

**THE EFFECT OF VOLUNTARY DISCLOSURE ON STOCK  
MARKET RETURNS OF COMPANIES LISTED AT THE  
NAIROBI SECURITIES EXCHANGE**

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL  
FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD  
OF THE DEGREE OF MASTER OF SCIENCE IN FINANCE,  
SCHOOL OF BUSINESS UNIVERSITY OF NAIROBI**

**NOVEMBER, 2014**

## DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the University of Nairobi for academic credit.

Signed: \_\_\_\_\_ Date: \_\_\_\_\_

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## **ACKNOWLEDGEMENTS**

First, I sincerely thank my parents, family, and friends, who provided the advice and financial support. The product of this research paper would not be possible without all of them. I also acknowledge my fellow students and lecturers at the University of Nairobi whose wells of knowledge I drew from through the academic period, and have made me a better professional.

I would like to express my profound gratitude and deep regard to my supervisor, Mr. Mirie Mwangi for his exemplary guidance, valuable feedback and constant encouragement throughout the duration of the project. His valuable suggestions were of immense help throughout my project. His perceptive criticism kept me working to make this project in a much better way. Working under him was an extremely knowledgeable experience for me. I would also like to specially thank my colleagues for their support in this project.

## **DEDICATION**

I dedicate this work to the Almighty God and to my family; my dearest mum Catherine Mwiti and dad Simon Mwiti as well as my siblings, for their encouragement and support throughout my studies. A special mention to my good friends whose input is invaluable.

## TABLE OF CONTENT

DECLARATION .....	ii
ACKNOWLEDGEMENTS .....	iii
DEDICATION .....	iv
TABLE OF CONTENT .....	v
LIST OF TABLES.....	viii
LIST OF FIGURE.....	ix
ABBREVIATIONS .....	x
ABSTRACT .....	xi
CHAPTER ONE: INTRODUCTION .....	1
1.1 Background of the Study.....	1
1.1.1 Voluntary Disclosure .....	2
1.1.2 Stock Market Returns.....	3
1.1.3 Effect of Voluntary Disclosure on Stock Returns.....	5
1.1.4 Firms Listed at the Nairobi Securities Exchange .....	6
1.2 Research Problem.....	8
1.3 Research Objective.....	10
1.4 Value of the Study .....	10
CHAPTER TWO: LITERATURE REVIEW .....	12
2.1 Introduction .....	12
2.2 Theoretical Framework .....	12
2.2.1 Efficient Market Hypothesis.....	13
2.2.2 Random Walk Theory.....	14
2.2.3 Agency Theory .....	15
2.3 Determinants of Stock Market Returns .....	16
2.3.1 Internal Developments .....	16
2.3.2 Exchange Rates.....	17
2.3.3 Investor Sentiment .....	17
2.3.4 Interest Rates .....	17

2.3.5 Inflation .....	18
2.5 Summary of Literature Review.....	23
<b>CHAPTER THREE: RESEARCH METHODOLOGY .....</b>	<b>26</b>
3.1 Introduction .....	26
3.2 Research Design.....	26
3.3 Population .....	27
3.4 Sample and Sampling Method .....	27
3.5 Data Collection Methods.....	28
3.6 Validity and Reliability.....	28
3.7 Data Analysis Methods .....	29
<b>CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION.....</b>	<b>32</b>
4.1 Introduction .....	32
4.2 Descriptive Statistics .....	32
Table 4.1 Descriptive Statistics.....	33
4.2.1 Indicators of Study Variables.....	33
Figure 4.1 Indicators of Study Variables .....	34
4.3 Correlation of Study Variable.....	34
Table 4.2 Correlation of Study Variable .....	34
4.5 Regression of Study Variables.....	35
4.5.1 Anova .....	35
Table 4.3 Anova .....	35
Table 4.4: Regression model summary of the effect of independent variables on the dependent variable .....	36
Table 4.5: Regression Coefficient of Determination of the effect of independent variables on the dependent variable .....	36
4.6 Discussion of Research Findings .....	37
<b>CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS .....</b>	<b>39</b>
5.1 Introduction .....	39
5.1 Summary of Findings.....	39
5.2 Conclusions .....	40
5.3 Recommendation .....	41

<b>5.5 Limitations of the Study.....</b>	<b>42</b>
<b>5.6 Suggestion for Further Research .....</b>	<b>43</b>
<b>REFERENCES .....</b>	<b>44</b>
<b>APPENDICES .....</b>	<b>49</b>
<b>Appendix 1: List of companies on the Nairobi Securities Exchange ....</b>	<b>49</b>
<b>Appendix 2: Voluntary Disclosure Index.....</b>	<b>51</b>
<b>Appendix 3: Computation of Stock Market Returns.....</b>	<b>54</b>
<b>Appendix 4: Voluntary Disclosure Index (<math>X_n</math>), and Stock Returns(<math>Y</math>)</b>	<b>55</b>

## LIST OF TABLES

<b>Table 4.1 Descriptive Statistics .....</b>	<b>33</b>
<b>Table 4.2 Correlation of Study Variable.....</b>	<b>34</b>
<b>Table 4.3 Anova.....</b>	<b>35</b>
<b>Table 4.4: Regression model summary of the effect of independent variables on the dependent variable .....</b>	<b>36</b>
<b>Table 4.5: Regression Coefficient of Determination of the effect of independent variables on the dependent variable.....</b>	<b>36</b>



**LIST OF FIGURE**

**Figure 4.1 Indicators of Study Variables.....34**

## **ABBREVIATIONS**

CBK	-	Central Bank of Kenya
CMA	-	Capital Market Authority
CPA	-	Certified Public Accountant
CSR	-	Corporate Social Responsibility
EMH	-	Efficient Market Hypothesis
EPS	-	Earnings per Share
FASB	-	Financial Accounting Standard Board
FTSE	-	Financial Times Securities Exchange
NSE	-	Nairobi Securities Exchange
NASI	-	NSE All Share Index
ROA	-	Return on Asset
SPSS	-	Statistical Package for Social Science
UK	-	United Kingdom
USA	-	United States of America

## ABSTRACT

Transparency and disclosure represent one of the pillars of corporate governance. Numerous scandals have occurred worldwide due to lack or improper corporate disclosures. It has been argued that managers should voluntarily disclose information that would satisfy the needs of various stakeholders. Voluntary disclosure is aimed at providing a clear view to stakeholders about the business's long-term sustainability and reducing information asymmetry and agency conflicts between managers and investors. Business organizations have over the years reported financial and non-information to the shareholders and the general public. Included in their reporting are voluntary disclosures, some of which are not statutorily required to be reported. Notably, every release of information by an organization has got some cost implication to the firm and therefore the value addition of such voluntary disclosure ought to be evaluated. The objective of this study is to determine the effects of voluntary disclosures on stock market returns of companies listed at the Nairobi Securities Exchange. The findings can help stock market participants understand the implications of voluntary disclosures on the company's stock returns. Company executives can therefore make an informed decision in engaging on voluntary disclosures. To the stock traders, the research can help them determine how to action after voluntary disclosures, so as to earn better returns for their investments. This research studied the effects of voluntary disclosures on stock market returns for the organizations listed at the NSE. The NSE is divided into 10 different sectors. Samples of 20 companies were selected from the 10 different sectors. The model shows a goodness of fit as indicated by the coefficient of determination  $r^2$  with value of 0.583. This implies that independent variables both explain 58.3% of the variations as a result of the factors affecting the market performance. 41.7% of variations are brought about by factors not captured in the objectives. The study recommends companies to have voluntary disclosure above the statutory requirements set by the regulatory bodies since it can work as a good corporate governance tool. There was a strong positive significant relationship was that was obtained between voluntary disclosure and stock returns therefore, the firms can increase stock returns by increasing voluntary disclosure. The government should also put more regulation on disclosure to ensure that individuals investing get more information.

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

Transparency and disclosure represent one of the pillars of corporate governance. Numerous scandals have occurred worldwide due to lack or improper corporate disclosures. Different stakeholders use corporate disclosure in their decision-making (Shehata1, 2013). All decision makers have a framework of what information they need to accomplish some purpose depending on their mental abilities and experience (Zareian, 2012). One of the key aims of accounting information reporting is to help the users of the information to predict the returns on their investment. The stock returns of an investor's investments in the stock market are affected by the financial information provided by the management (Guillaume, 2007). Furthermore, the investors use the financial information to estimate the rate of return (Asava, 2013). Much of the literature on voluntary disclosure in accounting considers the economic based models of disclosure by seeking to link financial reporting to economic consequences (Verrecchia, 2001). Investors - shareholders and debt-holders - are basically savers who want to invest their money in a 'good' business. However, linking savings to business investment opportunities is a complex process due to information asymmetry, where entrepreneurs have more and better information about businesses than savers. This leads to the agency problem: when savers invest in a business, they delegate their decision-making authority to entrepreneurs; in other words, savers are not actively involved in a business's management (Healy and Palepu, 2001).

