Does Quality of Corporate Governance affect Financial Performance of listed firms in NSE, Kenya?

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Abstract

The goal of this paper is to analyze the effect of corporate governance efficiency on the financial performance of listed companies in the Nairobi Securities Exchange in Kenya between 2008 and 2017. The pooled OLS estimation approach was used to evaluate the hypothesis using panel data from 650 firm year observations. Results showed that both Disclosure and Related Party transactions are positively and substantially related to financial performance. Nonetheless, legal compliance was negatively and strongly linked to financial performance. The results provide empirical evidence that there is a link between CG quality and financial performance in Kenya. These findings are relevant for financial regulators such as CMA in their efforts to improve corporate governance practices in Kenya.

Keywords: Corporate Governance Quality, Legal Compliance, Related Party Transactions, Financial Performance, Disclosure and Transparency

INTRODUCTION

Financial performance is a measure that represents the financial health of a company and is therefore important to corporate shareholders, management and other related stakeholders. In the recent past, there has been a growing trend over corporate a scheme that has led to fraud and failure (Allen, 2005; Jackling & Johl, 2009). This has caused a great deal of concern among corporate executives, shareholders and financial regulators. While existing studies have indicated that high levels of corporate governance practices improve the sustainability and performance of firms (Gupta & Sharma, 2014), the deterioration in financial performance in most companies worldwide has been due to low levels of CG practice (Ademola *et al.,* 2016). This is not unusual for Kenya, as most of the companies listed on the Nairobi Securities Exchange (NSE) have encountered deteriorating results and unforeseeable forecasts (Ogwoka *et al.,* 2017), in spite of efforts to tighten the regulatory framework, due to poor CG practices. Quality governance practices outline a set of underlying rules and practices that define best governance practices (De Nicolo *et al.,* 2008). It is therefore inherent for any country to initiate and implement guidelines that dictate how firms are governed.

The development and implementation of such practices in corporate governance has implications for the success of the firm. For example, sound governance practices can attract foreign investment, raise funds, protect the interests of shareholders, and enhance transparency and accountability (Bhandari & Arora, 2016; Di Gloria & Mantovani, 2017). Global corporations have been under great pressure in the recent past to review their governance processes, principles and laws (Chi, 2009; Dzingai & Fakoya, 2017). Generally, many countries around the world have made steady progress in improving CG quality, but in developed markets the corporate governance frameworks are well established and therefore not comparable to emerging markets such as Kenya (Outa & Waweru, 2016). This is because developing countries are contextually dissimilar to the need to undertake country-specific corporate governance studies (Waweru *et al*., 2011).

Extant studies have empirically suggested that the quality of CG increases financial performance (Gompers et al., 2003; Black et al., 2006b; Bebchuk et al., 2008) more so in world-class countries. Nevertheless, not much has been observed in developing countries (Ademola *et al.,* 2016). Although most studies in Kenya have focused on individual corporate governance systems for financial performance (Maina & Sakwa, 2010; Mang'unyi, 2011; Omboi, 2011; Okiro *et al.,* 2013; Mwangi *et al.,* 2014), there is inadequate knowledge of the standard of corporate governance and its relationship to financial performance. Nonetheless, according to the most recent paper, compliance with governance guidelines in Kenya increases financial performance and reputation (Outa & Waweru, 2016). Although the authors discussed the Board's evaluation and compliance as crucial measures of CG efficiency that affected firm financial performance, other factors such as legal compliance and related parties ' transactions remain unexplored. The aim of this paper was therefore to resolve this lack of knowledge by reviewing the standard of corporate governance and its connection with financial performance.

Theory, Literature Review and Hypothesis Development

This paper is based on the premises of the Agency's theory that shareholders and managers have a contractual relationship where managers are supposed to pursue interests aligned with those of owners (Jensen & Meckling 1976). More often, however, this is not the case because ownership and management are divorced, creating the main agent problem (Zheka, 2005) where executives pursue their own interests that are not beneficial to shareholders (Chalevas, 2011). This problem requires adequate and reliable governance structures to reduce management opportunism and agency costs (Solomon, 2010). Sound governance mechanisms are therefore inevitable for firms to maximize shareholder value and increase long-term profits. Since the standard of corporate governance refers to the rules and regulations that describe the firm's good governance system, the theory postulates that these practices are part of the firm's operations. For example, disclosure of financial information, related party transactions and compliance with the CG guidelines in annual reports may ultimately lead to the value of the shareholder being maximized and reduce the manager's exploitation of the company's own personal interest resources (Bebchuk & Weisbach, 2010; Allegrini and Greco, 2013; Ntim *et al.,* 2013).

