The Determinants of Forward-looking Disclosures in Interim Reports for Non-financial Firms: Evidence from a Developing Country

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Abstract

This paper examines the determinants of the forward-looking disclosures (FLD) in the interim financial reports (IFRs) of non-financial firms listed on the Nairobi Securities Exchange (NSE). Data were collected from a total of 91 firm-year observations for the mid interim periods between 2009 and 2011. A FLD score was developed for each firm in the sample based on the firm’s disclosure of forward-looking statements in its IFR. The results indicate that firms with higher debt, better performance, higher capital investment and with more concentration of foreign investment tend to have more FLDs in their IFRs. Conversely, cross listed firms are associated with lower FLDs, implying that cross listed firms provide lower forward-looking information compared to non-cross listed firms. Results show a high degree of FLD for better performing firms and firms with higher financial risk. This study contributes to literature by providing evidence to which financial reporting incentives contribute to FLDs in a developing country where enforcement is weak. As a conclusion, the paper recommends firms to provide comprehensive FLDs in future to effectively mitigate informational asymmetries between the management and owners of the firms, especially firms with more concentrated foreign ownership.

Keywords: Interim financial report, forward-looking disclosure, financial risk, informational asymmetry.
1. Introduction

The frequency of financial information disclosure by firms is one of the means of improving capital market efficiency. This occurs through a reduction in the level of informational asymmetry. Information with regard to the financial performance and position of a firm in a capital market has traditionally been provided through the annual financial reports (AFRs). To increase the frequency of disclosures, International Accounting Standard (IAS) 34 provides guidelines on interim financial disclosures. According to paragraph 8, IAS 34 explains that an interim financial report (IFR) should include, as a minimum, a condensed statement of financial position, a condensed statement of comprehensive income, a condensed statement of changes in equity, a condensed statement of cash flows and selected explanatory notes (IASB, 1998). However, IAS 34 neither mandates which entities should prepare IFRs, nor how frequently they should do so. This withstanding, some economies have mandated quoted companies to prepare IFRs, while others have not. Studies have established that mandating more frequent IFRs can influence a firm’s overall disclosure level as well as more voluntary disclosures (Gigler and Hemmer, 1998; Einhorn, 2005). In addition to the AFR and IFR, investors are exposed to other information sources such as press releases, conference calls, direct communication with analysts, profit warnings and cautionary statements (Aljifri and Hussainey, 2007).

This paper focuses on the information contained in IFRs of non financial firms listed on the Nairobi Securities Exchange (NSE) in Kenya. More specifically, the study examines the determinants that explain the disclosure of forward-looking disclosures (FLDs) in the selected explanatory notes. Kieso et al. (2009) argue that FLDs are useful to investors in their decision-making process. FLDs are examined as a dependent variable because investors seem to care more about the firm’s future prospects compared to its past performance (Hussainey, 2004). As noted by Yee (2004), academic research into interim financial disclosures is amazingly sparse. While studies have examined the informational content of interim earnings (Opong, 1988), others have examined IFRs and analyst expenditures (Yee, 2004). The relevance of FLDs has been recognized by various researchers and even professional bodies (AIMR, 2002; Beattie and Pratt, 2002).

The choice of NSE firms is based on three reasons. First, Kenya is a developing country characterised by weak financial reporting enforcement regulations (Bova and Pereira, 2012). Second, whereas IFR is mandatory for all listed firms on the NSE, the level of IFR disclosure by Kenyan firms has been found to be lower compared to other developing and emerging economies (McFie, 2006). Interestingly, annual financial disclosures by Kenyan listed firms are relatively higher compared to these countries. This raises the question: what factors determine IFR? In a brief commentary on the level of IFR disclosures by Kenyan listed firms, McFie (2006) posits that in order to raise every aspect of doing business in Kenya, IFR has to be improved. Third, there appears to exist higher heterogeneity in IFR disclosures by firms listed on the NSE. While some firms provide extensive IFRs, other firms seem to lag behind. Therefore, this paper examines what corporate or ownership characteristics influence this interim disclosure behaviour.

