EFFECTS OF DIVIDEND ANNOUNCEMENT ON THE PERFORMANCE OF SOCIALLY SCREENED PORTFOLIOS IN NAIROBI SECURITIES EXCHANGE

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DECLARATION

This research project is my original work and has not been submitted to any other university for award of a degree.

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This research project has been submitted for examination with my authority as the university supervisor.

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DEDICATION

This project is dedicated to my daughters Nicole and Sharlene. And to my wife Alice, God bless you for your support.

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ABSTRACT

Social screening involves prohibiting investments in the securities of companies or industries that an investor perceives to be engaged in socially negative behavior. Dividend policy of a socially screened firm has implications for investors, managers and other stakeholders. For investors, dividends whether declared today or accumulated and provided at a later date are not only a means of regular income, but also an important input in valuation of a socially screened firm. The impact of dividend announcement on stock prices has been a matter of intense debate for academics, the managers and shareholders of many companies for several years. Several theories have been developed to explain the relationship that exists between dividend announcement and stock prices. Studies done in this area have given contradicting findings. The objective of this study was to determine the effect of dividend announcement on the performance of socially screened portfolios in the Nairobi Securities Exchange. The study adopted a descriptive research design in determining the effect of dividends announcement on the performance of socially screened portfolio. Event study methodology was used. The target population for this study consisted of ten (10) socially screened firms listed on the Nairobi Securities Exchange. The companies were selected based on consistency in announcing dividends and trading actively during the forty one days window period. Secondary data was obtained from the firm's annual reports most of which were publicly available in NSE daily and annual reports. Abnormal returns during the event window of 41 days were determined using the event study methodology employing the market model on data from 10 socially screened companies. Inferential and descriptive statistics were used to test for significance on abnormal returns at 5% level. The t test values obtained from the sampled data over the four periods was less than 5% level of significance. Therefore the null hypothesis that, there is no significant difference between the returns of a socially screened portfolio before and after the announcement of dividends is rejected. The significance of cumulative abnormal returns after dividend announcement indicates that, stock prices for the socially screened portfolios reacted positively to this good news. This generally shows that, the performance of the firms improved after the announcement of dividends. The study was limited to observations based on the announcement of dividend payout by the socially screened firms. Also, the study was not able to account for price behaviour that is influenced by the fundamentals of the company as opposed to speculation. A census study is recommended for any further empirical investigations into NSE dividend announcements.

LIST OF ABBREVIATIONS AND ACRONYMS

CMA - Capital Markets Authority

CSR - Corporate Social Responsibility

EPS - Earnings per Share

M&M - Modigliani and Miller

NASI - NSE All-Share Index

NSE - Nairobi Securities Exchange

NYSE - New York Securities Exchange

SRI - Socially Responsible Investing

TABLE OF CONTENTS

LIST OF TABLES

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

According to Diltz (1995) social screening involves prohibiting investments in the securities of companies or industries that an investor perceives to be engaged in socially negative behavior while Dunfee (2003) defines social screening as the consideration of an investor's social, ethical or religious concerns in an investment decision making process. Social screening is one of the approaches of social responsible investing (SRI). SRI can best be characterized as investing in companies that conduct their operations with an eye on causing the least amount of harm to the environment and sustainability of our habitat. Thus, companies conducting their operations in a socially responsible manner should be viewed as comparatively better and relatively safer long-term investment choices (Sethi, 2005).

The proposed study is anchored on the following theories: the signalling hypothesis, the bird-in-the-hand hypothesis, the agency theory, clientele effect theory, and dividend irrelevance hypothesis. The signalling hypothesis advanced by Litner (1956) shows that, investors can infer information about a firm's future earnings through the signal coming from dividend announcements, both in terms of the stability and changes in dividends. The Bird-In-The-Hand Hypothesis (Lintner, 1956) concludes that, current dividends reduce investor uncertainty and results in higher value in the firm's stock. The Agency theory by Easterbrook (1984) suggests that a higher relative dividend payout or a higher effective dividend yield is expected to minimize agency costs and hence higher dividends

are relative to earnings. Thus focus is likely to be on future earnings performance as a means of maintaining the current dividend payout level. The clientele effect theory by Pettit (1977) affirms that, firm attracts shareholders whose preferences with respect to stability of dividends correspond to the pattern maintained by the firm itself. Some shareholders prefer stable dividends as a source of income while others may prefer to earn capital gains. The Dividend Irrelevance Hypothesis by Modigliani and Miller (1961) maintained that, the dividend policy employed by a firm does not affect the value of the firm.

