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Board Characteristics and Quality of Integrated Reporting of Firms Listed Nairobi Securities Exchange

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Abstract

Companies that opt for integrated reporting are in a favorable position to enhance a range of benefits, whether internal or external in nature. It encompasses improvements in resource allocation, shareholder engagement, and reputation. On the other hand, external advantages pertain to investors who rely on governance disclosure, as well as compliance with regulations, frameworks, standards, and guidelines set by stock exchanges. The expansion and adoption of integrated reporting are broadening its scope, with an increasing number of companies showing willingness to adopt this approach. The diffusion and adoption of reporting practices stem from diffusion theory, which has evolved from institutional theory, encompassing institutional factors that influence organizational behavior. The positive and statistically significant relationships between board characteristics highlight how crucial it is for publicly traded corporations to work to improve the independence of their boards of directors while also including members with financial expertise to facilitate the disclosure of both financial and non-financial information. The findings are significant especially in the implementation of board decisions, strategic planning, and in managing corporate governance attributes in the attempts to enhance information disclosure through the implementation of integrated reporting.

Keywords: Board characteristics, Quality of integrated reporting, Nairobi securities exchange

1. Introduction

Integrated reporting (IR) is a new reporting framework focused on firms' future value creation narratives. According to O'Dwyer, B., Humphrey, C., & Rowbottom, N. (2024) an integrated report is a concise communication by an entity concerning the governance strategy, prospects, and performance in relation to the external environment. With the forenamed in mind, it is evident that the concept of integrating reporting yields short-term, medium-term, and long-term value for an entity (IIRC, 2021). According to Grassmann, et al. (2019), the combination of information pertaining to sustainability and the financial performance of an entity in a single document provides an avenue for overcoming potential disconnects in the handling of these two types of information by professionals. Moreover, the combination of these two sets of information fosters and supports "integrated thinking" as advocated in IIRC (2021). Essentially, the practice of Integrated reporting (IR) purposes to overcome inherent limitations of traditional financial and stand-alone non-financial reports.

Eccles, R. G., Krzus, M. P., & Ribot, S. (2015), define an integrated report as a single report that combines the financial and narrative information found in a company's annual report with the non-financial (such as environmental, social, and governance issues) and narrative information found in a company's 'Corporate Social Responsibility or 'Sustainability' report. Even though it is called integrated reporting, the concept does not refer to the reporting procedure alone. In the <IR> Framework released in 2013, it is a far more important process for the organizations to start to think and act integrated. The IIRC states in the framework that it aims to Support integrated thinking, decision making, and actions directed at value creation in the short, medium, and long term (IIRC, 2021). Hence, there has been a development of the definition, realizing that to create a qualitative integrated report; organizations have to start by thinking and acting in an integrated way.

Corporations that choose to adopt integrated reporting are better placed to enhance a series of benefits of either internal or external nature. According to Willems et al. (2016), the internal benefits refer to improvements in resource allocation, shareholder engagement, reputation, while the external advantages relate to investors who rely on and governance disclosure and to stock exchanges regulation, frameworks, standards, guidelines and compliance with these criteria. Diffusion and adoption of integrated reporting are increasing its borders, as more and more corporations are willing to apply for this system. The diffusion and adoption of reporting practices originate from the diffusion theory, which has evolved from institutional theory and the institutional factors that influence the behavior of organizations.

However, the main limitations for the adoption and diffusion process represent the missing framework for integrated reports, lack of standards and specific guidelines, no measurements for non-financial information, and finally, the convergence between financial and non-financial information. More specific constraints are created because only a few corporations implement integrated reporting in their disclosure process. At the same time, the lack of non-financial information assurance leads to unreliable information.