Compared to AFRs, IFRs are subject to less rigid rules (Palepu, 1988) and highly condensed
financial statements that provide the minimum possible financial information. Due to cost-benefit and other factors, firms opt to provide the basic financial statements (i.e., statement of comprehensive income and statement of financial position) only. Firms often elect to provide a commentary to the financial statements including current and future operations of the company. This provides managers with greater discretion to selectively disclose information in interim reports. This contributes to higher heterogeneity in the level of interim financial disclosures across various sectors, with some providing more disclosures while others providing only the minimum required disclosures.

The AICPA’s Special Committee of Financial Reporting states that for a firm to meet user’s changing needs, they should provide more FLDs, focus on the factors that create longer term value, including non financial measures and better align information reported externally with the information reported internally. Studies have contended that FLDs tend to pre-empt the information contained in AFRs (Brown and Niederhoffer, 1968). However, the time horizon of the information contained FLDs in IFRs is essential to investors (Skinner, 1994; Johnson et al., 1999) and other financial statement users. For instance, financial analysts rely on IFRs largely in making their forecasts. This means that if the predictive value of the earnings contained in IFRs is anything to go by, then these forecasts must be closely related to the earnings in the AFRs. While prior research has demonstrated that IFRs pre-empt AFR information (Brown and Niederhoffer, 1968; Brown and Rozeff, 1979; Manegold and Nichols, 1983), the predictive ability of IFRs has not been clear. This is partly because interim earnings are considered incomplete. Furthermore, IFRs are not audited, rather, they are merely ‘reviewed’ by the auditors (Frankel et al. 2002).

On the other hand, FLDs are likely to signal to the market of some (un)expected event(s) surrounding the firm. The FLDs include information on future plans and projects which could signal strong reactions to the market (Aljifri and Hussainey, 2007). Studies such as Aljifri and Hussainey (2007) have examined the determinants of FLDs in annual reports. This study shifts focus to the determinants of FLDs by non-financial firms listed on the NSE for the mid interim periods between 2009 and 2011. The results indicate that firms with higher debt, better performance, higher capital investment and with more concentration of foreign investment tend to have more FLDs in their IFRs. Conversely, cross listed firms are associated with lower FLDs. Results show a high degree of FLD for better performing firms and firms with higher financial risk. As a conclusion, the paper recommends firms to provide comprehensive FLDs in future to effectively mitigate informational asymmetries between the management and owners of the firms, especially firms with more concentrated foreign ownership.

The remainder of this paper is organized as follows: section 2 discusses extant literature and the possible determinants of FLDs. Section 3 discusses the methodology adopted for the study. The section explains how the forward-disclosure score was calculated and the regression model used. Section 4 presents the results and discussion. Finally, section 5 concludes the paper.
2. Extant literature

In a world of perfect capital markets, the provision of additional disclosures in interim and AFRs would not be warranted. In such a case, the firm’s disclosure strategies would be value neutral. However, as previously discussed, the presence of market imperfections such as informational asymmetry, the disclosure of additional information has the potential to either enhance or erode firm value. Schleicher and Walker (1999) and Hussainey et al. (2003) posit that increased FLDs in annual report improve capital market’s ability to anticipate future earnings surprises. Information asymmetry is partly caused by inadequate financial disclosures.

The provision of additional disclosures in both IFRs and AFRs is aimed at minimizing informational asymmetry. These additional disclosures signal important information to investors who largely base their decisions on financial information. Studies have examined the effect of FLDs and informational asymmetry (Coller and Yohn, 1997). It has been argued that the provision on forward-looking information (FLI) helps in reducing informational asymmetry between managers and investors, thereby reducing the cost of external financing (Bujaki et al., 1999). Informational asymmetry might force firms to disclose more FLI in their interim reports. This is because of the effect that the disclosure of FLI might have on firm value.

