pearson correlation analysis was done to show correlation between variables and a panel regression model was used. The study found that profitability has a significant positive influence on quality of voluntary disclosure of commercial banks. It is recommended that banks should prioritize strategies that enhance their profitability. This is crucial for maintaining financial stability, as higher profitability allows for the accumulation of retained earnings, which in turn act as buffers to absorb potential losses.

Keywords: *Profitability, Quality of Voluntary Disclosure & Commercial Banks*

1.1 Introduction

The banking sector is featured and prioritized as one of the six key drivers of economic growth in Kenya's Vision 2030 (Kisembe & Muturi, 2018) as it plays a central role in mobilizing resources (Nyasha & Odhiambo, 2012). The bank operations transparency and information disclosure are amongst the key elements of governance as lack of it can gradually weaken the trust of all parties in the bank's contracts (Bidabad & Sherafati, 2019). Therefore voluntary disclosure by banking firms helps improve the openness of market transaction and force bankers to reduce the risk taking (Dhouibi & Mamoghli, 2013). Previous literature supports that the connection between firm profitability and the extent of disclosure is positive (Habbash, Hussainey & Ibrahim. (2016); Leuz & Wysocki (2016); Aragón-Correa, Marcus & Hurtado-Torres (2016); Wanjau, Muturi and Ngumi (2018). However, Khlif and Souissi (2010); Uyar Kilic and Bayyurt (2013) never found the effect of profitability on voluntary disclosure.

The information added and delivered by firms with the obligatory information beside it (Kanakriyah, 2016). According to Scaltrito (2015), voluntary disclosure means discretionary release of both monetary and non-monetary information not required by law to increase firm competitiveness and guarantee transparency among stakeholders. "Disclosure of information can be categorized as either mandatory or voluntary where voluntary disclosure refers to any other information that the management have freedom of choice to disclose whereas mandatory disclosure is focusing on presenting the requirements as per the laws and regulation - financial statements and their complementary footnotes (Uyar & Kiliç, 2012).

The demand for voluntary information, which supports investors in making sustainable financial and economic decisions, has grown substantially in recent years. This increased demand can be attributed to the limitations of traditional compulsory information disclosure (Jeewantha, Bandara, & Ajward, 2015). While compulsory disclosures provide a baseline level of information, stakeholders, particularly investors, have expressed dissatisfaction with the adequacy and relevance of this information. In response to this, firms have recognized the importance of voluntary disclosures as a means to cater to the evolving needs of their stakeholders (Binh, 2012). Voluntary disclosures have become a critical aspect of corporate communication, aimed at providing additional insights beyond what is mandated by regulations.

According to research conducted by Alqatameen et al. (2020), the information disclosed voluntarily by firms plays a crucial monitoring role in protecting the interests of various parties, including shareholders and management. These disclosures serve as a mechanism through which stakeholders can gain a deeper understanding of a company's financial health, strategic direction, and overall performance. By voluntarily sharing information, firms demonstrate transparency and a commitment to open communication, which can enhance trust and confidence among stakeholders.

Researchers have employed different methodologies to gauge the level of voluntary disclosure in various studies. Two common approaches include the use of unweighted and weighted indexes

(Scaltrito, 2015). In the weighted index approach, specific information items are assigned scores between zero and one, with the researcher determining the marks and weight of each item based on its perceived significance. Items that are not disclosed receive a value of zero. This method allows researchers to give more weight to information they consider more important, reflecting the varying degrees of relevance in voluntary disclosures (Omar & Simon, 2011). On the other hand, the unweighted index takes a simpler approach by considering whether an information item is disclosed or not. In this approach, all items are treated as equally important to the users of the constructed disclosure index. This method provides a straightforward binary assessment of disclosure without assigning different weights to individual items. Researchers may choose between these two approaches depending on the specific objectives of their studies and their views on the relative importance of various information items in the context of voluntary disclosure.