According to O'Dwyer et. al., (2024), integrated reporting should be an effective way of communication about the alignment of an organization's strategy, governance, prospects, and performance in line with the respective external environment. It is worth noting that integrated reporting incorporates both financial and non-financial information of an entity making full disclosure a subset of this concept. Full disclosure is the process of making facts or information known to the public which can either be financial and non-financial information creating a scenario where full disclosure is a subset of integrated reporting

As stated earlier, integrated reports can be leveraged by entities in the creation of short-term and long-term value. Moreover, integrated reports enhance the quality of information disclosed by an entity, reflecting a holistic view of an entity's value creation processes. Moreover, the dissemination of financial and non-financial information should not be done separately but rather combined in a single document to reflect a cohesive and integrated approach in managing diverse types of capital to create an acceptable return for capital providers (IIRC, 2021).

In the Kenyan context, there are several firms that have adopted integrated reporting as shown in Appendix B. Some of these firms include Safaricom and KCB banks and represent some of the top performers in their relevant industries thanks to their adoption and incorporation of integrated thinking in all their operations. These entities are focused in future value creation to all its stakeholders. Of note, IR helps in communication of governance strategy, prospects and performance in relation to external environment of a company (IIRC, 2021)

The International Integrated Reporting Council (IIRC) is credited for the conception of integrated reporting, whose journey commenced in 2010 after the formation council. The formation of IIRC was followed by the development of the International Integrated Reporting Framework to guide companies on how to prepare integrated reports in 2013 (IIRC, 2021). It is worth noting that the conception of the integrated reporting framework was necessitated by the need to facilitate scenarios in which managers and financial capital providers take into consideration the long-term consequences of a broader set of capitals. Essentially, through the adoption of integrated reporting, the IIRC hopes to engender a longer-term focus (forward-looking approach) among managers and investors, replacing the short-termism are often blamed for several of the ills of capitalism.

Since its inception, integrated reporting has gained momentum as a single comprehensive tool merging financial and non-financial information in a single report. Although integrated reporting was conceived as a tool for private sector entities, it has also been widely adopted by players in the public sector as a vehicle for enhanced transparency and accountability. Integrated reports provide a holistic view of an entity's operations by incorporating information pertaining to the relevant economic, social, and environmental issues for an entity compared to traditional financial statements (Williams &Lodhia, 2021). Integrated reporting ('IR') is grounded on seven components of content: business model; external environment; opportunities and risks; strategy; performance; future outlook; and governance. The combination of information from these elements presents a narration of an entity's business model and the factors affecting the entity's operations.

The critical role of integrated reporting in enhancing the accountability and transparency of both private and public going concerns is dependent on the quality of integrated reports produced by these firms. According to Iredele (2019), the quality of integrated reports denotes the extent to which integrated reports comply with the provision of a relevant framework. The IIRC (2021) stipulates that integrated reports should disclose information about matters that substantively affect the organization's ability to create value over the short, medium, and long term.

Several studies have been initiated to decipher the factors that affect the quality of integrated reports. According to Kurniawan and Wahyuni (2018), factors such as the type of ownership, profitability, company size, and inherent governance structures (board characteristics) elicited by corporate entities significantly impact the quality of integrated reports produced by entities. Although all the forenamed factors affect the quality of integrated reports to some extent, the impact of board characteristics on the quality of integrated reports supersedes that of the other factors.

According to Kurniawan and Wahyuni (2018), there is a positive relationship between board characteristics and the quality of integrated reports. Moreover, Raimo et al. (2020) posit that board characteristics such as board size, independence, diversity, and activity of a board affect the quality of integrated reports produced by entities. Zouari and Dhifi (2021) also evaluated the impact of board characteristics on the quality of integrated reports. In this study, it emerged that the independence of board members, CEO duality, and the size of the board of directors elicit a positive relationship with the quality of integrated reports produced by firms. Furthermore, Hurghiș (2017) also highlighted the critical role of corporate structure, especially the size of the board, on the quality of integrated reports.