While numerous studies have been performed on the determinants of annual corporate disclosures, few studies have examined the determinants of FLDs in interim reports. To the best of our knowledge, the study by Aljifri and Hussainey (2007) seems to be the closest with this respect. However, Aljifri and Hussainey (2007) examined FLDs in annual reports. This paper shifts its focus to interim reports, which have received minimal attention research wise by academics as noted by Yee (2004). The benefits of publishing forward disclosures is pegged on the role such disclosures play in informing financial statement user decisions. This is in addition to reducing the level of informational asymmetry between managers and investors (Bujaki et al., 1999).

Conversely, forward disclosures could be disadvantageous in various aspects. The uncertainty involved makes it difficult to forecast the future with accuracy. Again, in accurate forecasts might lead to lawsuits (Field et al., 2003; Kieso et al., 2009). This impedes a manager’s motivation to provide FLI. FLDs might reveal useful information for competitors to leverage on, and this might negatively impact on the firm’s future performance.

2.1 Background on forward-looking information disclosures

Compared to “backward-looking information”, “forward-looking information” refers to information that captures current plans and future forecasts to enable financial statement users assess the firm’s future performance (Hussainey, 2004). It consists of information which explains the firm’s current and future projections meant to enable financial statement users to assess a firm’s future financial performance (Aljifri and Hussainey, 2007). FLDs also include non-financial information including any uncertainties surrounding the firm. It contains any information about expected risks and uncertainties that could affect the actual results at the end of the period in the case of interim results. Such information is mainly contained in the
“future outlook” section in the selected explanatory section of an interim report.

A firm would disclose FLI in its annual reports for a variety of reasons. First, it is one of the management’s strategies to reducing agency conflicts with the shareholders. Disclosing FLI can be seen as a managerial effort to prove to the shareholders that they are concerned with the firm’s future growth. Secondly, the disclosure of FLI may be intended to improve the firm’s value. Existing and potential investors are motivated to buy a firm’s stock if the firm demonstrates its commitment to creating value for its owners. In so doing, it appears ‘impressive’ to the investors. Aljifri and Hussainey (2007) established that debt ratio and profitability of the firm are some of the significant determinants of FLI disclosures in AFRs.

The disclosure of FLI in IFRs entails extra costs. This discourages firms from providing additional disclosures in their IFRs. Preliminary observation of IFRs for companies in Kenya reveal that there exists heterogeneity in the disclosure of FLI. The raises an interesting question: what factors motivate firms to disclose FLI in their IFRs? This study performs an investigation of some of the firm, industry and ownership factors that would motivate firms to provide FLDs.

2.2 Determinants of forward-looking information

Extant literature has examined various features and effects of FLI. The accuracy of FLDs in annual reports has been examined by Mc Donald (1973), Waymire (1985), Pownall *et al.* (1993), How and Yeo (2001). Skinner (1994), Johnson *et al.* (1999) examine the time horizon related to FLDs. Other studies have examined the market reaction to annual FLDs with the aim of examining the informational content of FLDs (Patell, 1976; Penman, 1980; Lev and Penman, 1990; Ajinka and Gift, 1984; Waymire, 1984; Mc Nichols, 1989). While the informational content of FLDs in interim reports would be an interesting aspect to examine, this is not within the scope of this paper. Further research should consider examining the informational content of FLDs in IFRs.

Studies examining the association between disclosures and firm characteristics have produced mixed results. A variety of firm-specific characteristics have been found to influence the disclosure of FLI, though, with varied results. These factors include: gearing, profitability, firm size, liquidity, capital expenditure and the sector in which a firm operates (Dhaliwal, 1979; Barry and Brown, 1986; Prodham and Harris, 1989; Butler *et al.*, 2006; Aljifri and Hussainey, 2007).