The Nairobi Securities Exchange (NSE) is the principal bourse in Kenya, offering an automated platform for listing and trading of multiple securities such as equities and bonds. NSE demutualised and self listed in the year 2014 after being incorporated as a public limited company. NSE is reorganized into eleven independent market segments in which 71 firms are listed to trade their securities to the public (NSE Handbook, 2015). The NSE 20-share index and NSE All Share Index (NASI) are both indicators of portfolio performance. The NSE 20-Share Index has been in use since 1964 and measures the performance of 20 blue-chip companies with strong fundamentals which have consistently returned positive financial results. In addition, NASI was introduced in February 2008 to provide a better performance tool in the stock market as compared to NSE 20-share index. Previous research has shown that socially screened portfolio existed in NSE (Iraya and Musyoki, 2013). Also, the study done by Aziza (2010) found that islamically screened portfolio can be established at the NSE. The performance of islamically screened portfolio in NSE was found to be equally the same to that of a

conventional portfolio. However, the NSE-20 portfolio outperformed the socially screened portfolio when compared in terms of risk adjusted returns.

1.1.1 Dividends Announcement

Bitok et al (2010) defined dividends as the distribution of firm's earnings. The common ways of distributing part of firm's earnings to its owners include payment of cash dividends, repurchasing of stock and payment of stock dividends. Quoted companies usually pay dividends on a fixed schedule, commonly annually, bi-annually or quarterly, however they may declare dividends any time. It is a common practice for firms to announce final dividend per share payout during their statutory annual general meetings.

Dividend policy of a socially screened firm has implications for investors, managers and other stakeholders. For investors, dividends whether declared today or accumulated and provided at a later date are not only a means of regular income, but also an important input in valuation of a socially screened firm. Similarly, managers' flexibility to invest in projects is also dependent on the amount of dividend that they can offer to shareholders as more dividends may mean fewer funds available for investment (Jensen 1986).

1.1.2 Social Screening

Screening is the most common way for investors to practice socially responsible investing. Social screening is the process of selecting companies to invest in based on social and or environmental performance in addition to a company's financial performance. There are three forms of social screening. These are negative or avoidance screening, positive screening and best-in-class screening (Yaron, 2005). Negative screening is the earliest form of social investing. Negative screening is the conscious

decision not to invest in companies that are inconsistent with the personal values of the investor. There are various levels of screening, which range from excluding tobacco companies to funds that meet an extensive list of screens such as the exclusion of companies that do not meet diversity, workplace and environmental standards (Yaron, 2005).

Positive screening is the process of actively searching for companies to invest in, which reflect the values of the investor through leadership in product design, policies, environmental practices, and human rights. A common form of positive investing is choosing industry leaders to invest in despite the reputation of the industry as a whole with the hope that the standard of business will be raised to compete with the corporate social responsibility leaders within a particular industry (Yaron, 2005). The best-in-class screening is the inclusion of investment into a portfolio of best performers from each sector in order to avoid eliminating some sectors. Minimum criteria are set which the firms must meet. Those that satisfy the minimum threshold and also achieve the highest level of performance in each sector are selected for inclusion in the portfolio (Yaron, 2005).

1.1.3 Dividends Announcement and Social Screening

According to clientele effect theory, socially screened responsible investors generally prefer a stable dividend payout ratio because such investors expect it and reveal a preference for it. Socially responsible shareholders may want a stable rate of dividend payment for a variety of reasons. Risk adverse shareholders would be willing to invest only in those screened companies which pay high current returns on shares. The class of

socially responsible investors, which includes pensioners and other small savers, are partly or fully dependent on dividend to meet their day-to-day needs. Similarly, educational institutions and charity firms prefer stable dividends, because they will not be able to carry on their current operations otherwise. Such investors would therefore, prefer screened companies, which pay a regular dividend every year.