This research adopted the un-weighted disclosure index that was utilized in measuring quality of banks' voluntary disclosure in Turkey by Milad and Bicer (2020). A checklist consisting of 64 voluntary disclosures items classified into five broad sections based on their nature was utilized in gauging quality of voluntary disclosure. The researcher used these guidelines to score the quality of voluntary disclosure as used by Koduah (2020); "0.80 and above = excellent, 0.70 – 0.79 = above average, 0.60 – 0.69 = slightly above average, 0.50 – 0.59 = average, 0. 40 – 0.49 = below average and 0.39 and below = poor." The main reason behind the adoption of the approach in this research is to avoid the biasness that arises when the weighted scoring approach is used and it assumes that information items considered are of equal significance to all annual reports of commercial bank's user groups (Hawashe, 2015).

1.2 Statement of the Problem

The interests of management and stakeholders is protected by the monitoring of information disclosed voluntarily (Alqatameen *et al*., 2020). There has been a steady improvement in disclosure levels from 2012 to 2016 on both the extent and quality for large banks in Kenya. For instance, in 2012, the average disclosure level was at 42% and improved steadily to 58% in 2016 (Kemei, 2017). However, Gitahi (2019) identified a significant difference in the quality of the disclosure from company to company and from year to year between 2010 to 2015 for listed banks in Kenya. A case supported by Kabugu (2016) who found that there is no uniformity in the disclosure by board of directors in banks in Kenya for years 2013-2015. Mugo (2014) states that, the Kenyan commercial banks' level of voluntary disclosure was ranging between 47-55 % in 2008-2013. In 2013, In Kenya the voluntary corporate disclosure was at 62.8% 3 banks had a less than 405 disclosure scores, 8 banks releasing more than 70% of their data via yearly reports voluntarily and 20 banks disclosed 41-70% of information. Osembe and Chepkemoi (2016) posit that CBK placed Chace bank in receivership in 2016 and Imperial bank and Dubai bank in 2015 due to failure of adhering to disclosure requirements states in the CBK's issued prudential guidelines, this is despite the resilience and stability of the baking sector (CBK, 2015). The fact that these banks recently failed and earlier warning signals regarding the failures was not provided by the audited financial statements has brought attention amongst the general public on the financial reporting quality in the country (Jerubet, Chepng'eno & Tenai, 2017).

Different results have been reported by the existing studies with regards to firm specific characteristics and quality of voluntary disclosure thus various gaps are presented; Thinh (2021) study on how top 50 Vietnam listed companies (2015 – 2019) voluntary disclosure was impacted by firm characteristics conceptualized the variables differently and the context was only non-financial firms. The research thus sought to establish the effect of profitability on the quality of voluntary disclosure among commercial banks in Kenya.

1.2 Research Objective

To investigate the effect of profitability on quality of voluntary disclosure among commercial banks in Kenya

1.3 Research Hypotheses

H$_{O1}$: Profitability does not have a significant effect on quality of voluntary disclosure among commercial banks in Kenya.

2.1 Theoretical Review

Signaling Theory

Spence (1973) coined this theory and he states that the managers' decision of capital structure signals information to the market if they have insider information. It makes an assumption that compared to other stakeholders, most firm information is with the insiders (Bebchuk & Weisbach, 2010) who may exploit potentially the information for maximization of individual benefits (Jensen & Meckling, 1976). An organization should make an effort to give more information to investors in places where there is information inequality between investors and company managers, this helps in eliminating such; without bridging the gap, the investor may not understand the actual operational situation of the company (Spence, 1973).

Moreover, an empirical, practical and unique testable view on social selection issues under imperfect information conditions is provided by signaling theory (Connelly et al., 2011). Disclosure of high-quality information voluntarily can mitigate the information asymmetry as espoused by signaling (Harun et al., 2020). More precisely, the market participants receive signals from the company's managers by way of voluntarily disclosing information in annual reports (Khlifi & Bouri, 2010).