2.2.1 Leverage

Regarding the disclosure of FLI in annual reports, Aljifri and Hussainey (2007) argue that firms that experience a significant increase in gearing are likely to disclose more FLI. Wallace *et al.* (1994) established a positive association between corporate disclosure and leverage. The positive association could be explained by the fact that, highly geared firms tend to incur more costs in monitoring activities and thus, compensate this by incurring more debt. Securing more debt is one strategy firms may pursue in bid to repay existing debt holders. On the contrary, Hossain *et al.* (1994), Raffournier (1995) and Elzahar and Hussainey (2012) find gearing to be an insignificant determinant of narrative risk disclosures in interim reports. Thus, the association between FLI disclosure and leverage is not clear.
2.2.2 Profitability

It would seem a plausible proposition that managers of more profitable firms might provide more information as a way of increasing investor confidence. This in turn leads to a higher market value for its shares. As such, a positive association would be expected between profitability and the level of FLDs (Wallace et al., 1994); Barako, 2007). On the contrary, firms experiencing declining profitability are also likely to disclose more FLI (Wallace and Naser, 1995). Gearing and profitability have been used to assess a firm’s risk level (Barry and Brown, 1986; Prodham and Harris, 1989). One of the motivations for firms to disclose FLI could be due to high financial risk.

The disclosure of FLI by firms experiencing high financial risk could be interpreted as a positive signal. The effect of this could be a reduction in the cost of capital of the firm (Dhaliwal, 1979). On the other hand, studies such as McNally et al. (1982) and Raffournier (1995) establish insignificant association between the level of disclosure and profitability. With reference to IFR, Butler et al. (2006) found that firms that report more frequently are more profitable and less risky. Elzahar and Hussainey (2012) find insignificant association between profitability and the level of risk disclosures in interim reports. Thus, the direction of association between profitability and FLDs is not clear.

2.2.3 Company-size

Beattie et al. (2004), Hassan et al. (2006) and Alsaeed (2006) establish a positive relationship between the level of corporate disclosures and firm size. This implies that large firms provide more FLI disclosures. This could be attributed to the resources that they control. Small firms on the other hand, have fewer resources and thus are not in a position to provide more information owing to the associated costs. Again, large companies have larger investor following and are able to justify the benefits of providing this extra and costly information. It would also seem a strategy of addressing the more pronounced agency problems in these large firms (Alsaeed, 2006; Watts and Zimmerman, 1983). Thus a positive association between firm size and level of FLD is anticipated.

2.2.4 Liquidity

Liquidity risk management strategies have been found to be related to corporate disclosures. Consistent with the signaling theory, firms that disclose more information are characterized by high liquidity ratios. This is meant to distinguish them from those firms experiencing high liquidity risks. Extant research has produced mixed findings on the association between liquidity and the level of corporate disclosures. Wallace et al. (1994) establish a negative relationship while Elzahar and Hussainey (2012) establish an insignificant association. Marshall and Weetman (2007) and Elshandidy et al. (2011) establish that firms that have high liquidity ratios transmit positive signals to the market participants. In this case, it is difficult to anticipate the direction of influence of liquidity on FLDs.

2.2.5 Capital expenditure

The level of investment in capital investments has been found to have an association with agency-related issues. A firm that invests more in non-current assets is expected to reduce
agency problems with its owners. The information signaled by capital investments is that the company is investing the shareholders’ funds to generate more value. In such a case, less agency problems are expected in such a firm. If such a company discloses such information relating to future investments, then that would influence investor’s decisions to a great extent. Likewise, a firm that has invested heavily in capital investments is likely to disclose more FLI which contains additional disclosures indicating the performance of the investments.

Such information is perceived as potentially useful for external investment purposes by investors and financial analysts. Al-Qudah, Walker and Lonnie (1991) posit that companies are more likely to disclose news about their capital expenditure intentions when finance directors perceive so, due to requirement to do so and when the news relate to an increase rather than a decrease in capital expenditure. In this study, a positive relation between capital expenditure and FLDs is anticipated.