Although Raimo et al. (2020), Zouari and Dhifi (2021), Hurghiș (2017), and other studies initiated provide pertinent insights into the impact of board characteristics on the quality of integrated reports; they conspicuously lack to consider the impact of the effectiveness of audit committees on the quality of integrated reports. Lisic et al. (2015) posit that Audit committees play a vital and influential role in the oversight of financial reporting. Considering that integrated reports also have a financial connotation totem, it is therefore evident that the presentation of integrated reporting cannot be separated from the role of the audit committees. This argument aligns with the role of audit committees in various corporate policies, such as in the prevention of earnings management, compliance with regulations, disclosure and financial reporting.

2. Literature Review

Gender diversity is one of the key variables of board characteristics that affect board performance and, by extension, the quality of integrated reports produced by an entity. Several empirical studies purposed to decipher the impact of gender diversity on the quality of integrated reporting. Songini et al. (2021) is one of the studies that were purposed to decipher the impact of gender diversity on the quality of integrated reports produced by corporate entities. In this study, the number of women on the boards from a sample comprising 53 firms drawn from diverse parts of the globe that published integrated reports between 2013 and 2016 was used as one of the independent variables against the quality of integrated reports. The data for the sampled entities was obtained from the IR website. Songini et al. (2021) leveraged Descriptive statistics, univariate and Multivariate analysis to decipher the impact of board gender diversity on the quality of integrated reports. From this study, it emerged that board gender diversity did not critically affect the quality of integrated reports produced by corporate entities.

Tiron-Tudor et al. (2020) is another study that was initiated to investigate the impact of gender diversity on the quality of integrated reporting in corporate entities. The sample used in this study comprised European-headquartered publicly listed companies that produced integrated reports. Essentially, the IIRC website provided data on the integrated reports and firms analyzed in this study. Tiron-Tudor et al. (2020) leveraged content analysis, descriptive statistics and relationship analysis to evaluate the impact of board characteristics, including gender diversity, on the quality of integrated reports produced. Although Tiron-Tudor et al. (2020) hypothesized that entities with higher board gender diversity were likely to issue integrated reports that have a higher alignment level to IIRF, the findings of this study indicated the converse. Essentially, it emerged that the higher gender diversity of the board did not impact the information disclosure decision in integrated reports. However, it is also noteworthy that this study produced mixed results considering that its findings also indicated that women directors impacted corporate transparency behavior regarding CSR disclosure, which is a critical aspect in integrated reporting. Moreover, female directors in the sampled firms comprised only 21.53%, an attribute that may have had implications on the study's findings.

Mawardani & Harymawan (2021) also investigated the impact of board characteristics, including gender diversity, on the quality of integrated reports produced by corporate entities. This study was carried out on public companies listed on the Indonesia Stock Exchange (IDX) from 2017 to 2018. The researchers in this study leveraged Ordinary Least Square (OLS) Regression to analyze 936 observations. The researchers could not establish a significant relationship between board gender diversity and the quality of integrated reports published by the sampled firms from the analysis. However, Mawardani & Harymawan (2021) noted that the findings relating to the insignificant role of board gender diversity as presented in their study might be attributed to the low representation of women in boards of the Indonesian firms leveraged in the study. Essentially, Mawardani & Harymawan (2021) noted that only 764 out of 1,248 Indonesian firms had female members on boards during 2017- 2018 compared to 1,234 out of 1,248 firms with male members on boards during this time. With this in mind, the role representation of women in corporate boards may have influenced the findings concerning the role of gender diversity on the quality of IR.

Board Tenure refers to the length of service of the board of directors. Various studies have been initiated to investigate the impact of board tenure on the quality of integrated reports. Besides investigating the impact of gender diversity on integrated reporting, Tiron-Tudor et al. (2020) also investigated how board tenure affects a firm's ability to align their integrated reports with the IIRC framework. As stated earlier, the sample used in this study comprised European-headquartered publicly listed companies that produced integrated reports, and the findings were analyzed by leveraging descriptive statistics and relationship analysis. Concerning board tenure, Tiron-Tudor et al. (2020) established that entities with longer director tenures were more effective in preparing and implementing integrated reporting. The findings by implementation were attributed to the level of experience longer tenures apportioned directors to better understand their respective entities and their operations. However, this finding was not conclusive considering that Tiron-Tudor et al. (2020) also found no correlation was between board tenure and the company's environmental performance, a critical attribute in integrated reporting.