Zareian (2012) postulates that the extent of the effect of accounting information is somehow complicated. But since investors invest on any economic unit when they have enough information, managements' development of plans and policies to achieve

succinct levels of information disclosure to the capital markets can effectively communicate to the investors and leverage their knowledge about the stocks hence leverage their decision (Francis, 2003). Zareian (2012) linked voluntary accounting disclosure with stock returns in the capital markets.

### **1.1.1 Voluntary Disclosure**

Disclosure is defined in the accounting literature as informing the public by financial statements of the firm (Agca and Onder 2007). Disclosure is also defined as “the communication of economic information, whether financial or nonfinancial, quantitative or otherwise concerning a company’s financial position and performance” (Owusu-Ansah, 1998).

Voluntary disclosure refers to disclosure of information regarding the organization up-and-beyond the statutory requirements (Asava, 2013). The practice of voluntary disclosure has attracted a lot of attention from researchers. Meek et al. (1995) define voluntary disclosures as free choices on the part of company managements to provide accounting and other information deemed relevant to the decision needs of users of their annual reports. They go ahead and classify voluntary disclosures as strategic, non-financial and financial information. They classify the disclosures depending on what they are intended for and the contents of such disclosed information. Since the management know more about the company than the shareholders, customers, suppliers, creditors, and government regulators including capital market authorities (Feng and Li, 2007). The management finds it useful to inform the outsiders what they know about the company.

Disclosed financial information is essential for investors to efficiently allocate scarce resources (Cooke, 1989), and assess investment options (Gray, Meek, Roberts, 1995). Firms usually reports according to two dominant standards; Generally Accepted Accounting Principles (GAAPs) and International Financial Reporting Standards (IFRS). From the investors' perspective, these standards do not provide all the necessary information and as a result there are some deficiencies (Schuster and O'Connell, 2006 ). Voluntary disclosures results in increased transparency and decreased asymmetry. Agency costs are a consequence of information asymmetry and arise when investors undervalue the firm due to insufficient information (Guillaume, 2007). Increased transparency shows the true value and makes investors more willing to invest (Leuz andVerrecchia, 2000).

The key aim of voluntary disclosures is to inform the public more about the company. In turn, the management hopes that the stakeholders of the company will respond favorably to the company. Whether strategic, non-financial or financial voluntary disclosures, Meek, Roberts and Gray (1995) postulates that most organizations gain some benefits by virtue of disclosing more than is expected if the issued information is strategically availed to the important parties who are likely to act in favor of the company. The disclosures are sometimes not periodic while others are periodically released including voluntary disclosures released together with annual reports of an organization (Asava, 2013).

### **1.1.2 Stock Market Returns**

Stock market returns is sometimes synonymous to stock prices (Foster, 1986). A strong market can be seen as one that impounds new information to stock prices and hence making the stock prices for the firms stable and accurately valued. Due to misvaluations

of firms by public capital markets, managers provide the information known by them alone to the capital markets to correct the misvaluations, since stocks value is dependent on information (Velashani and Mehdi, 2008). Walter (2006), noted that since organizations in the same industry tend to copy from one another, voluntary disclosure by one organization is mimicked by other firms, leading to more information released to the market tending the capital markets towards efficiency.

The information asymmetry and agency conflict can adversely impede the allocation of resources in capital markets of an economy (Velashani and Mehdi, 2008). The disclosure requirements themselves and the bodies such as regulators, standards setters, auditors, and capital market intermediaries seek to facilitate and enhance the credibility of management disclosures hence playing an important role in mitigating the problem of information asymmetry and agency conflict (Healy and Palepu, 2001). (Deegan, 2010) postulates that corporate disclosure is critical for the well functioning of an efficient capital market. Furthermore, companies exercise voluntary disclosures for capital market reasons.

The market forces exerts pressure on the companies' such that they can only give relevant and perceived information so that their securities will fetch reasonable prices hence leverage their ability to get capital from the markets (Healy and Palepu, 2001). In support, of Foster (1986), Lim (2007), asserts that there is a relationship between economic theory and contemporary accounting implying that more disclosure means lower information asymmetry costs. Hence, the more a company discloses its state of affairs, the more it mitigates chances of obligations to shareholders or potential buyers and sellers of the entity's stocks and hence better performance of the market.

### **1.1.3 Effect of Voluntary Disclosure on Stock Returns**

There exists many studies reveal that organizations operating in industries highly dependent on external financing have a considerably higher level of voluntary accounting disclosures (Velashani and Mehdi, 2008). They further realized that the results were still up-held after controlling for differences in legal and financial systems amongst countries, and firm-specific controls for firm size and performance. The findings revealed that organizations with relatively higher levels of disclosure usually have lower costs of capital (Walter, 2006). Hence voluntary disclosures lower information asymmetry costs and hence the cost of external financing for the firm.

Notably, transaction costs reflected in the bid-ask spread should reduce as information asymmetry reduces. Marilyn and Heibatollah (1994) found out that accounting disclosure reduces the bid-ask spread as a proxy of transaction costs. Further, Botosan (1997) also revealed that cost of equity capital is reduced in firms with relatively higher levels of disclosures. In her research, she noted that companies with relatively more analyst reports had lower costs of equity capital. Partha (1998) noted that companies which were ranked highly by financial analysts had lower interest costs of issuing debts.

It is the economic benefits that encourage the managers to provide more information to the public through voluntary exposure. Also, since regulatory disclosures do not succinctly reflect the management performance, the management engages in voluntary disclosure to say more about the company. In turn, the stakeholders get to know more about the company, while reducing the costs of capital. There is an overall economic benefit for companies and the capital market since the cost of raising capital is reduced. Further, the market participants are informed by dealing with the demerits of



information asymmetry and its related costs. These factors attract more investors to a market hence an increased success of the market (Healy and Palepu, 2001).

#### **1.1.4 Firms Listed at the Nairobi Securities Exchange**

The Nairobi Securities Exchange, until recently was referred to as the Nairobi Stock Exchange has been providing stock market indexes since its formation in 1953. The NSE 20-share index was developed to provide a review of weighted movement in price of major counters. The index was revised in the year 2007 with an aim to ensure that it was a true barometer of the market since it was felt that the stocks which used to comprise the index had since lost their prominence in the market and that some sectors such as telecommunication market segments were not represented. Further NASI was introduced in the year 2008 as an alternative index which was an overall indicator of the market performance since it includes all the shares quoted in the market provided there was activity in the specific stock for the day. NASI has not gained prominence since its launch and therefore the NSE 20-share index still remains as the main market index (Asava, 2013). At the heart of the Exchange is market liquidity enhancement by fostering transformational and utmost ethical practices amongst the participants so that more investors are assured of free and fair information for their trade related decision making (Ngugi, 2003).

Therefore, the Kenyan Government has initiated reforms at the NSE aiming to transform the exchange to be the vehicle to mobilize domestic savings and to attract foreign capital investments (Barako, 2007). Consequently, corporate financial reporting and especially enhanced voluntary disclosures is an important ingredient of enhancing confidence and trust of the market by both local and foreign investors (Ngugi, 2003). Since the year 2008, the exchange has greatly emphasized on corporate governance

with some participants punished for faulting the acceptable market regulations (Asava, 2013).

Amongst other changes are enhanced communications by and within the NSE itself. In November 2011, the exchange launched the FTSE NSE Kenya 15 and FTSE NSE Kenya 25 Indices, as a result of an extensive market consultations with local asset owners and fund managers. The launch of the indices reveals the interest of growth into the domestic investment and diversification opportunities in the East African region. This was followed by the NSE becoming a member of Financial Times Services Division (FISD) of the Software and Information Industry Association (SIIA) in March 2012. By providing the indices in its website, the initiative provides the investors with current information of reliable indication of the Kenyan equity market's performance during trading hours (Asava, 2013)

With its emphasis on attracting more investors, NSE has to encourage all the participants in the market to provide as much information as is practically possible. Barako (2007) Postulates that the level of disclosures including voluntary disclosures amongst the participants in the NSE has increased over the years. Definitely, with the CMA emphasizing on tightening corporate governance amongst the market participants, the extent of disclosure including voluntary disclosure is bound to be enhanced at the NSE.