2.2.6 Sector type

The type of sector a firm operates in has been found to influence the disclosure of FLI. Positive association has been found to exist between sector type and the disclosure of risk information. Cooke (1989) found that a significant relationship exists between sector type and disclosure. Other studies have established an insignificant relationship between sector type and annual disclosures (Wallace et al. 1994). The general proposition in this study is that, there exists sectoral influence on the level of corporate FLDs.

2.2.7 Cross listing

Cross-listing has been found to have an influence on the level of corporate disclosures. Mangena and Pike (2005) and Rajab and Handley-Schachler (2009) found a positive association between cross-listing and corporate disclosures. Cross-listing exposes a firm to more market participants, hence, more sources of finance. It also aggravates agency problems. In so doing, cross-listed firms are forced to provide more disclosures in their financial statements. Surprisingly, Taylor et al. (2010) found that cross-listing has a negative association with corporate risk disclosures. This could be explained by the fact that cross-listed firms are fairly large and thus, they enjoy economies of scale. They are thus bound to survive even without providing the additional disclosures. Therefore, it becomes difficult to predict the nature of association between cross-listed firms and FLDs.

2.2.8 Institutional ownership

Institutional ownership has been found to influence the nature and the level of corporate disclosures. Mangena and Pike (2005) established a positive relationship between institutional ownership and corporate disclosures. This may be taken to imply that locally owned firms provide less risk disclosures compared to foreign-controlled firms. On the contrary, other studies have established an insignificant relation between the two variables (Eng and Mak, 2003). In such a case, the direction of causality remains unclear.
3. Research Methodology

3.1 Data

Data for the study were collected from 91 firm-years on firms listed on the Nairobi Securities Exchange for the interim periods between 2009 and 2011. The firms samples in each of the interim periods in the three years are 11, 39 and 41 respectively. The choice of the firms and the period was based on the availability and completeness of data. The data collected relates to the first-half of the IFRs. For the purpose of this study, all financial firms (mainly commercial banks and insurance firms) were excluded. This is because financial reporting for banks and insurance firms in Kenya is regulated by other bodies—the Central Bank of Kenya (CBK) and the Insurance Regulatory Authority (IRA). To ensure fair-level data analysis, only those firms not listed under the two segments were used in the study.

Consistent with Hussainey et al. (2003) and Aljifri and Hussainey (2007), the study adopts the same list of forward-looking words to examine the extent of disclosure of FLI. A dichotomous procedure is adopted. If a FLD sentence is identified, the item scores one if it is disclosed and zero if it is not disclosed.

The extent of FLD is measured as the ratio of the number of forward-looking sentences a firm discloses scaled by the total number of sentences in its narrative section in the IFR. Using the developed disclosure index, the study then examines the association between the extent of FLD and the identified firm characteristics. The forward disclosure score (FWD) a firm scores is additive and depends on the number of sentences it discloses which contain the forward-looking phrases.

\[ \text{FWD} = \sum d_i \]

Where FWD refers to the forward-looking sentences disclosed and \( d_i = 1 \) if the sentence contains a forward-looking phrase and 0 if not.

The FLD index (FLD) for each firm thus becomes FWD/MDS

Where MDS is the maximum disclosure provided by the firm in its interim financial report.

3.2 Empirical model

Following Aljifri and Hussainey (2007), a backward linear regression analysis is employed to test the hypotheses under investigation. This model incorporates the FLD as the dependent variable. The determinants of FLDs are introduced as independent variables. The model used is as follows:

\[ \text{FLD}_{it} = \beta_0 + \beta_1 \text{LEV}_{it} + \beta_2 \text{ROE}_{it} + \beta_3 \text{SIZE}_{it} + \beta_4 \text{LIQUID}_{it} + \beta_5 \text{CAPEX}_{it} + \text{OWN}_{it} + \text{CROSSLIST}_{it} + \lambda_{it} + \rho_{it} + \eta_{it} + \varepsilon_{it} \]
Where FLD represents the FLD index, LEV represents leverage, ROE represents firm profitability, SIZE represents firm size, LIQUID measures liquidity, CAPEX represents capital expenditure investment, OWN represents a dummy variable indicating 1 for foreign ownership and 0 otherwise, CROSSLIST indicates a dummy variable of 1 if the firm is cross-listed and 0 otherwise. Variable $\lambda_{it}$ captures the unobservable heterogeneity in the firms. Variables $\rho_{it}$ and $\eta_{it}$ represent sectoral and firm-year controls respectively. $\varepsilon_i$ represents independent random disturbances.