Integrated reports combine an entity's financial and non-financial information, including corporate social responsibility (CSR) disclosures by an entity. Rao & Tilt (2016) sought to establish the relationship between corporate governance variables, including board tenure on CSR disclosures. Rao & Tilt (2016) leveraged a sample of 115 Australian firms listed on the Australian Stock Exchange (ASX) to investigate this relationship. Regression analysis was applied by the researchers in this study to investigate the intended relationship. From this study, it emerged that board tenure has a positive correlation with enhanced CSR disclosures.

According to Liao et al. (2015), board independence is a critical attribute that defines the ability of boards of directors to effectively monitor and provide oversight of the management functions of corporate entities. Essentially, board independence works to reduce agency costs which elicit its importance in enhancing the disclosures of financial and non-financial reports. Several studies have been initiated to find the correlation between board independence and the quality of integrated reports produces by firms.

Vitolla et al. (2020) is one of the studies that investigated the impact of board independence on the quality of integrated reporting. The sample used in this study comprised 130 international companies that have adopted integrated reporting. The sample leveraged was obtained from the IIRC website to ensure that all firms chosen adhered to the IR framework. Vitolla et al. (2020) leveraged descriptive statistics, multivariate, and correlation analysis in analyzing the findings obtained from the sample firms. From the analysis, a positive correlation emerged between the level of board independence and the quality of integrated reports produced. Essentially, boards with a greater number of non-executive directors were associated with enhanced integrated reporting quality than those with a limited number of non-executive directors.

Li et al. (2018) is another study that sought to establish the importance of board financial expertise on financial disclosures and, by extension, integrated reporting. The sample used in this study comprised UK IC-intensive sector companies that were fully listed on the London Stock Exchange (LSE) as of 30 December 2005. Descriptive and regression analysis was leveraged in this study to establish the relationship between board financial expertise and disclosure. The researchers in this study established that board financial expertise positively affects financial disclosures and works to reduce the acute information asymmetry.

Velte (2018) also initiated a study to establish the impact of corporate governance variables, including board financial expertise, on the quality of integrated reports. This study leveraged a sample of 215 international firms that were observed for the period between 2014 and 2016. From the findings of this study, it emerged that board financial expertise has a pronounced effect on the quality of integrated reports. The preceding literature review shows that financial expertise among board members is a critical attribute in enhancing the quality of disclosures in corporate entities. However, it is also noteworthy that, except for the findings in Velte (2018) that are geared at establishing the impact of financial expertise on the quality of integrated reports, Li et al. (2018) and Abernathy et al. (2015) are focused on examining the relationship of board financial expertise on financial disclosure. It is, therefore, safe to posit that forenamed findings are not conclusive regarding the impact of board financial expertise on the quality of integrated reports.

3. Research Methodology

3.1. Research Design

The current investigation utilized an explanatory quantitative research framework. It is important to highlight that research designs with an explanatory focus typically aim to elucidate the occurrence of a phenomenon by addressing the question 'why' and establishing causal relationships between various variables. As George and Mallery (2016) suggest, explanatory research design offers researchers opportunities to accurately define and describe both the population sample and the phenomenon being studied.

3.2. Sample Size

Forty-four (44) companies listed in the Nairobi securities exchange were studied. Most of the companies were excluded because they failed to meet the requirement that stipulated that companies should have integrated reports dating back to 2013. Considering the present study takes into account ten years (2013-2022), a total of 440 observations were available for the present study.