## **1.2 Research Problem**

It has been argued that managers should voluntarily disclose information that would satisfy the needs of various stakeholders (Gray, Meek, Roberts, 1995). Voluntary disclosure is aimed at providing a clear view to stakeholders about the business's long-term sustainability and reducing information asymmetry and agency conflicts between managers and investors (Healy and Palepu, 2001). Financial reporting is anchored on the agency relationship between the management on one hand and the shareholders and stakeholders on the other hand. The managers who manage the organizations on behalf of the shareholders have to report to the shareholders. The stakeholders all make decisions which either impact the organization or they themselves are affected by the organizations, since the value of their decision is pegged on the position of the organization presently and its decisions thereafter (Karamanou and Vafeas, 2005).

Investors get information regarding the organizations trading in NSE through their annual reports and other announcements. It is the dire need of information so that stock prices in the NSE reflect the most current information, that the NSE, like any other exchange market encourages the firms to disclose as much information as is possible. This is advantageous since literatures reveal that organizations with good corporate governance, more so in corporate reporting are able to raise capital from the markets relatively cheap (Zareian, 2012). Furthermore, the greater the disclosures, the greater the extent to which the stock prices reflect the whole truth hence obeying the market fundamentals. This helps the investors to rightfully choose the securities to invest in (Asava, 2013).

Sing and Desay (1971) carried out a research in USA titled an experimental quality analysis of financial disclosure by firms in USA and found out that disclosure quality

is better in large firms compared to smaller ones. Dedman and Stephen (2006) carried out a research on Voluntary disclosure and its impact on share prices, they noted that the reported earnings of high- R and D expenditure firms were likely to convey less value-relevant information to investors than those of less research-intensive firms. Zareian (2012) in his research paper conducted a post event correlation analysis seeking to establish whether there is a significant relationship between information disclosure quality and stock returns change in investment firms and noted that the results kept varying in that in some years there was absolutely no correlation between disclosure quality and stock returns, while there were some correlation in other years. Hail (2001) investigated the impact of voluntary corporate disclosure on the expected cost of equity capital and stated that quality of disclosure is inherently subjective like cost of equity capital and its evaluation is very difficult. Botosan (1997) carried out a study in USA to examine the association between expected cost of equity capital and three types of disclosure and concluded that aggregating across different types of disclosure results in a loss of information and potentially erroneous conclusions.

Lwangu (2009) performed a study to investigate the link between corporate governance, company size and company announcements on disclosure compliance for companies quoted at the NSE. He noted that there was also a positive correlation between company size and compliance but a negative correlation with company announcements Wesonga (2008) in his study on the use of financial disclosures for decision making by investors in Kenya, found out that the majority of the institutional investors use financial disclosures as a source of vital information for investment decisions. Mwirichia (2008) carried out a survey of corporate governance disclosures among Kenyan firms quoted at Nairobi stock exchange. He found out that financial

sectors make more intensive corporate governance disclosure than the non-financial sector. Barako (2007) in his study of determinants of voluntary disclosures in Kenyan Companies Annual Reports observed that organizations cannot link their disclosures and financial performance.

Literatures from past studies reveal that most researchers have been skewed to the factors that influence the extent of voluntary disclosure. Those studying the relationship between voluntary disclosure and stock market returns, like Zarein (2012), Wesonga (2008) and Mwirichia (2008) concluded that there was no relationship between voluntary disclosures and stock market returns. Other researchers elsewhere have linked causality between quality voluntary disclosures and stock returns and in turn the stock market performance. Yet again, some have had conflicting results. Since voluntary information disclosures have a cost implication, there is a need to establish whether voluntary information disclosures impacts the stock market returns expected by the investors. Hence the question that really begs is whether voluntary information disclosures by the companies listed in Nairobi Securities Exchange, impacts the market stock returns of the particular organization.

### **1.3 Research Objective**

The objective of this study is to determine the effects of voluntary disclosures on stock market returns of companies listed at the Nairobi Securities Exchange.

### **1.4 Value of the Study**

The findings can help stock market participants understand the implications of voluntary disclosures on the company's stock returns. Company executives can therefore make an informed decision in engaging on voluntary disclosures. To the stock

traders, the research can help them determine how to action after voluntary disclosures, so as to earn better returns for their investments.

Also, this study will greatly contribute to the body of literatures on the implications of voluntary accounting disclosures and stock market returns and related fields as not much work has been done in Kenyan case on the topic. As a result, future researchers can draw literatures from the study.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter provides literatures from past researchers and scholars on the implications of voluntary accounting disclosures on stock market performance. The chapter examines the concepts of voluntary accounting disclosures on stock market prices in relation to the extent to which organizations have exercised voluntary accounting disclosures and its effect to the stock market performance. By considering the work from diverse authors, the chapter builds on the theoretical and the conceptual framework on the effects of voluntary accounting disclosures on stock returns.

### **2.2 Theoretical Framework**

One of the accounting information goals is helping users in predicting the returns on their investment. Some variables affecting firms' stock returns in the market result from financial information provided by management. Extent of effect of this information is complicated and somehow unknown. Investors, invest on an economic unit when they have enough information, including financial information (Botosan, 1997).

Decision making requires information; and managers are always confronted with a problem on which information to release to investors to aid in their decision making. One of the major difficulties in accounting standards development is the lack of knowledge of decision making nature and logical process which decision makers attempt to access (Asava, 2013). The firm's rate of return on investment is one of the main decision making criteria for investors and its calculation as a criterion for firm performance evaluation is obtained from information disclosed by the firm management (Barako, 2007).

### **2.2.1 Efficient Market Hypothesis**

The efficient markets hypothesis has historically been one of the main cornerstones of academic finance research. In finance, a stock price reflects or contains financial information. Proposed by the University of Chicago's Eugene Fama in the 1960's, the general concept of the efficient markets hypothesis is that financial markets are "informationally efficient" - in other words, that asset prices in financial markets reflect all relevant information about an asset. The efficient-market hypothesis (EMH), also called Joint Hypothesis Problem (Barako, 2007). Consequently, one cannot consistently achieve returns in excess of the average market returns on a risk-adjusted basis, given the information available at the time the investment is made, since before any investor acts on the information, the market will have adjusted the stock prices to reflect new information (Fama and French, 1992).

The three major versions of the hypothesis include: weak form, semi-strong form, and strong form. The weak-form EMH claims that prices on traded assets including stocks, bonds, or property already reflect all past publicly available information. The semi-strong-form EMH claims that prices reflect all publicly available information. The strong-form EMH asserts that prices instantly reflect even hidden or insider information. Its proponents argue it is pointless to search for undervalued stocks or to try to predict trends in the market through either fundamental or technical analysis (Zareian, 2012).

While academics point to a large body of evidence in support of EMH, many dissensions have been raised. Critics have blamed the belief in rational markets for many of the late 2000s financial crisis (Asava, 2013). For example, investors, such as Warren Buffett have consistently beaten the market over long periods of time, which



by definition is impossible according to the EMH (Feng and Li, 2007). Detractors of the EMH also point to events, such as the 1987 stock market crash when the Dow Jones Industrial Average (DJIA) fell by over 20% in a single day, as evidence that stock prices can seriously deviate from their fair values.

In response, proponents of the hypothesis have stated that market efficiency does not mean having no uncertainty about the future. Market efficiency is a simplification of the world which may not always hold true, and that the market is practically efficient for investment purposes for most individuals (Asava, 2013).

### **2.2.2 Random Walk Theory**

Random walk hypothesis which is consistent with the efficient-market hypothesis is a financial theory stating that stock market prices evolve in a random fashion hence cannot be predicted (Hubert, 2001). The theory precisely states that stock price changes have the same distribution and are independent of each other, so the past movement or trend of a stock price or market cannot be used to predict its future movement. It is the notion that stocks take a random and unpredictable path. Proponents of the random walk theory believe that it is impossible to outperform the market without assuming additional risk.

Critics of the theory, however, contend that stocks do maintain price trends over time. They argue that it is possible to outperform the market by carefully selecting entry and exit points for equity investments. Martin Weber, a leading researcher in behavioral finance, found trends in stock markets after performing many studies. In one of his ten years stock market analysis, he looked at the market prices for noticeable trends and found that stocks with high price increases in the first five years tended to become

under-performers in the following five years contradicting the random walk hypothesis (Hubert, 2001). Another contradiction was his findings of stocks that had an upward revision for earnings outperforming other stocks in the following six months.

Hubert (2001) asserts that an investor with this knowledge has an edge in predicting which stocks to pull out of the market and which stocks — the stocks with the upward revision — to leave in. Martin Weber's studies detract from the random walk hypothesis, because there are trends and other tips to predicting the stock market. Furthermore, the contradictions of the efficient market hypothesis allows for some investors to earn an abnormal earnings by capitalizing on the weaknesses in the market.