In addition, stakeholder theory represents a broader perspective and that a shareholder is just one among many stakeholders (Freeman, 1984; Heath & Norman, 2004). Likewise, Edgley et al. (2010) argued that the theory is based on the idea that "companies are so large, and their impact on society is so universal, that accountability should be given to diverse individuals within society, not just shareholders, and that not only are the stakeholders affected by the company, but in turn affect companies in some inimitable ways." The theory thus suggests that managers should be accountable to various stakeholders to ensure that their interests are well served (Chen & Roberts, 2010). Extant studies have integrated stakeholder theory into governance research (Tse, 2011), but most of these studies have either argued for or rejected stakeholder theory. Although the theory has been criticized (Sternberg, 1997), it remains relevant as a central theory in corporate governance (Chen & Roberts, 2010) to tackle the misfortunes of insufficient organizational structures to various stakeholders. Blair (1995) noted that numerous stakeholders are placing their investments at risk in order to achieve their goals, and therefore each of them has a moral right to claim a share of the value of their investments. The theory is therefore applicable to the analysis because it is anticipated that the effects of quality CG activities will ultimately benefit various stakeholders.

Corporate Governance Quality and Financial Performance

The definition of CG quality is a broad, complex and difficult variable to assess due to the fact that CG is a type of meta-management that consists of a collection of relationships between the firm and its stakeholders (Tomšić, 2016). From this viewpoint, CG quality is a structure within which a business sets out its priorities and ways of achieving them. It also applies to a specific set of basic laws, regulations and agreed practices that define how companies are governed (De Nicolo *et al.,* 2008). Therefore, companies with high-quality CG activities adopt and comply with common standards for corporate governance. It is obviously not enough for companies to design and develop a system for CG, but they should also ensure that such strategies are widely accepted and beneficial. Various scholars generally agree that the development and implementation of good CG practices not only improves transparency and accountability, but also increases market value and financial performance (Hermalin & Weisbach, 2012).

Despite the vast contributions of good governance practices, the evaluation of the standard of CG is a controversial and contentious issue among established researchers due to the legal and contextual discrepancies between listed companies (Tomšić, 2016). Existing literature indicates that CG indexes assess the consistency of corporate governance. This is attributable to an all-inclusive view and comprehensive information on how companies are managed and run (Sarkar *et al.,* 2012). The Agency's theoretical standpoint argues that the use of these indexes, where the organization complies with the specified CG code, represents better monitoring and control mechanisms to safeguard the interests of shareholders (Ahmad *et al.,* 2016). Empirically, there is evidence linking CG quality and financial performance in developed countries where institutions and legal frameworks are well-founded (Gupta *et al.,* 2013; Farag *et al.,* 2014).

Although this evidence provides the basis for discourse in governance studies, the results are both inconclusive and mixed (Bhagat et al., 2008). For example, better-run companies are more profitable, competitive and pay more cash dividends to shareholders (Brown & Caylor, 2004; Bin Tariq, 2007; Bhagat *et al.,* 2008; Sarkar *et al.,* 2012). The most recent studies seem to support the idea that corporate governance is crucial to firm success (Cheung et al., 2014; Javaid & Saboor, 2015; Naushad & Malik, 2015; Srairi, 2015; Achim et al., 2016; Abdallah & Ismail, 2017), but Buallay et al., (2017) noted that corporate governance activities are not key to improving financial performance.