Given the diversity in corporate objectives and environments, it is conceivable to have divergent dividend policies that are specific to screened firms. Through the research, an attempt has been made to suggest how dividend policy can be set at micro level. Finance managers would be able to examine how the various market frictions such as asymmetric information, agency costs, taxes, and transaction costs affect their firms, as well as their current socially responsible claimholders, to arrive at reasonable dividend policies. Previous research studies have focused on performance on unscreened firms and markets (Dilts,1995). Aziza (2010) evaluated the performance of an Islamic portfolio at the NSE.

1.1.4 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) is the principal stock exchange of Kenya. It began operations in 1954 as an overseas stock exchange while Kenya was still a British colony with permission of the London Stock Exchange. NSE is reorganized into eleven independent market sectors including: Agricultural, Commercial and Services, Telecommunication and Technology, Manufacturing and Allied, Banking, Automobiles and Accessories, Insurance, Energy and Petroleum, Construction and Allied and Investment. 71 firms are listed currently (NSE Handbook, 2015). Two indices are popularly used to measure performance. The NSE 20-Share Index has been in use since

1964 and measures the performance of 20 blue-chip companies with strong fundamentals and which have consistently returned positive financial results. The other index is the NSE All Share Index (NASI) which was introduced as an alternative index. Its measure is an overall indicator of market performance. The Index incorporates all the traded shares of the day (Iraya and Musyoki, 2013).

A good number of listed firms in NSE have been reporting good performances over the last five years. The perfect examples are Equity Bank Limited, Safaricom Limited, Nation Media Group Limited and many more. A deep analysis shows that some of these firms have are socially screened and have been declaring dividends every year despite difficult economic conditions in the country.

1.2 The Research Problem

Social screening involves making investment decisions by integrating financial and non-financial considerations which includes personal values, societal demands, environmental concerns and corporate governance issues. The aspect of investing in socially screened firms in Kenya today has grown tremendously over the years. Socially screened firms in Kenya appear to be well managed, stable despite economic turbulences and are profitable. Investors are therefore assured of annual dividends, capital gains and better return on investment. These firms practice ethical corporate practices hence attracting socially responsible investors. Also, several legislations such as Ethics and Anti Corruption Crimes Act, laws on anti poaching and by laws on public smoking have been enacted to discourage non ethical business practices hence encouraging firms in Kenya to adopt screening practices.

According to Schröde (2004) socially screened assets seem to have no clear disadvantage concerning their performance compared to conventional assets. Their risk-adjusted performance is similar to conventional assets and – on average – an investor does not have to expect a significantly lower performance due to the restricted investment universe. Chegut et al (2010) found that much of the SRI literature is inconsistent in its treatment of data quality, social responsibility verification, survivorship bias, benchmark treatment and robustness analysis. They suggested that future research includes and treats dividend yield and fees in the analysis, incorporates independent and third party social responsibility verification, corrects for survivorship bias, tests multiple benchmarks and analyzes the impact of fund composition, management influences and SRI strategies through sensitivity and robustness checks.

Odhiambo (2009) carried out a research on the Nairobi stock exchange with the aim of finding out if dividends are informative about a firm's future earnings per share. She concluded that the data revealed a weak relationship between dividend changes and future earnings per share. Njuru (2007) observed a continuation of positive returns in the days following stock dividend announcement and concluded that there is existence of under reaction of stock dividend announcement at the NSE. The previous studies have shown both positive and negative results of the effects of dividend announcements on stock returns. Moreover, studies on effects of dividends announcement on the performance of socially screened portfolios are scarce. This is the research gap which the

current study sought to fill by answering the research question; what are the effects of dividend announcement on the performance of socially screened portfolios in the NSE?

1.3 Research Objectives

The objective of the study was to determine the effect of dividend announcement on the performance of socially screened portfolios in the Nairobi Securities Exchange.

1.4 Value of the Study

This study will help the investors to make informed decisions on which company's stock to invest in. It will also help them to understand the effects of dividend announcement on stock prices such that they will know when to buy and sell the shares and maximize their returns.

The corporate manager will benefit from this research in the sense that, they will be able to know the value of the firm from understanding how dividends announcement affects the stock returns. They will also be able to know whether they should announce dividends or re-invest the profits into the company.

For the academicians, this paper will be a resource material for knowledge and hopefully it will act as a motivation for them to conduct researches in other countries or even to explore other factors that affect the performance of socially screened securities in any securities market.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter focuses on both the theoretical and empirical literature review and ends with a summary of the empirical review and research gap(s).