In this study, leverage was measured by total debt scaled by total assets. Profitability was measured as net income after tax scaled by shareholders funds. Firm size is measured the natural logarithm of the firm’s total assets\(^1\). Liquidity is measured by current assets scaled by current liabilities. Capital expenditure is measured by the ratio of non-current assets scaled by total assets. Sector variables are measured by introducing ten dummy variables (0,1). Cross listing was also measured by a dummy variable with 1 representing cross listed firms and zero if otherwise. Finally, a dummy variable (0,1) was introduced to indicate foreign ownership (1) and local ownership (0).

Variance inflation factors (VIFs) were utilized to check whether multicollinearity was a problem amongst the identified variables. The VIFs ranged between $0 \leq \text{VIF} \leq 3$ meaning that multicollinearity was not a problem since this was within the limits prescribed by Montgomery and Peck (1982) and also Chartlergee and Price (1977).

4. Results and discussion

4.1 Univariate analysis

In this section, empirical methods used to examine the determinants of FLDs of the study and the results are presented. Table 1 presents summary statistics on key variables used in the study. Overall, the mean (median) FLD index is 16.9% (18.2%) which is relatively low. A typical firm has a mean leverage ratio of 16.9% with profitability of 2.9%. The descriptive statistics on the other variables are also presented.

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\(^1\) Aljifri and Hussainey (2007) measured firm size as natural log of net sales.
Table 1: Summary statistics of key variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>25%</th>
<th>Median</th>
<th>75%</th>
<th>Mean</th>
<th>StDev</th>
</tr>
</thead>
<tbody>
<tr>
<td>FLD index (FLD)</td>
<td>0.052</td>
<td>0.182</td>
<td>0.250</td>
<td>0.169</td>
<td>0.136</td>
</tr>
<tr>
<td><strong>Independent variables</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Financial risk measures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales (KShs. ‘millions’)</td>
<td>703</td>
<td>2,320</td>
<td>8,718</td>
<td>9,435</td>
<td>16,084</td>
</tr>
<tr>
<td>Leverage (LEV)</td>
<td>0.000</td>
<td>0.007</td>
<td>0.327</td>
<td>0.169</td>
<td>0.240</td>
</tr>
<tr>
<td>Profitability (ROE)</td>
<td>0.019</td>
<td>0.058</td>
<td>0.103</td>
<td>0.029</td>
<td>0.187</td>
</tr>
<tr>
<td><strong>Agency cost measures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets (KShs. ‘millions’)</td>
<td>1,867</td>
<td>5,637</td>
<td>18,154</td>
<td>22,462</td>
<td>43,584</td>
</tr>
<tr>
<td>Firm size (SIZE)</td>
<td>7.543</td>
<td>8.654</td>
<td>9.811</td>
<td>8.690</td>
<td>1.825</td>
</tr>
<tr>
<td>Capital Expenditure (CAPEX)</td>
<td>0.281</td>
<td>0.577</td>
<td>0.749</td>
<td>0.525</td>
<td>0.260</td>
</tr>
<tr>
<td><strong>Liquidity risk measures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current ratio (LIQUID)</td>
<td>1.095</td>
<td>1.454</td>
<td>2.123</td>
<td>2.015</td>
<td>2.247</td>
</tr>
<tr>
<td>Institutional ownership (OWN)</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.231</td>
<td>0.424</td>
</tr>
<tr>
<td>Cross listed (CROSSLIST)</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
<td>0.110</td>
<td>0.314</td>
</tr>
</tbody>
</table>

Table 2 presents the Spearman correlation coefficients. The table shows that leverage, return on assets and ownership is positively correlated with FLDs. The table also shows that cross-listing has a negative association with FLDs.