Moreover, organizations which have greater profitability have a likelihood of disclosing more information to the markets, with the aim of increasing investor confidence (Van Zijl, Wöstmann & Maroun, 2017) and preventing their shares undervaluation (Shehata, 2014). Growth and disclosure are expected to be positively related (Omran & Ramdhony, 2015) as firms which have a rate of growth give more information to be more appealing in the market. The connection between monetary leverage and disclosure is predicted to be possible by signaling theory but the

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association direction is not clear (Ghabayen, Mohamad & Ahmad, 2016). Hence, relying on the past related researches, and this theory as theoretical base, age and profitability positively affect voluntary disclosure (Bhuyan, 2018; Elfeky, 2017; Lan et al., 2013; Abeywardana & Panditharathna, 2016).

Voluntary disclosure is among the signaling means, in which firms give out more information than what is needed by regulations and laws so as to signal their betterment (Lo & Lin, 2018). This theory's arguments benefited the study in investigating how firm specific characteristics and quality of voluntary disclosure among Kenyan commercial banks are associated.

2.2 Empirical review

Dahiyat (2020) conducted a study in Jordan, focusing on the determinants of voluntary disclosure quality among manufacturing companies listed on the Amman Stock Exchange. Using a multiple regression model for the year 2019, the research revealed a positive correlation between voluntary disclosure and company size, profitability, and age. However, available assets and financial leverage had an insignificant and weak association with voluntary disclosure levels. These findings provide insights into the relationship between financial metrics and voluntary disclosure practices, which can be relevant for understanding similar patterns among Kenyan commercial banks.

Rody, Sousa, Souza, and Reina (2020) examined the impact of profitability on the voluntary disclosure levels of Brazilian equity companies from 2010 to 2018. Their findings indicated that lower voluntary disclosure levels were associated with higher profitability. While their study focused on equity companies in Brazil, it raises intriguing questions about how profitability might affect voluntary disclosure practices in the context of commercial banks. Notably, the use of multiple linear regression models, as opposed to panel data methods, differentiates their approach from the current study, which samples both listed and unlisted commercial banks in Kenya.

Dawd (2018) investigated the financial disclosure practices in Kuwait, an emerging market, employing index-based analysis and multivariate and univariate regression evaluations. The study reported a negative correlation between profitability and compulsory disclosure practices among listed companies in Kuwait. While this study differs in focus from the current research, which concentrates on the quality of voluntary disclosure among Kenyan commercial banks, it underscores the significance of financial performance in shaping disclosure practices.

Yusuf, Adebayo, and Yusuf (2018) explored the effect of financial performance on discretionary disclosure among Nigerian listed financial firms over ten years from 2008 to 2017. Their study, using probit regression analysis, concluded that financial performance did not significantly affect voluntary disclosure among Nigerian listed financial firms. This contrasts with the hypothesis of the current research, which posits a positive connection between these variables. Furthermore, the use of a panel data model in the current study distinguishes it from Yusuf et al.'s probit regression approach, and the research extends its focus to both listed and unlisted commercial banks in Kenya.

In a study conducted by Islam, Bhuiyan, & Tuhin (2014) in Bangladesh, the researchers explored the discretionary financial information disclosure level in annual reports of listed banks. Their findings, based on a sample of Dhaka Stock Exchange listed banks, did not reveal a significant connection between profitability and discretionary financial information disclosure. This finding challenges the hypothesis of the current study, which suggests a positive relationship between profitability and the quality of voluntary disclosure among both listed and unlisted banks in Kenya. The differences in findings may be attributed to the specific context and characteristics of the banks and markets under investigation.

2.5 Conceptual Framework

Kothari (2011) describes it as a diagrammatical representation of the connection between study variables. The framework diagrammatically and graphically presents the variables' correlation. Figures 1 demonstrates how firm profitability on quality of voluntary disclosure for commercial banks.