2.2 Theoretical Review

The theoretical literature review is focused on five dividend theories which include the dividend irrelevance theory, bird in hand dividend theory, clientele effect of dividend theory, the information content of dividends (signalling) theory and the agency costs and free cash flow hypothesis of dividend policy. The theories are discussed in turn here below.

2.2.1 Dividend Irrelevance Hypothesis

The proponents of this school of thought were Modigliani and Miller (1961). They stated that, the dividend policy employed by a firm does not affect the value of the firm. They argued that, the value of the firm is dependent on the firm's earnings which result from its investment policy, such that when the investment policy is given, the dividend policy is of no consequence. Miller and Modigliani (1961) argued that, in a perfect world the value of a firm is unaffected by the distribution of dividends and is determined solely by the earning power and risks of its assets. They stated that "given a firm's investment policy, the dividend payout policy it chooses to follow will affect neither the current price of its shares nor the total returns to shareholders".

Modigliani and Miller (1961) further suggested that, to an investor, all dividend policies are effectively the same since investors can create “homemade” dividends by adjusting their portfolios in a way that matches their preferences. Investors calculate the value of companies based on the capitalized value of their future earnings, and this is not affected by whether firms pay dividends or not and how firms set their dividend policies.

2.2.2 Bird-In-The-Hand Hypothesis

Investors therefore prefer the “bird in the hand” of cash dividends rather than the “two in the bush” of future capital gains. Increasing dividend payments may then be associated with increase in firm value. As a higher current dividend reduces uncertainty about future cash flows, a high payout ratio would reduce the cost of capital, and hence increase share value. This was supported by Lintner (1956) and Walter (1963).This theory assumed that the firm is all equity firm that is, has no debt in its capital structure.

It also assumed that no external financing is available and consequently retained earnings are used to finance any expansion of the firm. It utilized the assumption that there are constant returns which ignores diminishing marginal efficiency of investment and that the firm incurs a constant cost of capital. Investors are generally risk averse and attach more risk to promised future dividends and capital gains than to current dividends. Thus current dividends reduce investor uncertainty and results in higher value in the firm’s stock.

2.2.3 Clientele Effects of Dividends Hypothesis

In their seminal paper M&M (1961) pointed out that the portfolio choices of individual investors might be influenced by certain market imperfections such as transaction costs and differential tax rates to prefer different mixes of capital gains and dividends. M&M (1961) argued that, these imperfections might cause investors to choose securities that reduce these costs. M&M (1961) termed the tendency of investors to be attracted to a certain type of dividend-paying stocks a “dividend clientele effect”.

Pettit (1977) provided empirical evidence for the existence of a clientele effect by examining the portfolio positions of 914 individual investors. He found a significant positive relationship between investors’ ages and their portfolios’ dividend yield, and a negative relationship between investors’ incomes and dividend yield. Pettit suggested that elderly low-income investors tend to rely more on their portfolios to finance their current consumption, and avoid the transaction costs associated with selling stocks. Consequently, they have more of a tendency to invest in high dividend stocks. Pettit also showed that, investors whose portfolios have low systematic risk prefer high-payout stocks, and he found evidence for tax-induced clientele effect.

A firm attracts shareholders whose preferences with respect to stability of dividends correspond to the pattern maintained by the firm itself. Some shareholders prefer stable dividends as a source of income while others may prefer to earn capital gains. A firm that has established a certain dividend policy should not change it arbitrarily because it may adversely affect its preferred dividend clientele.

2.2.4 The Information Content of Dividends (Signalling) Hypothesis

According to the signalling hypothesis, investors can infer information about a firm's future earnings through the signal coming from dividend announcements, both in terms of the stability of, and changes in, dividends. An increase in dividend payout may be interpreted as the firm having good future profitability (good news), and therefore its share price would react positively. Similarly, dividend cuts may be considered as a signal that the firm has poor future prospects (bad news), and the share price may then react unfavourably. Accordingly, it would not be surprising to find that, managers are reluctant to announce a reduction in dividends. Lintner (1956) argued that, firms tend to increase dividends when managers believe that earnings have permanently increased.

This suggests that dividend increases imply long-run sustainable earnings. This prediction is also consistent with what is known as the "dividend-smoothing hypothesis". Managers endeavour to smooth dividends over time and not make substantial increases in dividends unless they can maintain the increased dividends in the foreseeable future.