Not much has been studied in CG quality – financial performance relationship in particular the developing countries (Mohd Ghazali, 2010; Bhatt and Bhattacharya, 2015). Although globalization and the growing economic importance of upcoming markets have precipitated research interests on CG quality in developing contexts, there is still not enough study to date. This is because of the belief that in the developing countries, CG framework is not well grounded owing to differentials in skilled manpower, judicial and legal systems (Mensah, 2002; Dahawy, 2008). Thus, there is need to conduct country specific studies to explore the different aspects of CG practices such as disclosures (Kim *et al.,* 2013; Shahwan, 2015); legal compliance (Roy & Pal, 2017); related party transactions (Tambunan *et al.,* 2017; Umobong, 2017) and its relation to financial performance.

Disclosure and Financial Performance

Disclosures have been recognized as one of the main pillars of CG efficiency. The organization is said to have revealed if it offers a well-timed, accurate and reliable view of its state of affairs, including its financial information in terms of value and quality through its financial statements, reports and evaluations (Sharif & Lai, 2015). Shareholders and other related stakeholders can effectively monitor management of corporations (Rahman and Salim, 2010; CMA, 2015). It ultimately improves the quality of CG operations and thus increases financial performance. Many corporate frauds, scandals and failures affecting internationally recognized companies have caused a need to deliver detailed financial reports to potential users in a transparent manner (Halter *et al.,* 2009; Byun *et al.,* 2012; Kim *et al.,* 2013).

Globally, the majority of listed companies have continued to make further efforts to improve their accountability and disclosure to build long-term credibility rather than to make short-term gains (Chang *et al.,* 2007; Janney *et al.,* 2009). Therefore, by providing investors with relevant, acceptable and accurate statistics, they gain trust, confidence, and maintain high financial performance (Runhaar & Lafferty, 2009; Chiang & He, 2010). Enhanced reports thus improve the long-term sustainability of the company (Aksu & Kosedag, 2006). The disclosure of financial data to potential users through annual reports is a key component of the CG process and, by extension, is important for the evaluation of CG efficiency (Zaman *et al.,* 2015). Previous studies have shown that companies affiliated with best practices are making more comprehensive reports to shareholders and other stakeholders (Beeks and Brown, 2006). Logically and empirically believed that exchanging financial reports would publicly improve economic growth and competitiveness in most countries (Sadka, 2004).

Other scholars have suggested that stakeholder's quest for better disclosures reduces the possibility of uncertainty about the future prospects and ability to make profound evaluation of a company (Fung, 2014). Moreover, McKinsey (2002) noted that over 60% of investors relied on disclosure and transparency of financial information to make investments choices. Based on agency theory, disclosure of information reduces conflict between management and shareholders (Htay *et al.,* 2012). Thus, inherent for management to disclose the information required by investors. Existing studies have tested the relationship between disclosure and financial performance, however, the results are mixed and inconclusive. Some have reported positive or negative relations. For instance, previous studies showed positive association (Heaney *et al.,* 2007) to return on assets. Recent studies have also shown a similar trend (Kim *et al.,* 2013; Sharif & Lai, 2015; Ojeka *et al.,* 2015; Bhandari & Arora, 2016). Contrary, Shahwan (2015) found negative and statistically significant association between disclosure and financial performance. Therefore, transparency and disclosure of financial data to the shareholders and other relevant stakeholders of the firm is expected to improve financial performance. Thus, the current study hypothesized that:

$H_{O1:}$ Disclosure does not significantly influence financial performance

Legal Compliance and Financial Performance

Globally, the development and implementation of codes of CG has often been perceived as a yardstick for quality corporate governance (Akinkoye, & Olasanmi, 2014) especially for public listed corporations. In the recent past, there has been an upward trend of CG codes introduced to promote the quality of CG among listed firms regardless of whether they are developed or still developing (Albassam, 2014). As a result, these codes have helped reduce the possibility of corporate frauds and failures thus improving the performance (Aguilera & Cuervo-Cazurra, 2009). Although CG codes have been instigated in many parts of the world, they are not legally binding, as opposed to the US 2002 Sarbanes-Oxley Act which is binding that is "comply or else" model (albssam, 2014) but 'comply or explain' model generally recommend firms to adopt good CG practices so as to regulate stakeholder management relations (Michelberger, 2016). However, the level of compliance differ owing to dissimilar firm and country level governance systems (Samaha *et al.,* 2012) thus may not be relevant in other settings.