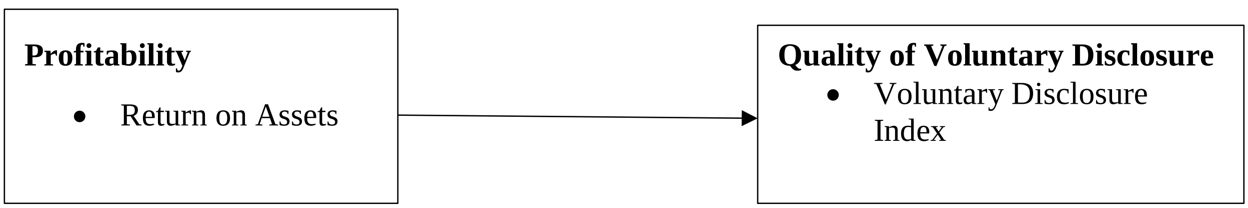

Figure 1 Conceptual Framework

3.1 Research Methodology

This study adopted positivistic philosophy and explanatory research design. The study period was between the years 2013- 2020 and 38 out of 41 commercial banks in Kenya licensed by the Central Bank of Kenya as at 2020 were selected as the sample using purposive sampling method. The needed data was extracted and compiled for evaluation from the financial statements using the document review guide. Descriptive and inferential statistics evaluated the data. Descriptive analysis was performed and displayed through the mean, mode, median, standard deviation as well as ratios. Pearson correlation analysis was done to show correlation between variables. In investigating how the variable relate, panel regression model was used. Diagnostics test conducted included heteroscedasticity, multicollinearity, normality test, panel unit root, autocorrelation, and test for fixed or random effects and they all met the threshold.

4.1 Results and Findings

4.2 Descriptive Statistics

Descriptive statistics: mean, standard deviation, maximum and minimum were established. Gravetter, Wallnau & Forzano (2016) notes that, the preferred central tendency measure was the mean as it is related closely to standard deviation and variance (most common variability measure), utilizes all score in the distribution and is more representative. Sharma (2018) cites that in comparison to measures of variation, standard deviation was preferred as it can compare skewness and correlation and is less affected if the sample size fluctuates. Table 1 displays the results.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Quality of Voluntary Disclosure	304	0.650	0.117	0.410	0.920
Profitability	304	2.312	0.463	-0.830	3.600

Table 1 shows that quality of voluntary disclosure proxied by voluntary disclosure index has a mean value of 0.650 with a 0.117 std. dev., it indicates a high variation degree with 0.920 maximum value against 0.410 minimum value as evidence. This indicates that quality of voluntary disclosure had lot of fluctuation over the period under study as evidenced by the 0.117 std. dev. and 0.650 mean. Profitability measured by Return on Assets had an average value of 2.312 and a -0.830 minimum value and 3.600 maximum value indicating that some months experienced a decline in Return on Assets. The standard deviation of 0.463 indicates a large deviation of Return on Assets from the mean indicating high variation in the various commercial banks.

4.3 Correlation Analysis

Correlation analysis was carried out to detect the association between the independent and the dependent variables. The mean score for each of the independent variables was calculated and the Pearson's correlation. When the p-value is less than or equal to 0.05 the correlation is statistically significant. However, if the p-value is greater than 0.05 or the significant level then correlation is not statistically significant (Statistics Solution, 2018). Positive correlation implies that as one variable increases the other variable has a tendency to also increase. Negative correlation implies that as one variable increases the other variable has a tendency to decrease. The results for correlation are as shown in Table 2.

Table 2: Correlation Outputs

	Quality of Voluntary Disclosure	Profitability
Quality of Voluntary Disclosure	1.000	
Profitability	0.767	1.000
	0.000	
	0.000	0.000

Profitability was positively and significantly connected to quality of voluntary disclosure among commercial banks in Kenya (r= 0.767, p=0.000<0.05). Implying that profitability portrayed a positive association to quality of voluntary disclosure among commercial banks in Kenya.

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4.4 Hypothesis Testing

The hypothesis testing section covers the tests of the hypotheses emanating from the research of objectives of the study. Test of hypotheses was based on the firm specific attributes on voluntary disclosure quality. The hypothesis was tested using a regression model. Coefficients and their P values were estimated and interpreted at 5 percent significance level (0.05). The results are as shown in Table 3.