3.3. Data Types and Sources of Data

The present study leveraged secondary data to analyze the impact of board characteristics and quality of integrated reporting of firms' listed Nairobi Securities Exchange. The secondary data leveraged in this case was sourced from published materials by the sampled entities, including audited annual financial reports and non-financial reports availed in their respective websites and at the Nairobi Securities Exchange website for the period between 2013 and 2022. Moreover, data was also collected from published articles and advertisements detailing the activities and reports disseminated by the sampled entities.

3.4. Model Specification

The study employed fixed effects model. The fixed effects model is crucial in statistical analysis, especially in the context of panel data or longitudinal studies. Fixed effects help control for individual-specific characteristics (firm characteristics) remain constant over time but may affect the dependent variable. This is particularly important in panel data where the same entities (individuals, firms, etc.) are observed across multiple time periods. The fixed effects model helps mitigate the impact of unobserved variables that are constant over time but vary across entities. By including fixed effects for each entity, it accounts for individual-specific factors that might otherwise lead to biased or inconsistent estimates. By controlling for individual-specific effects, the fixed effects model improves the internal validity of the study. This means that the model is better able to isolate the true causal relationship between the board characteristics and quality of integrated financial reporting by minimizing the influence of confounding factors.

4. Results and Interpretation

Board characteristics in this study were measured using indicators such as board gender, board tenure, board independence and board expertise. According to Brown and Caylor (2004), board characteristics can be measured using several indicators, but this study chose four mentioned above indicators since they are associated with the structure of the board of directors' characteristics. It was observed that the board independence in NSE has a maximum board size 23 members and is in banking sector (see Table 1). Firms in investment had 19 maximum board members. Firms in automobile and accessories sector had the least number of members in the board.

Table 1. Descriptive Statistics Per Sector

Firm Sector	QIR	FS	Lev	BS	BG	BT	BI	BE
Agricultural	0.819	24.299	3.977	17	4	7	14	14
Automobiles and accessories	0.845	23.043	0.315	8	1	4	7	4
Banking	0.826	28.889	1.053	23	6	7	21	19
Commercial and Services	0.822	26.378	0.560	17	6	5	15	15
Energy and Petroleum	0.825	26.662	0.404	17	7	3	14	11
Insurance	0.818	26.052	0.295	14	5	4	10	10
Investment	0.819	25.205	3.676	19	5	3	10	10
Manufacturing and Allied	0.817	24.673	1.311	15	5	7	12	12
Telecommunication	0.796	25.844	0.104	14	4	3	11	11
Grand Total	**0.822**	**28.889**	**1.320**	**23**	**7**	**7**	**21**	**19**

Source: Research Data Analysis, 2023

The characteristics of a board can have a major impact on the quality of integrated reporting inside a business. By presenting financial, environmental, social, and governance information in a consistent and clear manner, integrated reporting strives to provide a holistic view of an organization's performance and value generation. The board of directors' engagement and characteristics can influence the effectiveness and quality of integrated reporting in the following ways: A diverse board of directors with members from varied backgrounds, industries, and experiences can help to produce a more thorough and well-rounded integrated report. Different points of view can help to improve understanding of the organization's impacts and risks across multiple dimensions, resulting in a more accurate and informative report.

In essence, board characteristics that encourage diversity, expertise, ethical behavior, responsibility, and a long-term view are likely to have a favorable impact on the quality of integrated reporting. These attributes lead to a more comprehensive, transparent, and accurate portrayal of an organization's performance and value generation initiatives across multiple dimensions.