### **2.2.3 Agency Theory**

Jensen and Meckling (1976) defines the agency relationship as a contract under which one or more persons (the principals) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent. Agents correspond to managers, whereas principals correspond to shareholders from a companies' perspective. Agency costs arise from the assumption that the two parties, agents and principals, have different interests. Monitoring costs are paid by the principals, shareholders, to limit the agents' aberrant activities. Bonding costs are paid by the agents, managers, to guarantee that no harm of the principal's interests will result from their decisions and actions. Residual loss stems when decisions of the agents diverge from decisions that would maximize the principal's welfare. Accordingly, the agency cost is the summation of the monitoring cost, bonding cost, and the residual loss (Jensen and Meckling, 1976).

The agency relationship leads to the information asymmetry problem due to the fact that managers can access information more than shareholders (Jensen and Meckling, 1976). Optimal contracts is one of the means of mitigating the agency problem as it helps in bringing shareholders' interests in line with managers' interests (Healy and Palepu, 2001). In addition, voluntary disclosure is another means of mitigating the agency problem, where managers disclose more voluntary information reducing the agency costs (Barako, 2006) and also to convince the external users that managers are acting in an optimal way (Watson, 2002).

Finally, regulations are another means of mitigating the agency problem as they require managers to fully disclose private information (Healy and Palepu, 2001). However, full disclosure is never guaranteed even in the presence of regulations (Al-Razeen and Karhari 2004). The absence of full disclosure is explained by the conflict that exists between the interests of managers and shareholders (Lev and Penman,1990). In addition, corporate reporting regulations are intended to provide investors with the minimum quantity of information that helps in the decision-making process (Al-Razeen and Karhari 2004).

### **2.3 Determinants of Stock Market Returns**

Some of the factors that affect the stock returns include; internal developments, change in interest rate, Inflation rate and exchange rates.

#### **2.3.1 Internal Developments**

Developments that can occur within companies will affect the price of its stock, including mergers and acquisitions, earnings reports, the suspension of dividends, the development or approval of a new innovative product, the hiring or firing of company

executives and allegations of fraud or negligence. Stock price movements will be most drastic when these internal developments are unexpected (Healy and Palepu, 2001).

### **2.3.2 Exchange Rates**

Foreign currency rates have a direct impact on the price and value of stocks in foreign countries, and changes in exchange rates will increase or decrease the cost of doing business in a country, which will affect the price of stocks of companies doing business abroad. While long-term movements in exchange rates are affected by fundamental market forces of supply and demand and purchase price parity, short-term movements are driven by news, events and futures trading and are difficult to predict (Barako, 2007).

### **2.3.3 Investor Sentiment**

Investor sentiment or confidence can cause the market to go up or down, which can cause stock prices to rise or fall. The general direction that the stock market takes can affect the value of a stock a bull market refers to a strong stock market where stock prices are rising and investor confidence is growing. It's often tied to economic recovery or an economic boom, as well as investor optimism while a bear market refers to a weak market where stock prices are falling and investor confidence is fading. It often happens when an economy is in recession and unemployment is high, with rising prices (Lopokoiyit, 2012).

### **2.3.4 Interest Rates**

The government through the central bank can raise or lower interest rates to stabilize or stimulate the economy. This is known as monetary policy. If a company borrows money to expand and improve its business, higher interest rates will affect the cost of its debt.

This can reduce company profits and the dividends it pays shareholders. As a result, its share price may drop. When interest rates are raised, many investors sell or trade their higher risk stocks for government-backed securities such as bonds to take advantage of the higher interest rates they yield and to ensure that their investments are protected (Fama and French, 1992).

### **2.3.5 Inflation**

Inflation means higher consumer prices. This often slows sales and reduces profits. Higher prices will also often lead to higher interest rates. For example, the Central bank may raise interest rates to slow down inflation. These changes will tend to bring down stock prices. Commodities however, may do better with inflation, so their prices may rise (Fama and French, 1992).

## **2.4 Empirical Literature**

Cases of works on information disclosure are summarized in the following paragraphs so that it is concluded with ease which information should be reflected in financial reports and how people process information for achieving their prediction and decision making regarding future uncertain events as per available literatures.

Sing and Desay (1971) carried out a research in USA titled an experimental quality analysis of financial disclosure by firms in USA. They argue that information disclosure by the firms may be in various forms and that an annual report to stockholders is an important form of periodical disclosure. They found that: disclosure quality is better in large firms compared to smaller ones. From their research, they also noted that disclosure quality was better in the firms with more number of stockholders. As part of

their findings, they argue that disclosure quality is better in the firms audited by CPA institutes compared to the firms audited by small institutes.

Dedman and Stephen (2006) carried out a research on Voluntary disclosure and its impact on share prices evidence from the UK biotechnology sector. From their research, they noted that the reported earnings of high-R and D expenditure firms were likely to convey less value-relevant information to investors than those of less research-intensive firms. Using a sample of firms from the high-R and D UK biotechnology/pharmaceutical sector, they found out that earnings announcements had a much lower price impact than drug development announcements. They also found out that there were significantly more 'good news' voluntary announcements than 'bad news' announcements. Their findings also indicated that these firms were more likely to announce late than early stage developments, and that the pattern of disclosures, and the market's reaction to them, varied between larger, dominant firms and their smaller counterparts.

Zareian (2012) in his research paper conducted a post event correlation analysis seeking to establish whether there is a significant relationship between information disclosure quality and stock returns change in investment firms. He conducted Kolmogorov - Smirnov test analysis on all firms listed in the Tehran stock exchange in the period 2004-2008, with disclosure quality and stock returns as the variables, he noted that the results kept varying in that in some years there was absolutely no correlation between disclosure quality and stock returns, while there were some correlation in other years.

Hail (2001) investigated the impact of voluntary corporate disclosure on the expected cost of equity capital and stated that quality of disclosure is inherently subjective like

cost of equity capital and its evaluation is very difficult. He scaled sample firms in Switzerland for fiscal year 1997 based on disclosure index in three categories for calculation of disclosure quality of financial accounts such as; Context and non-financial information including 10 items and totally 20 scores, procedural analysis and managerial analysis including 11 items and 20 scores, and information on value based risk and project related information including 9 items and 14 scores. Hail concluded that there is a negative and highly significant association between the disclosure quality and the expected cost of equity capital.

Botosan (1997) carried out a study in USA to examine the association between expected cost of equity capital and three types of disclosure (annual report, quarterly and other published reports, and investor relations). His sample consisted of 3,620 firm/year observations with Value Line data, which were also included in the AIMR's Annual Reviews of Corporate Reporting Practices dated from 1985/86 through 1995/96. The disclosure rankings produced by the AIMR were employed to proxy for disclosure level. The finding was that cost of equity capital was decreasing in annual report disclosure level. The magnitude of the difference in cost of equity capital between the most and least forthcoming firms was approximately ½ - 1% points. These results confirmed and extended the results of Botosan (1997) to include larger, more heavily followed firms, across a diverse group of industries, over a number of years. The result was a positive association between cost of equity capital and the level of more timely disclosures, such as the quarterly report. The magnitude of the difference in cost of equity capital between the most and least forthcoming firms being approximately 1 – 2% points. This result, while contrary to that predicted by theory, was consistent with managers' claims that greater timely disclosures increase cost of equity capital, possibly

through increased stock price volatility. They concluded that there was no association between cost of equity capital and the level of investor relations activities. Based his results he concluded that aggregating across different types of disclosure results in a loss of information and potentially erroneous conclusions.

Lwangu (2009) performed a study to investigate the link between corporate governance, company size and company announcements on disclosure compliance for companies quoted at the NSE. In his findings, he noted that all 23 companies sampled had been complying with the corporate governance disclosures, but with the introduction of the other variables, he noted that most of the firms (84%), didn't comply when it came to corporate governance and board size but only 17.2% (4.3%) of the sample population did comply with the CMA regulations. He also noted that there was also a positive correlation between company size and compliance but a negative correlation with company announcements which is attributable to the fact that company announcements are a prerogative of the company's board and the law is not clear on what is or is not to be announced.

Wesonga (2008) in his study on the use of financial disclosures for decision making by investors in Kenya with a case study of institutional investors at Nairobi Stock Exchange, found out that the majority of the institutional investors use financial disclosures as a source of vital information for investment decisions. Investors have exerted little pressure to managers and preparers of information for adequate disclosures. He also noted that Kenya lacked comprehensive legal framework to ensure relevant information flow for investment decision making and investor protection. As part of his findings, he noted that investors do not have confidence in financial analysts and stockbrokers in the use of relevant and reliable financial information and that



investment decisions were complex and required both financial and non-financial information, insight and experience.