Table 3: Regression Outputs

Voluntary Disclosure Quality	Coef.	Std. Err.	z	P>|z|
Profitability	0.0545	0.0074	7.390	0.000
cons	0.4239	0.0275	15.430	0.000
Wald chi2(4)	905.95			
Prob > chi2	0.000			
R-squared	0.765			

Based on the results, the determination coefficient R Square is 0.765. The study objective was to investigate the effect of profitability on quality of voluntary disclosure among Kenyan commercial banks. Consequently, the null hypothesis that Profitability does not have a significant effect on quality of voluntary disclosure among Kenyan commercial banks was formulated to address this objective at 95 percent confidence level. Table 3 indicates that profitability had a coefficient of 0.0545 with a 0.000 P value, which < 0.05 leading to the rejection of the null hypothesis. This also led to finding that profitability affected quality of voluntary disclosure positively at 5 percent significance level implying that increasing profitability signify improved performance in the market and this results to rise in quality of voluntary disclosure.

Furthermore, the findings shed light on the practical implications of this relationship. It was observed that as profitability increased, there was a corresponding improvement in performance in the market. This suggests that commercial banks in Kenya that experience higher profitability tend to enhance their voluntary disclosure practices, which, in turn, contributes to improved transparency and information provision to stakeholders. The positive relationship between profitability and the quality of voluntary disclosure underscores the importance of financial performance as a driver for transparency and accountability within the banking sector. This outcome has significant implications for regulatory authorities, investors, and the broader financial market in Kenya, emphasizing the need to incentivize and encourage profitable banking practices that ultimately benefit all stakeholders.

The results of this study provide valuable insights into the interplay between profitability and the quality of voluntary disclosure among commercial banks in Kenya. The rejection of the null hypothesis and the statistically significant positive coefficient of profitability highlight the pivotal role that financial performance plays in influencing the transparency and disclosure practices of these institutions. As profitability increases, commercial banks are more inclined to enhance their voluntary disclosure, resulting in a more informed and confident financial market. These findings underscore the importance of fostering an environment that promotes profitability in the banking sector, as it not only benefits individual institutions but also contributes to the overall transparency and stability of the financial system in Kenya.

The findings agree with Dahiyat (2020) who examined the Voluntary disclosure quality determinants on Amman Stock Exchange listed manufacturing companies and the findings disclosed a positive correlation between the voluntary disclosure and company size, profitability and age. Rody, Sousa, Souza and Reina (2020) verified that profitability positively impact on companies' voluntary disclosure level of Brazilian equity companies and was found out that lower voluntary disclosure levels relates with higher profitability. However, the findings disagree with Dawd (2018) whose research confirmed the presence of a negative correlation between compulsory disclosure and profitability. Yusuf, Adebayo and Yusuf (2018) findings revealed financial performance does not significantly affect Nigeria’s listed financial firms’ voluntary disclosure. Islam, Bhuiyan and Tuhin (2014) findings showed no significant connection between profitability and the discretionary financial information disclosure level.

5.1 Conclusion

The study concluded that profitability has a significant positive influence on quality of voluntary disclosure of commercial banks. For financial stability, bank profitability matters. Among the crucial capital sources is retained earnings that enable banks in building buffers for absorbing more losses and therefore voluntary disclosure based on profitability was found to be higher as it adds on customer confidence of the bank.

6.1 Recommendations

Based on the findings that profitability significantly and positively influences the quality of voluntary disclosure in commercial banks, it is recommended that banks should prioritize strategies that enhance their profitability. This is crucial for maintaining financial stability, as higher profitability allows for the accumulation of retained earnings, which in turn act as buffers to absorb potential losses. Additionally, banks should focus on transparent and comprehensive voluntary disclosure practices, particularly regarding profitability metrics. Such practices not only comply with regulatory standards but also boost customer confidence in the bank's financial health and operational integrity. These measures collectively contribute to a more robust and trustworthy banking sector, ultimately benefiting both the banks and their stakeholders.

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