It is inherent for modern firms to embrace the model of "comply or explain" approach in their annual reports (Kluijtmans, 2016). This is because it allows for a deviation as long as it is justified, which means that it is not compliance alone, but the extent of the information provided to justify the non-compliance that forms the basis for assessing the firms ' overall CG practices (ASX, 2003; Kluijtmans, 2016). Hence, transparency and accountability to the shareholders and other relevant stakeholders would greatly be enhanced (Hermalin and Weisbach, 2012; Allegrini and Greco, 2013). Previous studies have shown empirical evidence of the connection between legal compliance and financial performance (Bebchuk and Weisbach, 2010; Bozec and Bozec, 2012; McNulty *et al.,* 2013). However, the results are mixed as others have shown either positive or negative findings (Stiglbauer, 2010; Stiglbauer & Velte, 2012; Farag *et al.,* 2014; Ebeling, 2015) or no association to legal compliance index and financial performance (Mustaghni, 2012).

It has been in literature that the type of government in place and in particular, the developing countries define the extent of legal compliance (Klapper and Love, 2004; Solomon, 2010). Hence, the level of compliance may vary depending on country specific characteristics. The evidences provided in literature are inadequate and incomprehensive with regard to legal compliance - firm performance relations. For instance, Albassam (2014) found that compliance-index is positively related to financial performance. Therefore, as companies comply with corporate governance rules and regulations, firm efficiency will be improved. On the contrary, Bhandari & Arora (2016) reports that company efficiency cannot be changed whether or not a firm complies with the regulations. In the African setting, the studies on legal enforcement and financial performance are relatively low compared to developed countries, but a few studies have attempted to uncover and demystify on the relationship. For instance, Ntim (2013) using a sample of 169 South African (SA) listed corporations, registered positive and statistically significant nexus between legal compliance index and financial performance. Using a panel data from 520 observations of listed corporations in Kenya, Outa & Waweru (2016) showed that when a firm complies with the guidelines it is likely to improve its performance and value. Thus, the current study hypothesized that:

$H_{O2:}$ Legal Compliance does not significantly influence financial performance

Related Party Transaction and Financial Performance

Globally, related party transaction is a core aspect of effective corporate governance. Related party transaction defined as - dealings between the firm and its own executives, directors, principal owners or affiliates (Nekhili & Cherif, 2011; Downs *et al.,* 2016). From the accounting perspective, IAS 24 defines RPTs as "a transfer of resources, services, or obligations between a reporting entity and a related party, regardless of whether a price is charged." Similarly, CMA (2015) defines the related party transaction as "a business arrangement between two or more parties joined by a special relationship before the deal and includes, transactions between a major shareholder and the company." Hence, simply put they are transactions as a result of the connection between firm and its diverse stakeholders. Related party transactions may be harmful or beneficial to the shareholders (Gordon et al., 2004) and therefore, in view of the harmful nature of the transaction, RPTs establish a conflict of interest between the principal and the agent as part of the agency's theory by manipulating the company's resources. This is known as tunneling and is hazardous to the shareholders' interests. Moreover, RPTs can be viewed as beneficial if managers serve to accomplish the economic needs of the firm and its relevant stakeholders (Friedman *et al.,* 2003).

Generally, RPTs data would help firms to optimize and allocate internal resources, reduce costs of transactions and eventually improve financial performance (Shan, 2009; Ge *et al.,* 2010). As an important aspect of CG quality, RPTs ought to be presented in view of the transactions entered into by managers and other related parties. According to the efficient transaction principle, any transaction entered into by the company is expected to meet the company's standards (Umobong, 2017) and its disclosure in the financial statements helps to reduce the conflict between the shareholders and the management. This would improve the efficiency of CG practices that is engrained in firm operations. Therefore, improved CG practices eventually augments financial success. Studies conducted earlier concentrated on developed countries and are inconclusive. For instance, there are scholars who have found negative (Kohlbeck & Mayhew, 2010; Xiao & Zhao, 2012; Munir & Gul, 2010; Elkelish, 2017), positive (Bhandari and Arora, 2016) and no relations (Umobong, 2017). Hence, this study hypothesized that:

$H_{O3:}$ *Related Party Transaction does not significantly affect financial performance*

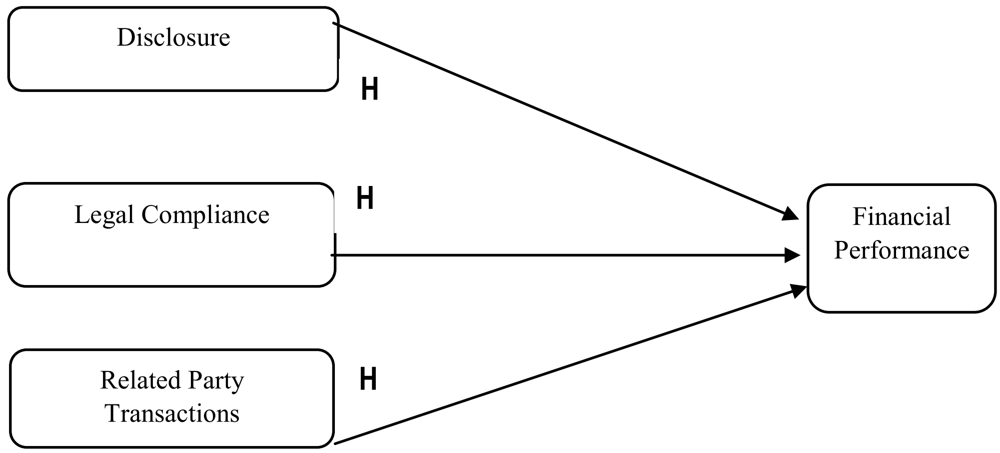

Figure 1: Model of the study

METHODOLOGY

The longitudinal design was used to derive data from 65 listed firms in the Nairobi Securities Exchange for a period of 10 years from the year 2008 to 2017. This gave a total of 650 firm year observations. The longitudinal research design was preferred because it ensures that the data is arranged in a panel data form (Connaway & Powell, 2010) and mitigate the limitations associated with the "snap shot" approach of cross sectional designs (Kawor & Kportorgbi, 2014). This paper used pooled OLS panel data analysis models to test the hypothesis. Specifically, the Fixed Effect Model (FEM) and Random Effect Model (REM) was used. These models were used to establish the relationship between corporate governance quality and financial performance for panel data analysis. The model is specified as follows:

$$y_{it} = \beta_0 + \beta_1 x_{1it} + \beta_2 x_{2it} + \beta_3 x_{3it} + \varepsilon_{it}$$

Where;

Y_{it}= represents the financial performance of firm *i* in year time *t*

β_0= is the constant term or intercept

$\beta_1 \ldots \beta_3$ = represents the coefficients of the independent variables in the model.

X_{1it} = represents the disclosure index of firm *i* in year time *t*

X_{2it} = represents the legal compliance index of firm *i* in year time *t*
X_{3it} = represents the related party transactions index of firm *i* in year time *t*

Measurement of Variables

***Dependent Variable*:** Empirically, there is no total unanimity on the precise calculation of financial performance (Haniffa and Hudaib 2006; Mangena *et al.,* 2012). Therefore, study used the market based measure such as earnings per share (EPS) as financial performance proxy. The ROA measure has largely been used in CG studies than earnings per share (Renders *et al.,* 2010; Munisi and Randoy, 2013). The EPS, which is a market-based indicator, was therefore measured as the ratio of income after tax to the total number of equity shares (Sheikh and Karim, 2015; Wahyudin & Solikhah, 2017). The EPS measure was preferred in the current study because it improves comparability with existing studies and its use provides robustness check for the study results (Mangena *et al.,* 2012; Ntim *et al.,* 2012b). EPS, as a financial performance proxy, would enable readers and future researchers to understand how corporate governance index affect financial results particularly in the Kenyan setting.