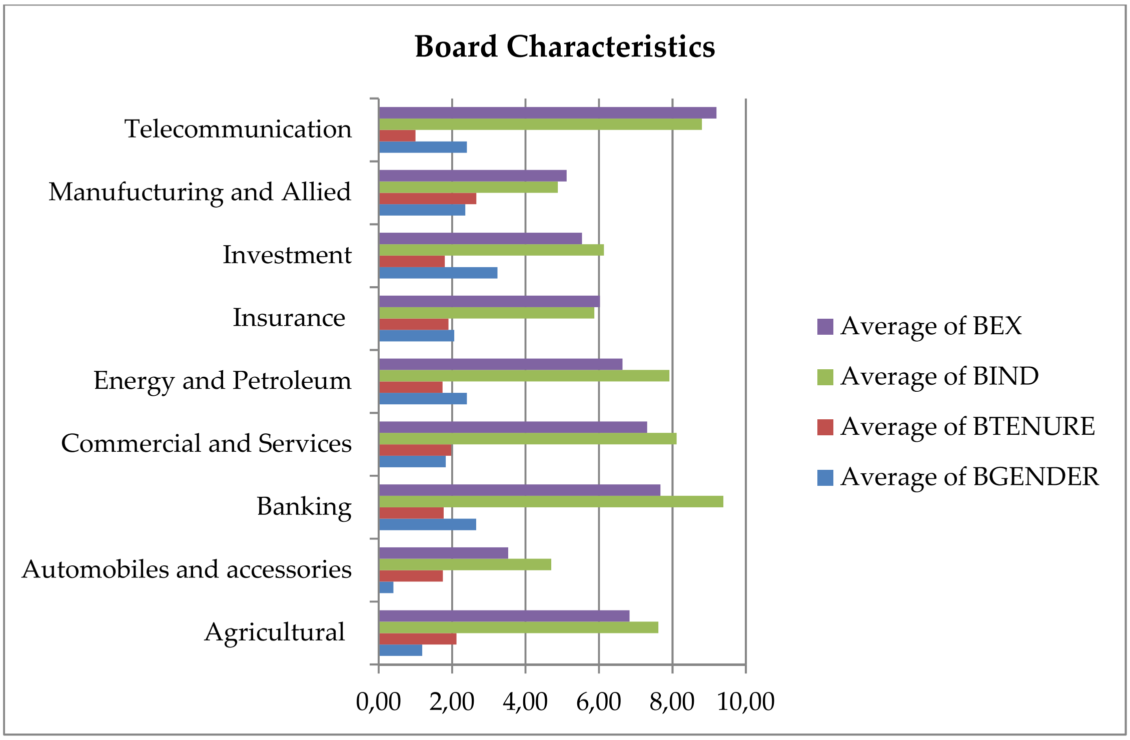

Figure 1. Board Characteristics Per Sector
Source: Research Data Analysis, 2023

Board gender is the number of females in the board. Firms listed in NSE have a female member in the board as shown by the minimum of 0 and maximum of 7 females. It is further seen that majority of firms with the most females in the board are in investment sector as indicated by the Figure 1. The board of directors in NSE is likely to be independent members in each firm listed in NSE. This is explained by the fact the NSE has the highest 21 members are independent. Board expertise which is the number of board members with financial expertise indicates that NSE has higher number of 19 members with financial experience and at least every firm has at least one member in the board with financial expertise and this is a good indication for NSE.

Table 2 presents results fixed effect model. The findings indicate that by accounting for individual-specific characteristics that do not change over time, the control variables firm size and leverage did not show any statistical significance on quality of integrated reporting. Coefficient for determination was high at 58 percent (R-square=0.58) and the probability of F-statistic was significant. This implies fixed model was fit and the variation of quality of integrated reporting of firms listed in NSE explained by the choice of independent variables at 58 percent. Board gender, board tenure and board independence have had a positive and significant effect on quality of integrated reporting whereas board financial expertise did not.