Mwirichia (2008) carried out a survey of corporate governance disclosures among Kenyan firms quoted at Nairobi stock exchange. He found out that financial sectors make more intensive corporate governance disclosure than the non-financial sector and that in general; companies have been found to be more active in making financial disclosures rather than non-financial disclosures. Local ownership, the size of the company, whether or not the company is a multinational, and size of the company were found not to have any significant impact on corporate governance disclosure.

Barako (2007) in his study of determinants of voluntary disclosures in Kenyan Companies Annual Reports observed that most voluntary disclosures are aimed at informing the public more about the positive attributes of the company than it is for negative attributes. He also noted that rarely do companies report negative informations voluntarily. He further postulates that organizations cannot link their disclosures and financial performance.

Munyao (2012) studied the effects of corporate governance practices on the financial performance offorex bureaus in Kenya. Established board of diretors, independent board members and strong internal controls which emphasise inclusive financialreporting were cited as important corporate governance practises. He cited benefits such as improved profitability, return on investment and reduced business risk as accruing to Forex Bureaues with good financial controls and reporting.

Lopokoiyit (2012) investigated the effect of corporate governance practices on the share prices of companies listed in theNSE. He noted that there is a direct relationship between corporate governance practices and share prices. He also observed that corporate governance practices led to improvement of EPS, debt/equity ratio and return on assets.

Many literatures reveal that there are various reasons for reluctance of the firms to increased financial information disclosure level. Firstly, information disclosure informs everybody including competitors who become aware of the firm's unfavorable situation. This is harmful for stockholders. Secondly, they argued that labor unions may bargain better when they gain information on wages. Thirdly, they argued that investors are not able to understand accounting procedures and policies and information disclosure leads to their aberrance rather than their guidance. They also observed that other available information sources may provide financial information needed by investors with a lower cost than information provided by financial statements. Lastly, they advanced that the lack of awareness of investors' needs is a reason for limiting information and in fact less information disclosed.

## **2.5 Summary of Literature Review**

Many theories such as Efficient market hypothesis, Agency theory and Random walk theory have underpinned the importance of financial information in advising the users of the financial information in their decision making. Since the users of the financial information are many and have diverse needs, theorists suggest that organizations can either offer a common financial information or a tailor-made annual report for the financial users' needs to be met. They all agree that the level of disclosure is not possible to be met notwithstanding the diverse needs of the financial information

users. Furthermore, the cost of disclosure is most of the times uncompensated for. It is the general costs of information disclosures that calls for organizations to decide the extent to which to disclose. Executives' key question is for what value are the voluntary disclosures.

Literatures reveals that there is no relationship between voluntary disclosures and stock market returns. Lack of relationship between disclosure quality and stock returns changes in investment firms is consistent with findings of different authors. On the other hand, lack of such relationship can be attributed to: limitation due to subjectivity of the disclosure quality measurement. That is, a change in disclosure quality measurement index will affect its value which may influence the research results. Also, it can be attributed to ineffectiveness of the markets. Again, investors in capital markets may not rely on financial accounts for decision making. The presence of other variables, of which authors may not be able to control, or may be unknown by the author could have an influence on the research results. Finally, it may be due to limited voluntary information items provided by the firms resulting from disclosure culture in the different markets (Zareian, 2012).

Although no significant relationship was obtained between disclosure quality and stock returns, it is observed that the relationship direction is mostly positive. In other words, stock returns increase with increase in disclosure quality. Therefore, the firms can increase stock returns by increasing disclosure quality, though it is low.

Considering the necessity of increased knowledge in stockholders on investment in stock exchange, different markets ought to be studied in order to advise investors and corporate leaders accordingly. Furthermore, Kenya's capital market is becoming a key

target by the government to raise necessary capital to meet the national development needs. This predicts that more investors will invest in the stock markets and that many unlisted organizations are likely to be listed. The need to link the necessity of voluntary disclosure amongst the firms listed in the NSE is therefore paramount. Scanty literatures on the effect of voluntary disclosures on stock returns in the context of the NSE listed firms exist and hence the necessity of this study.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter provides the methods and procedures employed to conduct the study. The chapter discusses the research design of the study, data collection methods and techniques employed to analyze the collected data.

### **3.2 Research Design**

A research design refers to a systematic arrangement of the measures, factors and the tools to be applied in the collection and analysis of the obtained data in order to achieve the objectives of the study in the most efficient and effective way. Kothari (2004) in her research postulates that a research design directs the researcher by offering him or her with guidelines on how to collect, analyse and interpret the data in an coherent manner.

This study assumed a descriptive research design aiming to determine a causal relationship between voluntary disclosures and stock returns of the NSE listed firms. A descriptive study design can be used to find out the present state of affairs in relation to what extent organizations voluntarily disclose non-statutory required data to the public and the implications the voluntary disclosure on the stock returns for a firm trading in the NSE.

Furthermore, the descriptive study design has been preferred since it is suitable in its applicability within little time and cost constraints (Mugenda and Mugenda, 2003). Further, it is dependable, valid and generalizable in this kind of a research in that it is

good for the purpose of data collection and analysis, regardless of whether the data is qualitative or quantitative.

### **3.3 Population**

A population can be defined as a sum of all the items considered under a study. (Mugenda and Mugenda, 2003). According to Bryman and Bell (2007), a population is the totality of the individuals and objects from which a scientifically generalizable inference can be achieved. The population for this study included the 63 companies in the Nairobi Securities Exchange as at August 1, 2014. *See appendix 1*

### **3.4 Sample and Sampling Method**

A sampling frame can be defined as the set of all the available sample units from which a researcher can choose. (Donald and Theresa, 2009). According to Mugenda and Mugenda (2003), the sample frame should contain only the elements of the population which are eligible for selection.

This research studied the effects of voluntary disclosures on stock market returns for the organizations listed at the NSE. The NSE is divided into 10 different sectors. A sample of 20 companies were selected from the 10 different sectors. For a firm to be selected, it had to satisfy the following condition;

- (i) Annual reports must be available at the stock exchange and
- (ii) The firm must have been listed for the entire period of the study 2009–2013.

Such a cohesive representation enabled the research findings to be generalizable to all the companies listed on the NSE.

### **3.5 Data Collection Methods**

This study used secondary data sources. Secondary data can be defined as data that is already available having been collected in the past by other parties other than the researcher for the purpose of the current study (Mugenda and Mugenda, 2003). Its main advantage being availability, hence fast and easy to collect. It is also efficient in both monetary and time constraints. On the other hand its main disadvantage is its likelihood for obsolescence. However for the purpose of this study, secondary data collection is the only method that could be used. Importantly, the impact of out-datedness did not arise, since the data to be used span within the last 5 years between 2009 and 2013. This is deemed important since this study sought to describe the effects of voluntary disclosure on stock returns for the firms listed in Nairobi Securities Exchange.

For the purpose of this study, a brief content analysis on financial reports of the sampled companies during the period 2009-2013 were analyzed. Specifically, the study looked for non-statutory disclosures. Four categories of common voluntary disclosures such as release of; strategy disclosures, competition and outlook, production, marketing strategy, and human capital were identified.

For the stock returns, the data on annual dividends and share prices of the sampled firms for the period 2009-2013 were obtained from NSE. The data was used to compute the stocks return for each period.

### **3.6 Validity and Reliability.**

Reliability is a way of determining the study's authenticity where a high level of reliability implies that it is replicable. The study performed regression analysis, and hence the reliability was not be a problem since subjectivity has been eliminated.

Validity indicates how well the study actually measure what it intends to measure and can therefore be described as how well the operationalization of the study examine the empirical phenomenon it intend to examine

A disclosure index is considered as a useful way of measuring disclosure level when the index satisfies the requirements of reliability and validity (Marston and Shrives, 1991). Realizing the difficulty in measuring the disclosure level and the problem of the researchers' subjective assessment applying the scoring model, it is important to assess the validity of the resulting measure. Therefore, different set of analyses were used to assess the reliability and validity of a self-constructed disclosure index. These analyses were suggested by Botosan (1997). Firstly, Cronbach's coefficient alpha (Cronbach, 1951) is the most common estimate of internal consistency that uses repeated measurement to assess the degree to which the correlation among the measurements is attenuated due to random error. The closer the coefficient alpha to one, the more reliable the generated index is.

### **3.7 Data Analysis Methods**

The collected secondary data was analyzed using Statistical Package for Social Science (SPSS) version 20. A regression analysis was conducted on the data set. The Pearson Product Moment was used to analyze the data in which correlation coefficient ( $R^2$ ) and the coefficient of determination (R) of the data set (each form of voluntary disclosure, and stock returns) is to be established. The findings from the analysis were organized, summarized and presented using tables, and used to answer the study question.