Independent Variables: The CGQ variable was measured using corporate governance indices which were consistent with previous studies conducted in both the developed and developing markets (Gompers *et al.,* 2003; Klapper & Love, 2004; Brown & Caylor, 2006; Bhagat *et al.,* 2008; Bebchuk *et al.,* 2008; Renders *et al.,* 2010; Aguilera *et al.,* 2015; Outa & Waweru, 2016). The argument for the use of CG indices was that different CG mechanisms may seem to be unproductive if examined individually but could largely have positive implications on outcomes such as financial performance if a combined index was used (Aguilera *et al.,* 2012) or 'bundles' of CG practices put together (Schnyder, 2012). Therefore, the study used CG sub-indices to measure the quality of CG. According to Bhandari & Arora (2016), Disclosure, Legal Compliance and Related Party Transaction were used as proxies for CG quality: They were measured as follows;

Disclosure Index was measured as to; (if yes =1, otherwise = 0)

- whether the related party transactions is disclosed to shareholders in the CG report
- whether the company puts annual financial reports on the website
- does the company put the directors report on the web
- whether the CG report is disclosed on the website of the company
- whether the use of risk management practices is disclosed in the CG report
- whether the provision for the adoption of code of ethics is disclosed in the CG report
- whether the provision for internal control system is disclosed in the CG report
- whether the details of transactions between the company and the directors are disclosed in the annual report
- whether the use of accounting standards are disclosed in the annual report

Legal compliance index was measured as to; (if yes =1, otherwise = 0)

- whether the company have the policy against insider trading
- whether the audit committee exist in the company
- Does the board risk committee exist in the company
- Does the compensation (remuneration) committee exist in the company
- Does the company adopt the whistle blower policy
- Whether board credit committee exist in the company

- Whether board members are evaluated by the company

Related party transactions index was measured as to; (yes = 1, otherwise =0)

- Is the detailed report statement of related party transactions given in the annual report
- Are related party transactions at arm's length
- Are related party transactions reported before the audit committee for review
- Does the company take loans from related parties
- Does the firm give loans to related parties
- Are related party transactions presented before the board for review
- Do related party transactions cause any conflict of interest in the company

RESULTS

Descriptive Statistics

Table 1 shows the results of disclosures, legal compliance and related party transactions between 2008 and 2017. Based on the descriptive results, the firms' disclosure was at an average of about 72% (mean = 0.717). Apparently, the level of disclosure was high, which meant that it was easier for firms to evaluate their performance as well as gain investor confidence and trust. Furthermore, legal compliance index was at 53% (mean = 0.536) while related party transactions at 60% (mean = .605). Finally, the EPS had a mean of 4.554.

Table 1 : Descriptive Statistics

	Min	Max	Mean	SD	Skewness	Kurtosis
Disclosure	.33	.94	.717	.135	-1.118	.963
Legal Compliance	.13	1	.536	.214	.008	-.304
Related Party Transaction	.16	.93	.605	.181	-.286	-.263
Earnings Per Share	-3.86	22.7	4.554	4.619	2.345	5.941

Correlation Results

The correlation matrix showing the magnitude and direction of the relationship between each pair of variables being analysed is shown in Table 2. The negative sign of the correlation equation indicates that there is an opposite association between the two variables. From the findings in the Table, the Disclosure is positively correlated with earnings per share (EPS) with a Pearson correlation coefficient ($r = .146$) which is significant at $\rho < .01$. Moreover, related party transaction (RPTs) are positively related to EPS with a coefficient of ($r = .256$) significant at $\rho < .01$. However, Legal compliance has an inverse relationship with the EPS ($r = -.386, \rho < .01$). In overall, the results show moderate correlations between variables.

Table 2: Correlation Results

Variables	1	2	3	4
Earnings Per Share	1			
Disclosure	.146**	1		
Legal Compliance	-.386**	.153	1	
Related Party Transaction	.256**	.179	.110	1