2.2.5 Agency Costs Theory

The theory suggests that, payment of dividends reduces free cash flows available for management to engage in perquisite consumptions, entrenchment and over investment. The free cash flow hypothesis of Easterbrook (1984) and Jensen (1986) states that companies with substantial free cash flow always tend to face conflicts of interest between stockholders and managers. Easterbrook (1984) argued that dividends could be used to reduce the free cash flow in the hands of managers. Easterbrook hypothesized that dividend payments will oblige managers to approach the capital market to raise

funds. In this case investment professionals such as bankers and financial analysts would also be able to monitor managers. Therefore, shareholders are able to monitor managers at lower cost. This suggests that dividend payments increase management scrutiny by outsiders and reduce the chances for managers to act in their own self-interest.

A higher relative dividend payout or a higher effective dividend yield is expected to minimize agency costs, as dividends lower the level of available liquidity which increases the potential default risk of firms. Hence, the higher the dividends are relative to earnings, the stronger is the focus likely to be on future earnings performance as a means of maintaining the current dividend payout level.

2.3 Relevance of the theories

The signalling hypothesis advanced by Litner (1956) shows that, investors can infer information about a firm's future earnings through the signal coming from dividend announcements.The Bird-In-The-Hand Hypothesis (Lintner, 1956) concludes that, current dividends reduce investor uncertainty and results in higher value in the firm's stock. The Agency theory by Easterbrook (1984) suggests that, a higher relative dividend payout or a higher effective dividend yield is expected to minimize agency costs and hence higher dividends are relative to earnings. The clientele effect theory by Pettit (1977) affirms that, firm attracts shareholders whose preferences with respect to stability of dividends correspond to the pattern maintained by the firm itself.

All the above theories supports the payments of dividends by firms since this action will results in positive reaction in share prices, improved returns and hence growth in firm

value. The findings of this study are in line with these theories in that announcement of dividends by socially screened firm results in higher cumulative abnormal returns. This study also rejects Dividend Irrelevance Hypothesis by Modigliani and Miller (1961) which states that, the dividend policy employed by a firm does not affect the value of the firm.

2.4 Determinants of Portfolio Performance

Portfolio performance attribution, while not new, is still an evolving discipline. Early papers on the subject, focusing on risk-adjusted returns, suggested the initial framework, but paid little attention to multiple asset performance measurement. Other factors influenced the purchase and disposal of shares in the stock market. These influences consisted of family and religious background, improved exchange rates, day to day profits, inflation, past profitability of the companies their decisions were based on, management stability of the companies, availability of shares in the market and company capitalization in the market.

The process of selecting a portfolio may be divided into two stages. The first stage starts with observation and experience and ends with beliefs about the future performances of available securities. The second stage starts with the relevant beliefs about future performances and ends with the choice of portfolio.

2.5 Empirical Review

Studies have been conducted to determine the effects of dividend announcement on stock returns in different scenarios. However, the findings of these studies vary from market to

market and author to author. The studies analysed here are both local and international covering different securities markets.

Watts, (1973) studied the impact of dividends on both stock prices and future earnings to see whether dividends contained any information for investors. Watts found that after conditioning on current and past earnings, dividends could not be used by investors to reliably predict future earnings.

Asquith and Mullins (1983) examined the market's reaction to dividend announcements for a sample of 168 firms that initiated dividends either for the first time in their corporate history or resumed paying dividends after at least a ten-year hiatus. Asquith and Mullins (1983) tested the average 26 daily excess stock returns, ten days before and ten days after the announcement of dividend initiation. For the two-day announcement period their results show that, there is an excess return of about +3.7 percent. Moreover, using cross-sectional regression analysis, Asquith and Mullins found a positive and significant relationship between the magnitude of initial dividends and the abnormal returns on the announcement day. This suggests that, the size of dividend changes may also matter. In another empirical study, Asquith and Mullins (1986) reinforce their earlier findings and offer more support to the information content of dividend hypothesis.

Michaely, Thaler and Womack (1995) have gone further by examining the impact of both initiations and omissions of cash dividends on share prices reaction. They observed 561 dividend initiation events and 887 dividend omission events over the period 1964-1988.