The relationship between voluntary disclosures and stock market performance for the purpose of this study is deemed to take the expression;



$$R_i = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + \mu_e.$$

Where;  $R_i$  (Computed as  $\frac{d_1 + P_1 - P_0}{P_0}$ ) = Actual Stock Return,  $a$  = is the part of the stock return explained by other variables,  $x_1$  = Voluntary disclosures,  $x_2$  = Rate of inflation,  $x_3$  = Exchange rate,  $x_4$  = Interest rate and  $\mu_e$  = refers to an error term.

Inflation refers to increase in prices in the economy. For this research, inflation rate was measured using the Consumer price index (CPI). An interest rate is the rate at which interest is paid by a borrower (debtor) for the use of money that they borrow from a lender (creditor). This research used the average lending rates by commercial banks. An exchange rate between two currencies is the rate at which one currency will be exchanged for another. This research used the exchange rate between Kenya Shilling and the USA dollar. The study conducted a multiple regression analysis so as to determine the relationship between independent variable and dependent variable.

### **3.7.1 Measurement of Voluntary Disclosure**

Measurement of voluntary disclosure is difficult because it is not directly observable. Consequently, one way in which voluntary disclosure can be measured is by the use of a disclosure index. This research used the self-constructed disclosure index by Petersen and Plenborg (2006) which they used to measure the level of voluntary disclosure of Danish firms. Because of the following reasons it is determined that this disclosure index is representative for this research. Until now, there is no disclosure index constructed or either used for Kenyan firms. Second, with the harmonization of accounting framework, most countries have to comply with the same financial reporting standards (IFRS). Third, the disclosure index consists of general disclosure issues, that is, issues that are essential for every firm.

The disclosure index is based on an investor's perspective, which implies that, the disclosure items incorporated within the disclosure index are based on what investors qualified as relevant or important. The disclosure index consists of five disclosure categories: (1) strategy, (2) competition and outlook, (3) production, (4) marketing strategy and (5) human capital. It encloses 62 disclosure items spread among these five categories, *see appendix 2*.

The use of the disclosure index measured the amount of voluntary disclosure within annual reports. This research used the company's annual reports of 2009 to 2013 to create the disclosure index for each year. To measure the amount of voluntary disclosure a binary coding scheme was applied in which the presence of each disclosure item scores one (1) point and the absence of each disclosure item scores zero (0) point. Consequently, one point was assigned to each of the 62 disclosure items that the firms provide through their annual report, whereas each firm could reach a maximum of 62 points.

## **CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION**

### **4.1 Introduction**

This chapter presents the results of the analysis, findings and discussions on the effect of voluntary disclosure on stock returns of companies listed at the Nairobi Securities Exchange. The data of the study was obtained through content analysis of the annual reports of the 20 companies listed at the NSE. The NSE is divided into 10 different sectors. A sample of 20 companies were selected from the 10 different sectors. The study used data from the 10 different sectors as this was deemed to be a better representation of the companies listed at the NSE as opposed to using the 20 share index that is mainly composed of the large companies. The study intended to find the relationship between voluntary disclosures and stock market performance. The independent variables for the study were Rate of inflation, Exchange rate, Interest rate and Voluntary disclosures. The dependent variable was market performance.

### **4.2 Descriptive Statistics**

This study undertakes to research on the relationship that exists between stock market performance and some selected independent variables. Monthly stock market performance using the NSE All share index was collected from NSE, the monthly inflation rates were obtained from reports published by various government bodies such as central bank of Kenya (CBK) and the Kenya National bureau of statistics (KNBS).

**Table 4.1 Descriptive Statistics**

	Minimum	Maximum	Mean	Median	Std. Deviation
Voluntary disclosures (Index)	26.00	42.00	33.86	33.50	4.13
Exchange rate	77.33	88.86	83.22	84.52	4.30
Interest rate%	13.87	20.04	16.76	16.99	2.24
Rate of inflation %	4.100	14.00	8.740	9.400	3.52
Market performance-Ratio	-0.29	1.670	0.650	0.570	0.46

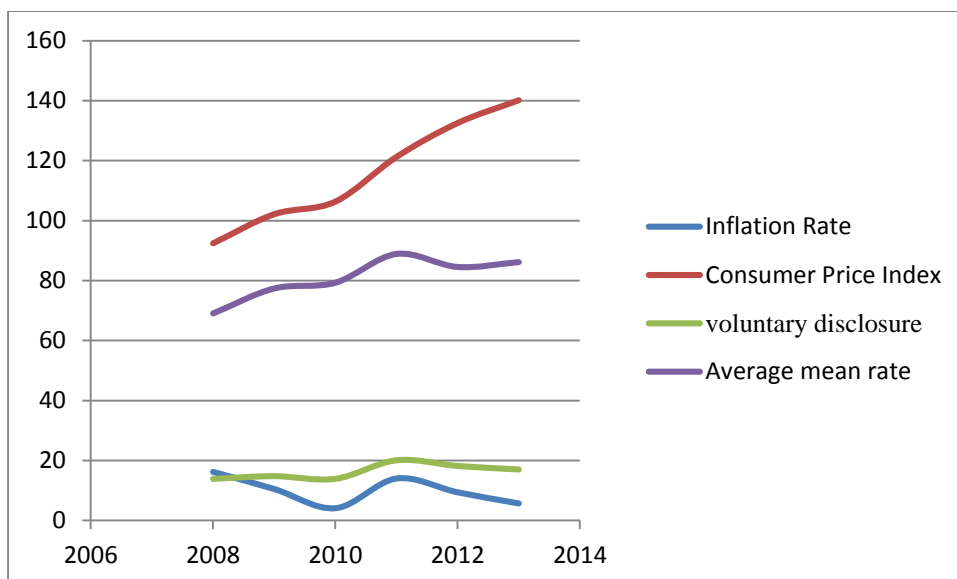
Source: Researcher (2014)

The table above shows the descriptive statistics from the study where the study variables mean, standard deviation and variance are displayed. Where the voluntary disclosures has a mean of 33.86 and a standard deviation of 4.13, the exchange rate has a mean of 83.22 and standard deviation of 4.3, interest rate means is 16.76 and a standard deviation of 2.24, Rate of inflation mean is 8.74 and standard deviation of 3.52 and the market performance has mean of 0.65 and a standard deviation of 0.46.

#### **4.2.1 Indicators of Study Variables**

The figure shows the data of changes in independent variable from the year 2008-2013.

This shows the change in data from those years.



**Figure 4.1 Indicators of Study Variables**

### 4.3 Correlation of Study Variable

Correlation tests were carried out on the original data to show the extent or strength and direction of the relationship between variables. It should be noted that correlation does not show causality between independent and dependent variables. It only informs on the magnitude with which a dependent variable changes due to a unit change in the independent variable. The table below shows correlation of study variables.

**Table 4.2 Correlation of Study Variable**

	Correlations				
	Market performance	Voluntary disclosures	Exchange rate	Interest rate	Rate of inflation
Market performance	1.000				
Voluntary disclosures	.690	1.000			
Exchange rate	.628	.653	1.000		
Interest rate	.572	.638	.551	1.000	
Rate of inflation	.687	.635	.567	.643	1.000

Source: Researcher (2014)

The researcher analyzed the variables using Pearson correlation which is used to test the direction, strength and significance of the bivariate relationship among all the variables that have been measured at interval or ratio level (Sekaran and Bougie, 2012).

As shown in table 4.2 all the predictor variables had a mildly strong and positive correlation between themselves. The positive correlation means that the variables vary together in the same direction; when any of the variables increase the others increase and when any decrease the others decrease and the correlation was all significant at 0.01 two tailed.

#### 4.5 Regression of Study Variables

##### 4.5.1 Anova

The test is a check for whether the homogeneity of variance has been met. The test is used to examine mean differences between two or more groups. The table below shows the Anova of the study variables

**Table 4.3 Anova**

ANOVA <sup>b</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.153	5	1.538	5.248	.000 <sup>a</sup>
	Residual	4.397	15	.293		
	Total	10.550	19			

a. Predictors: (Constant), Rate of inflation, Voluntary disclosures, Interest rate , Exchange rate

b. Dependent Variable: Market performance

Source: Researcher (2014)

From table 4.17, the significance value is 0.000; this means all factors have significant effect because the significance value is lower than 0.05.

**Table 4.4: Regression model summary of the effect of independent variables on the dependent variable**

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	R Square Change
1	.764 <sup>a</sup>	.583	.472	.54141	.583

a. Predictors: (Constant), Rate of inflation, Voluntary disclosures, Interest rate , Exchange rate  
b. Dependent Variable: Market performance

Source: Researcher (2014)

From the results shown in table 4.4, the model shows a goodness of fit as indicated by the coefficient of determination  $r^2$  with value of 0.583. This implies that independent variables both explain 58.3% of the variations as a result of the factors affecting the market performance. 41.7% of variations are brought about by factors not captured in the objectives.