** Correlation is significant at the 0.01 level (2-tailed).

Regression Results

Multiple Regression results are presented in Table 3. To test the appropriateness of the fixed or random effect in testing the hypotheses, Hausman test was used. The null hypothesis of the Hausman test statistic was that Random effect model was adequate to test H_{01} to H_{03}. Hausman test statistic reported a Chi-Square (χ^2) of 4.260 ($\rho = .235 > .05$) suggesting that at 5 percent level of significance, the Chi – Square value found is insignificant, thus the null hypothesis was held (Greene, 2008). H_{01} predicted that disclosure has no significant effect on financial performance, however, the results showed a positive and significant effect on financial performance ($\beta = 5.983$, $\rho<.05$) and so the hypothesis was not supported. This means that when firms disclose financial information to the relevant stakeholders, they will end up improving financial performance. In tandem with other scholars, when firms disclose information transparently, the more improve CG practices and so does financial performance (Aksu & Kosedag, 2006; Rahman and Salim, 2010 Sharif & Lai, 2015; Ojeka *et al.,* 2015; Bhandari & Arora, 2016) but inconsistent with findings of Shahwan (2015). Undoubtedly, firms can gain more with the transparency and disclosure financial information.

H_{02} postulated that legal compliance does not influence financial performance. The results indicate that legal compliance negatively influenced financial performance ($\beta = -9.741$, $\rho<.05$). The hypothesis was not held. This suggests that when firms comply with the legal requirements of the CG guidelines, they reduce financial performance. This finding is surprising since it contradicts the expectation that when firms comply they are more likely to improve their performance. Though previous work found positive effects (Albassam, 2014; Ntim, 2013; Outa & Waweru, 2016), this study argues that when firms increase the emphasis to comply and explain when reporting financial statements, it reduces financial performance.

H_{03} assumed that the related party transactions did not affect financial performance. The reported results indicate that there is a positive effect on financial performance ($\beta = 6.916$, $\rho<.05$). Thus, hypothesis was not accepted. This implied that when firms undertake transactions from related parties, it tends to improve financial performance. This finding is consistent with the proposition that explanations regarding related party transactions allow firms to allocate and optimize internal resources which reduces transactions costs while enhancing firm performance (Shan, 2009; Ge *et al.,* 2010). However, it inconsistent with the argument that related party transactions is detrimental to financial performance (Munir & Gul, 2010).

Table 3: Model Summary

	Fixed Effects Model			**Random Effects Model**		
	Beta	**SE**	**P >|t|**	**Beta**	**SE**	**P > |z|**
Constant	.398	2.407	.869	1.315	2.342	.574
Disclosure	6.853	3.036	.026	5.983	2.924	.041
Legal Compliance	-9.145	1.900	.000	-9.741	1.827	.000
Related Party Transactions	6.872	2.278	.003	6.916	2.159	.001
Model Statistics						
R-Sq (within)	.260			.258		
F(3,96)	11.220			-		
Sig.	.000			-		
sigma_u	1.329			.000		
sigma_e	4.017			4.017		
Rho	.098			.000		
Wald χ^2 (3)	-			39.470		
Sig.	-			.000		
Hausman Test						
χ^2 (3)	4.260					
Sig.	.235					

CONCLUSION AND RECOMMENDATIONS

Results show that disclosure of financial statements is a key indicator of good financial performance. From the point of view of the stakeholders, this paper argues that when companies publish their financial statements, they are more likely to gain trust and confidence from investors who can contribute funds to invest in their businesses. This will enhance their long-term profitability. It is therefore necessary for companies to conduct better financial reporting and strengthening their transparency, in their annual reports. In fact, the disclosure of information in the financial statements makes it easier for companies to assess their results and make sound decisions about future prospects. In addition, investors are best placed to make reasonable and informed decisions on the basis of detailed published financial reports. Perhaps significantly, with increased disclosure of information in the financial statements, there has been a significant increase in financial performance.

In order to enhance our perception of the consistency of corporate governance and the efficiency of the company, the findings also demonstrate that related party transactions play a key role in enhancing financial performance. This study suggests that it is more relevant for companies which are listed on the stock exchange to enhance their financial health to engage related parties. This is due to the fact that when related party transactions are undertaken, firms are more likely to make optimal use of internal resources to better their performance. Moreover, the results tend to suggest that legal compliance is harmful to financial performance because it is inconsistent with previous findings that indicate a favorable correlation between legal compliance and the financial performance of firms. In general, this study indicates that companies should publish more of their annual reports, conduct more relevant transactions to boost financial performance. Firms need to strengthen their legal enforcement in order to maximize their financial viability.

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