Table 2: Spearman correlation coefficients matrix

<table>
<thead>
<tr>
<th></th>
<th>FLD</th>
<th>LEV</th>
<th>ROE</th>
<th>SIZE</th>
<th>LIQUID</th>
<th>CAPEX</th>
<th>OWN</th>
</tr>
</thead>
<tbody>
<tr>
<td>LEV</td>
<td>0.091 *</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROE</td>
<td>0.209 **</td>
<td>-0.281 ***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>0.155</td>
<td>-0.021</td>
<td>0.197 *</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LIQUID</td>
<td>0.116</td>
<td>-0.306 ***</td>
<td>0.062</td>
<td>-0.168</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAPEX</td>
<td>0.069</td>
<td>0.034</td>
<td>-0.061</td>
<td>-0.019</td>
<td>-0.247</td>
<td></td>
<td></td>
</tr>
<tr>
<td>OWN</td>
<td>0.031 *</td>
<td>-0.083</td>
<td>0.067</td>
<td>-0.149</td>
<td>-0.169 *</td>
<td>-0.141</td>
<td></td>
</tr>
<tr>
<td>CROSSLIST</td>
<td>-0.180 *</td>
<td>-0.027</td>
<td>0.312 ***</td>
<td>0.259 **</td>
<td>-0.029</td>
<td>-0.117</td>
<td>-0.026</td>
</tr>
</tbody>
</table>

FLD index – FLD; Leverage – LEV; Return on Equity – ROE; Firm Size – SIZE; liquidity measure – LIQUID; Capital Expenditure – CAPEX; Institutional ownership – OWN; Cross listing – CROSSLIST. Heteroskedastic-consistent standard errors are used to compute t-values, which are shown in parentheses. ***, ** and * represent significance levels at the 1%, 5% and 10% respectively.

4.2 Multivariate analysis

To examine the determinants of FLDs, the FLD index is modeled as a function of the possible
determinants. Table 3 presents the results from the multiple regression estimation. Two models namely, the two-stage least squares and heteroskedastic panel corrected standard errors estimation models are used to provide robust results from the collected data. Both models address the weaknesses inherent in panel data and help in improving the reliability of the results.

Table 3: Determinants of forward-looking disclosures

<table>
<thead>
<tr>
<th>Dependent variable: Forward-looking disclosure index (FLD)</th>
<th>Model 1</th>
<th>Model 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leverage (LEV&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>0.034** (0.42)</td>
<td>0.034** (0.47)</td>
</tr>
<tr>
<td>Return on equity (ROE&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>0.333*** (2.81)</td>
<td>0.333*** (3.18)</td>
</tr>
<tr>
<td>Firm size (SIZE&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>-0.003 (-0.31)</td>
<td>-0.003 (-0.34)</td>
</tr>
<tr>
<td>Current ratio (LIQUID&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>-0.002 (-0.36)</td>
<td>-0.002 (-0.42)</td>
</tr>
<tr>
<td>Capital expenditure (CAPEX&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>0.110** (1.70)</td>
<td>0.110** (1.92)</td>
</tr>
<tr>
<td>Institutional ownership (OWN&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>0.023** (0.64)</td>
<td>0.023** (0.74)</td>
</tr>
<tr>
<td>Cross listing status (CROSS LIST&lt;sub&gt;it&lt;/sub&gt;)</td>
<td>-0.109** (-2.20)</td>
<td>-0.109*** (-2.46)</td>
</tr>
<tr>
<td>Intercept</td>
<td>0.182* (1.57)</td>
<td>0.182* (1.74)</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>0.123</td>
<td>0.289</td>
</tr>
<tr>
<td>N</td>
<td>91</td>
<td>91</td>
</tr>
</tbody>
</table>

This table presents regression estimates on the determinants of FLDs in interim financial statements of firms listed on the Nairobi Securities Exchange for the periods 2009 – 2011. Model (1) has been estimated using the two-stage least squares. T values are shown in parentheses. Model (2) has been estimated using heteroskedastic panel corrected standard errors estimation model. In Model 2, heteroskedastic-consistent standard errors are used to compute t-values, which are shown in parentheses. ***, ** and * represent significance levels at the 1%, 5% and 10% respectively.