**Table 4.5: Regression Coefficient of Determination of the effect of independent variables on the dependent variable**

Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
1 (Constant)	2.180	.813			2.681	.017
Voluntary disclosures	.529	.117	.832		4.526	.000
Exchange rate	.312	.131	.527		2.371	.032
Interest rate	.321	.148	.490		2.169	.047
Rate of inflation	.580	.137	.885		4.236	.001

a. Dependent Variable: Market performance

Source: Researcher (2014)

The study conducted a multiple regression analysis so as to determine the relationship between independent variable and dependent variable (market performance).

The regression equation ( $Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \alpha$ ) was:

$$Y = 2.180 + 0.529 X_1 + 0.312 X_2 + 0.321 X_3 + 0.580 X_4$$

Whereby Y = Market performance, X<sub>1</sub> = Voluntary disclosures; X<sub>2</sub> = Exchange rate; X<sub>3</sub> = Interest rate and X<sub>4</sub> = Rate of inflation

According to the regression equation established, taking all factors (Voluntary disclosures, Exchange rate, Interest rate and Rate of inflation) constant at zero, Market performance of the stock exchange as a result of these independent factors was 2.180. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in voluntary disclosure will lead to a 0.529 increase in market performance. A unit increase in exchange rate will lead to a 0.312 increase in effect on market performance; a unit increase in interest rate will lead to a 0.321 increase in effect on market performance, while a unit increase in rate of inflation will lead to a 0.580 increase in effect on market performance. This therefore implies that all the four variables have a positive relationship with market performance and the variables voluntary disclosure and rate of inflation having the most effect.

#### **4.6 Discussion of Research Findings**

Lopokoiyit (2012) conducted a research on the effect of corporate governance practices on the share prices of companies listed in theNSE. He noted that there was a direct relationship between corporate governance practices and share prices. He also observed that corporate governance practices led to improvement of EPS, debt/equity ratio and return on assets.

Zareian (2012) in his research paper conducted a post event correlation analysis seeking to establish whether there is a significant relationship between information disclosure



quality and stock returns change in investment firms. He conducted Kolmogorov - Smirnov test analysis on all firms listed in the Tehran stock exchange in the period 2004-2008, with disclosure quality and stock returns as the variables, he noted that the results kept varying in that in some years there was absolutely no correlation between disclosure quality and stock returns, while there were some correlation in other years.

Asava (2013) sought to establish the effect of voluntary disclosures on stock returns of companies listed in the Nairobi Securities Exchange using a content analysis of annual reports of companies composing the NSE 20 Share Index. The findings revealed that there is no relationship between voluntary disclosures and stock returns

Hail (2001) had studied the impact of voluntary corporate disclosure on the expected cost of equity capital and stated that quality of disclosure is inherently subjective like cost of equity capital and its evaluation is very difficult.

In this research, it was noted that voluntary disclosures have a positive relationship with stock returns as depicted by Pearson Product Moment of equal 0.69. Even in the combined model, it was established that there is positive relationship between voluntary disclosures and stock returns as depicted by a Pearson Product Moment 0.529

This study conducted a longitudinal analysis of the voluntary disclosures and stock return of companies 20 Companies listed at the NSE over a five year period from 2009-2013. The results of the analysis were consistent with past researchers such as Lopokoiyit and Zareian. However the findings of Asava and Hill were contrary to the findings of this study.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

The study sought to establish the effect of voluntary disclosure on stock returns of companies listed at the Nairobi Securities Exchange. This chapter is a synthesis of the entire study, and contains summary of research findings, exposition of the findings, commensurate with objectives, conclusions and recommendations based thereon.

### **5.1 Summary of Findings**

Descriptive statistics were used to analyze the variables Where the voluntary disclosures has a mean of 33.86 and a standard deviation of 4.13, the exchange rate has a mean of 83.22 and standard deviation of 4.3, interest rate means is 16.76 and a standard deviation of 2.24, Rate of inflation mean is 8.74 and standard deviation of 3.52 and the market performance has mean of 0.65 and a mean of 0.46.

Correlation of study variable was done to the variables and the voluntary disclosures had a correlation of 0.690, exchange rate had a correlation of 0.628, interest rate was 0.572 and Rate of inflation 0.687. This showed that the entire variables had a strong correlation. This implies that all variables had an effect on the market performance.

The model shows a goodness of fit as indicated by the coefficient of determination  $r^2$  with value of 0.583. This implies that independent variables both explain 58.3% of the variations as a result of the factors affecting the market performance. 41.7% of variations are brought about by factors not captured in the objectives.

According to the regression equation established, taking all factors (Voluntary disclosures, Exchange rate, Interest rate and Rate of inflation) constant at zero, Market performance of the stock exchange as a result of these independent factors was 2.180. The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in voluntary disclosure will lead to a 0.529 increase in market performance. A unit increase in exchange rate will lead to a 0.312 increase in effect on market performance; a unit increase in interest rate will lead to a 0.321 increase in effect on market performance, while a unit increase in rate of inflation will lead to a 0.580 increase in effect on market performance. This therefore implies that all the four variables have a positive relationship with market performance and the variables voluntary disclosure and rate of inflation having the most effect.

## **5.2 Conclusions**

The Kenya Government initiated reforms at the Nairobi Stock Exchange (NSE) aimed at transforming the exchange into a vehicle for mobilizing domestic savings and attracting foreign capital investment. Given the increasing amount of focus on and the growing significance of the NSE as an important venue for attracting foreign investments and to encourage local residents to invest in shares, Kenyan companies may engage in voluntary disclosure as a means to enhance the value of their stocks. Moreover, there are empirical evidences suggesting that increased information disclosure reduces a firm's cost of capital by reducing information asymmetry (Botosan, 1997). Several prior studies have investigated various determinants of companies' voluntary disclosure practices. A consistent finding is that size is an important predictor of corporate reporting behaviour. In meta-analysis of 29 disclosure studies, conducted by Ahmed and Courtis (1999), size, listing status and financial

leverage were found to have a significant impact on disclosure level. Other company attributes associated with corporate disclosure include, industry type (Cooke, 1989). From our findings it was determined that there was a relationship between the independent variable and the dependent variable. This findings are similar to several findings by Zareian (2012) noted that while there was absolutely no correlation between disclosure quality and stock returns in some years, there were some correlations in other years.

### **5.3 Recommendation**

The study recommends companies to have voluntary disclosure above the statutory requirements set by the regulatory bodies since it can work as a good corporate governance tool. The extent of voluntary disclosure in the annual report is related to a company's corporate governance practices. There was a strong positive significant relationship was that was obtained between voluntary disclosure and stock returns, it is observed that the disclosure helps the investors to make better investments. In other words, stock returns increase by increase in voluntary disclosure. Therefore, the firms can increase stock returns by increasing voluntary disclosure, since the relationship is strong.

The government should also put more regulation on disclosure to ensure that individuals investing get more information. This is because the since the management know more about the company than the shareholders, customers, suppliers, creditors, and government regulators including capital market authorities (Feng and Li, 2007). The management finds it useful to inform the outsiders what they know about the company. Disclosed financial information is essential for investors to efficiently

allocate scarce resources (Cooke, 1989), and assess investment options (Gray, Meek, Roberts, 1995). This is why further regulation should be necessary.

### **5.5 Limitations of the Study**

In measuring the amount of voluntary disclosure, this research used a self-constructed disclosure index. It can be argued that this type of measurement method is a subjective measurement method of voluntary disclosure. A binary coding scheme was used where 1 was allocated to presence of a disclosure and 0 for absence. The subjective measurement of voluntary disclosures through assigning an index by the researcher would have affected the findings since different researchers will no doubt give different ratings.

The research sample consists of 20 companies listed at the NSE. The companies were spread across the different sectors. Because this is a relative small sample, this could bias the results. In addition, the selected years 2009 to 2013 may not be enough to generalize the results. Furthermore, the research was performed for companies listed at the NSE in Kenya and consequently the results cannot generalize for other countries.

Limitation about the study's ability to generalize its findings concerns that this research only focuses on voluntary disclosure related to one communication source (annual financial reports) while other communication sources exist that facilitate voluntary disclosure. This research study only used one type of voluntary disclosure, as a result the measurement of voluntary disclosure may include an element of bias.

The criteria used was that; the companies needed to have been listed for throughout the five year period (2008-2013) as well as financial statements being available at the NSE. This locked some companies from being selected and hence the research may not generalize on the companies that have been listed after 2009.