Table 2. Fixed Effect Regression Results

QIR	Coef.	St. Err.	t-value	p	[95%Conf.	Interval]	Sig
Firm size	.006	.008	0.73	.463	-.010	.023	
Leverage	.000	.001	0.38	.707	-.002	.003	
Board Gender	1.121	.062	18.18	.000	.999	1.242	***
Board Tenure	.966	.066	14.69	.000	.836	1.095	***
Board independence	.207	.054	3.80	.000	.100	.314	***
Board Expertise	-.101	.052	-1.94	.053	-.204	.001	*
Constant	-.431	.209	-2.06	.040	-.843	-.020	**

Mean dependent var	0.216	SD dependent var	0.249
R-squared	0.580	Number of obs	440
F-test	89.599	Prob > F	0.000
Akaike crit. (AIC)	-690.235	Bayesian crit. (BIC)	-661.628

*** *p<.01*, ** *p<.05*, * *p<.1*

A positive effect of board gender indicates that having a diverse composition of male and female board members is associated with higher quality integrated reporting. This implies that a mix of perspectives and experiences contributes to a more comprehensive and well-rounded approach to integrated reporting practices. The positive effect of board tenure suggests that longer-serving board members are associated with better-integrated reporting quality. This may imply that experienced directors have a deeper understanding of the company's operations and are more effective in conveying this information in an integrated manner.

Further, the positive effect of board independence indicates that a higher proportion of independent directors on the board is linked to improved integrated reporting quality. Independent directors are expected to provide objective oversight, ensuring that the integrated reports are transparent, accurate, and in the best interests of stakeholders. Collectively, these findings suggest that gender diversity, longer board tenure, and a higher level of board independence contribute positively to the overall corporate governance and reporting practices of the listed firms. This aligns with the idea that diverse, experienced, and independent boards play a crucial role in enhancing the quality and credibility of integrated reports.

Quality integrated reporting is important for effective communication with stakeholders. A positive and significant effect suggests that firms with a more diverse, experienced, and independent board are better equipped to communicate their sustainability, financial, and non-financial performance in an integrated and transparent manner. The positive effects may also imply that diverse, tenured, and independent boards are more engaged in strategic decision-making related to integrated reporting, recognizing its significance in portraying a comprehensive view of the firm's value creation and sustainability efforts.

5. Conclusion

This study offers useful information on the connections between board characteristics and integrated reporting quality. The results show that a number of board characteristics, such as gender diversity, board tenure and independence, have a favorable impact on the quality of integrated reporting for companies listed on the Nairobi Securities Exchange. These findings imply that transparent reporting, independence, and diversity are supported by excellent corporate governance practices, which can increase investor confidence and decision-making. The positive and statistically significant relationships between board characteristics highlight how crucial it is for publicly traded corporations to work to improve the independence of their boards of directors while also including members with financial expertise to facilitate the disclosure of both financial and non-financial information.

6. Recommendations

Firms listed should ensure that the board includes a diverse set of directors, including women. Research has shown that diverse boards are more likely to consider a broader range of issues, including sustainability and social responsibility. They should promote equal opportunities for women in leadership positions within the company. Encourage women to participate in leadership development programs and provide mentorship opportunities. Offer diversity and inclusion training to board members and executives to raise awareness and foster an inclusive board culture that values different perspectives.

Firms listed in NSE need to implement board refreshment policies to ensure a healthy turnover of directors over time. This can help prevent long tenures that may lead to complacency or lack of diversity in thinking. Develop a robust succession planning process to identify and groom new directors. Ensure that new directors bring fresh perspectives and expertise to the board. Consider implementing term limits for board members to encourage periodic turnover and introduce new skills and viewpoints.

Maintain a sufficient number of independent directors on the board. Independent directors can provide unbiased perspectives on integrated reporting and ensure that reporting is transparent and accurate. Establish independent committees within the board, such as audit and sustainability committees, to oversee relevant reporting processes. These committees should have a clear mandate and reporting responsibilities. Conduct regular evaluations of director independence to identify and mitigate any conflicts of interest that could compromise reporting quality.

Develop a skills matrix for the board to identify gaps in expertise related to integrate reporting. Seek new directors or external advisors with the necessary knowledge in areas such as sustainability reporting, and integrated reporting frameworks. Encourage board members to engage in continuous education and training programs relevant to integrated reporting and sustainability trends. This ensures that the board remains updated on best practices.

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