The results in table 3 show that a significant positive association between FLDs and leverage exists (p<0.05). This finding confirms the proposition by Aljifri and Hussainey (2007) who argue that firms that experience significant increase in gearing are likely to disclose more FLD. Highly geared firms face higher financial risk. From an agency perspective, providing more FLDs is one way of mitigating the adverse effects of high debt levels. The suppliers of finance and investors need to know how the firm is utilising the debt. In this case, firms are
forced to provide disclosures regarding their future prospects and how the funds have been spent.

Profitability is also significant and positively related to FLDs (p<0.000). This finding is consistent with Wallace et al. (1994) and Butler et al. (2006) who found a positive relation between corporate disclosures and profitability. The finding seems to suggest that more profitable firms disclose more FLDs. The long run effect of these disclosures is an improvement in firm value and market position. On the other hand, more profitable firms tend to have a greater bargaining power. They are thus able to source funds from many sources. Providing more FLDs serves as a way of showing that they are profitable and this increases investor and creditor confidence in the firm.

The level of FLD is also positively related with capital expenditures (p<0.01). This finding seems to suggest that the more capital expenditure a firm has, the more the level of FLDs it provides. The increase FLD is meant to explain to the stakeholders how the firm is currently utilizing its investment in non-current assets. Al-Qudah et al. (1991) posit that firms provide more disclosures if their investments in capital expenditure is likely to increase. This means that, given the existing level of investment in capital assets, additional disclosures would be meant to minimize agency problems and increase investor confidence in the firm’s management.

Institutional ownership is also significant and positively related to the FLDs (p<0.05). This finding suggests that foreign firms disclose more FLI due to pressure exerted on them. Consistent with Mangena and Pike (2005), such firms have to provide additional disclosures to convince the foreign owners that the management is doing something to create value for them. Cross-listing was also found to be a significant determinant of FLDs at the 10% level. This implies that cross listing does not enhance the firm’s propensity to provide more disclosures.

Finally firm size, liquidity and sector type were found to be insignificant determinants of FLDs. This is consistent with Elzahar and Hussainey (2012) who found insignificant relation between corporate disclosures and liquidity. These results are also consistent with previous studies such as McNally et al. (1982) and Wallace et al. (1994) who found insignificant association between sector type and corporate disclosures.

5. Conclusion

In this study, an examination of the determinants of FLDs in IFRs for non-financial firms listed on the NSE for the mid interim periods between 2009 and 2011 is presented. Using regression analysis, the results show that firms with higher debt, better performance, higher capital investment and with more concentration of foreign investment tend to have more FLDs in their IFRs. Conversely, cross listed firms are associated with lower FLDs. This implies that cross-listing does not improve the firm’s disclosures. Results show a high degree of FLD for better performing firms and firms with higher financial risk. The study suffers from the following limitations. First, the availability of IFRs on the firms was a challenge. This led to the selection of 91 firm-years for firms whose IFRs were readily available. Second, the findings in this study have been performed for three interim financial periods. This means...
that one has to be careful when generalizing the findings from this study. A longer period of study is expected to provide more generalisable results. Discussions with the management of the firms in the study regarding the phenomenon under examination would certainly improve the results. These limitations withstanding, the findings in the study would prove beneficial to financial analysts, academicians, regulators and investors. As a conclusion, the paper recommends firms to provide comprehensive FLDs in future to effectively mitigate informational asymmetries between the management and owners of the firms, especially firms with more concentrated foreign ownership. Further research could investigate any other constructs linked to FLDs (for example, market reaction).

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References


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