### **5.6 Suggestion for Further Research**

The findings of this study are only confined to the relationship between voluntary disclosure and stock returns. Based on these findings further research can be done to determine that relationship between the variables under different business cycles.

The study recommends that further research focusing on the specific industries could perhaps reveal more focused results as different industries may respond differently to certain information releases. Also, an analysis of the effect of voluntary information release on stock returns as soon as it is released can help depict the short term effect of such information disclosures on stock return.

Further studies can be carried out to determine whether or not there is relationship between the voluntary disclosure and the cost of equity capital in Kenyan context and if it is consistent over the years.

Further research can also be carried out to determine the effect of other type of publications disclosure on the stock market returns in comparison to the annual financial reports of the companies listed at the Nairobi Securities Exchange.

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## APPENDICES

### Appendix 1: List of companies on the Nairobi Securities Exchange

<b>AGRICULTURAL</b>	<b>TELECOMMUNICATION AND TECHNOLOGY</b>
Eaagads Ltd	Safaricom Ltd
Kapchorua Tea Co. Ltd	
<b>Kakuzi</b>	<b>AUTOMOBILES AND ACCESSORIES</b>
Limuru Tea Co. Ltd	Car and General (K) Ltd
Rea Vipingo Plantations Ltd	CMC Holdings Ltd
Sasini Ltd	Sameer Africa Ltd
Williamson Tea Kenya Ltd	Marshalls (E.A.) Ltd
<b>COMMERCIAL AND SERVICES</b>	<b>BANKING</b>
Express Ltd	Barclays Bank Ltd
Kenya Airways Ltd	CFC Stanbic Holdings Ltd
Nation Media Group	Diamond Trust Bank Kenya Ltd
Standard Group Ltd	Housing Finance Co Ltd
TPS Eastern Africa (Serena) Ltd	Kenya Commercial Bank Ltd
Scangroup Ltd	National Bank of Kenya Ltd
Uchumi Supermarket Ltd	NIC Bank Ltd
Hutchings Biemer Ltd	Standard Chartered Bank Ltd
Longhorn Kenya Ltd	Equity Bank Ltd
<b>INSURANCE</b>	The Co-operative Bank of Kenya Ltd
Jubilee Holdings Ltd	<b>MANUFACTURING AND ALLIED</b>

Pan Africa Insurance Holdings Ltd	B.O.C Kenya Ltd
Kenya Re-Insurance Corporation Ltd	British American Tobacco Kenya Ltd
Liberty Kenya Holdings	Carbacid Investments Ltd
British-American Investments Company (Kenya) Ltd	East African Breweries Ltd
CIC Insurance Group Ltd	Mumias Sugar Co. Ltd
<b>INVESTMENT</b>	Unga Group Ltd
	Eveready East Africa Ltd
Olympia Capital Holdings ltd	Kenya Orchards Ltd
Centum Investment Co Ltd	A.Baumann CO Ltd
Trans-Century Ltd	<b>ENERGY AND PETROLEUM</b>
Nairobi Securities Exchange	KenolKobil Ltd
<b>CONSTRUCTION AND ALLIED</b>	Total Kenya Ltd
Athi River Mining	KenGen Ltd
Bamburi Cement Ltd	Kenya Power & Lighting Co Ltd
Crown Berger Ltd	Umeme limited
E.A.Cables Ltd	<b>GROWTH ENTERPRISE MARKET</b>
E.A.Portland Cement Ltd	Home Africa limited

## **Appendix 2: Voluntary Disclosure Index**

### **Strategy**

1. Has provided a statement of corporate goals or objectives?
2. Has provided a general statement of corporate strategy?
3. Have commented on actions taken to achieve the corporate goal?
4. Has provided a period for achieving corporate goals?
5. Has provided attitude towards ethic questions?
6. Has provided strategy towards environmental issues?
7. Has provided detailed segment performance?
8. Have provided changes in ROCE (Return on capital employed) or EVA (Economic value added)?
9. Have provided commercial risk assessments?
10. Have provided financial risk assessments?
11. Have commented on interest or exchange risks?
12. Have commented on other risk assessments?

### **Competition and outlook**

13. Have identified the principal markets?
14. Have described specific characteristics of these markets?
15. Have estimated the market sizes?
16. Has provided Market share?
17. Have commented on the competitive landscapes?
18. Have commented on barriers to entry?
19. Have estimated the market growths?
20. Has commented on change in market shares?
21. Has commented on impact of barriers to entry on profits?

22. Has commented on the impact of competition on profits?
23. Has estimated a forecast of market share?
24. Has commented on impact of barriers to entry on future profits?
25. Has commented on the impact of competition on future profits?

### **Production**

26. Has provided a general description of the business?
27. Have identified the principal products/services?
28. Have described specific characteristics of these products/services?
29. Has commented on speed to market?
30. Have commented on R&D expenditures?
31. Have commented on investments in production?
32. Has commented on product development cycle?
33. Has commented on ratio of inputs to outputs on outputs?
34. Have commented on new products?
35. Have commented on rejection/defect rates?
36. Has commented on volume of materials consumed?
37. Have commented on changes in production methods?
38. Have commented on changes in product materials?

### **Marketing strategy**

39. Has provided a marketing strategy?
40. Has described a sales strategy?
41. Have described distribution channels?
42. Have provided sales and marketing costs?
43. Have commented on brand equity/visibility ratings?
44. Have commented on customer turnover rates?

- 45. Has commented on customer satisfaction level?
- 46. Has commented on customer mix?
- 47. Have commented on revenues from new products/services?
- 48. Has provided order backlog?
- 49. Has provided percent of order backlog to ship next year?
- 50. Has provided amount of new orders placed this year?
- 51. Has commented on change in inventory?

**Human capital**

- 52. Has commented on experience of management team?
- 53. Has provided description of workforce?
- 54. Has provided amount spent on education?
- 55. Have provided employee retention rates?
- 56. Has provided average revenue per employee?
- 57. Has provided average age of key employees?
- 58. Has provided age of key employees?
- 59. Has provided other measurement of intellectual capital?
- 60. Has provided investment in ERP?
- 61. Has commented on strategy for measurement of human capital?
- 62. Has commented on strategy regarding ERP system



### Appendix 3: Computation of Stock Market Returns

Stock	Start Price	End Price	Divid ends	Capital gain	Dividend+Ca pital gain	Stock market return
	a	b	c	d=b-c	e=c+d	f=e/a
Centum Investment Company 0.50						
AccessKenya Group						
Pan Africa Insurance Holdings						
ScanGroup						
CFC Stanbic Holdings 5.00						
Housing Finance Co						
Total Kenya						
Crown Paints Kenya						
Car & General (K)						
Jubilee Insurance Co.						
Kenya Commercial Bank						
KenGen.						
Rea Vipingo Plantations						
Nation Media Group						
Unga Group						
Kakuzi						
Equity Bank						
Sameer Africa						
Williamson Tea Kenya						
TPS Eastern Africa						

**Appendix 4: Voluntary Disclosure Index ( $X_n$ ), and Stock Returns(Y)**

<b>Company Name</b>	<b>Year</b>	<b>X1</b>	<b>X2</b>	<b>X3</b>	<b>X4</b>	<b>Y</b>
Centum Investment Company 0.50	2009					
	2010					
	2011					
	2012					
	2013					
AccessKenya Group	2009					
	2010					
	2011					
	2012					
	2013					
Pan Africa Insurance Holdings	2009					
	2010					
	2011					
	2012					
	2013					
ScanGroup	2009					
	2010					
	2011					
	2012					
	2013					
CFC Stanbic Holdings 5.00	2009					
	2010					
	2011					
	2012					
	2013					
Housing Finance Co	2009					
	2010					
	2011					
	2012					
	2013					
Total Kenya	2009					
	2010					
	2011					
	2012					
	2013					
Crown Paints Kenya	2009					
	2010					
	2011					
	2012					
	2013					
Car & General (K)	2009					
	2010					

	2011					
	2012					
	2013					
Jubilee Insurance Co.	2009					
	2010					
	2011					
	2012					
Kenya Commercial Bank	2013					
	2009					
	2010					
	2011					
KenGen	2012					
	2013					
	2009					
	2010					
Rea Vipingo Plantations	2011					
	2012					
	2013					
	2009					
Nation Media Group	2010					
	2011					
	2012					
	2013					
Unga Group	2009					
	2010					
	2011					
	2012					
Kakuzi	2013					
	2009					
	2010					
	2011					
Equity Bank	2012					
	2013					
	2009					
	2010					
Sameer Africa	2011					

	2012					
	2013					
Williamson Tea Kenya	2009					
	2010					
	2011					
	2012					
	2013					
		2009				
TPS Eastern Africa	2010					
	2011					
	2012					
	2013					
<b>Total</b>						