Michaely et al (1995) documented that, during three days surrounding the announcements, the average excess return was about –7.0 percent for omissions and +3.4 percent for dividend initiations. Note that, the market reactions to dividend omissions are greater than for dividend initiations. This implies that the market reacts optimistically toward dividend initiations.

Benartzi, et al (1997) studied on whether changes in dividends signal the future or the past. The population consisted of all the companies that traded on the NYSE for at least 2 years during the period 1979 – 1991 with a sample of 7186 firms. They reported that, while changes in dividend policy were generally unrelated to changes in future earnings, there was some evidence to suggest that firms that increased dividends were relatively unlikely to experience subsequent earnings decreases. They interpret their results to be consistent with the signalling hypothesis; if managers initiate dividends only when they believe that such dividends are sustainable, and then we expect that, these initiations will rarely be followed by significant earnings decreases. They need not, however, be followed by large increases in profitability.

Zahid and Rahman (2002) examined the reliability of the signalling content of a dividend cut in light of the fact that, firms often reduce dividend payments as part of a cost-reduction program. They empirically examined unanticipated earnings changes following dividend cuts and omissions for firms that implement one or more operational measures and firms that do not take any measure. They took the perspective that, when a firm reduces dividends and concurrently undertakes other value-enhancing measures, it is less

likely sending a signal that poor earnings will follow. In this case, the dividend cuts can be viewed as ways to conserve cash and improve earnings. On the other hand, firms that reduce dividend payments but do not implement the cost-reducing measures are the ones likely to experience a drop in future earnings consistent with the signalling theory.

Bali (2003) presented evidence consistent with the preceding results. He reported an average 1.17 percent abnormal return for dividend increases and -5.87 percent for decreases. In addition, Bali (2003) examined the long run drifts of stock prices reaction to dividend increases and decreases and concluded that the stock market exhibits delayed response to dividend change information and that stock returns around dividends announcement for quarter t+1 to t+16 for increases and t+1 and t+3 for decreases are predictable base on the dividend change in quarter t.

Bernhardt, et al (2005) carried out a research aimed at distinguishing the hypothesis that dividends are used as a signalling device from the hypothesis that dividends contain information. The study period was 1962-1996. The sample size was all the firms that were listed on the NYSE that make regular quarterly cash dividends and have a complete set of price, distribution and return information at the declaration date of each dividend. Their findings indicate that the information content in dividend is not positively related to the marginal cost of dividends in the manner implied by the dividends signalling theory.

Bitok (2004) conducted a study on the effect of dividend policy on the value of the firm quoted in the NSE over the period 1998 to 2004 and found that, there is a weak relationship between the dividend payout ratio and the value of the firm. Despite all the

empirical work testing the dividend irrelevance hypothesis, the impact of dividend policy on the value of a firm remains unresolved.

Mulwa (2006) studied the signalling efficiency of dividend changes on the future profitability of quoted companies at the NSE covering a period of 5 years from 1998 to 2002. Secondary data was obtained from NSE and Stockbrokers. He established that, at least in the year of dividend payment a weak or insignificant relationship exists with stock returns.

Njuru (2007) examined whether the behaviour of stock prices following stock dividend announcement showed evidence of reaction anomaly at NSE. The population consisted of 48 companies listed at the NSE and covered a period of 8 years (1st Jan 1999 to 31st Dec 2006) taking a sample from all the companies that declared stock bonus. He found out that there was a continuation in the positive returns after the stock dividend announcement, meaning that the effect of stock dividend announcement at the NSE is not fully incorporated in stock prices in the event day.

Odhiambo (2009) carried out a research on the Nairobi stock exchange with an aim of finding out if dividends are informative about a firm's future earnings per share. She used regression analysis to estimate the relationship between dividend changes and EPS using financial results of listed companies for a period of 10 years covering the period from1998 to 2008. She concluded that the data revealed a weak relationship between dividend changes and future earnings per share.

Kimathi (2009) tested the applicability of constant dividend model by companies listed at the Nairobi stock exchange. Data was collected from annual reports and share prices schedules obtained from the NSE and CMA from a population of 20 companies that paid dividends consistently from 2002 to 2008. The findings of the research established that the dividend model was not employed by the companies listed in the NSE. Most firms instead employed a constant and predictable policy where a specific amount of dividend per share each year was paid each year.

2.6 Summary of Literature Review

Asquith and Mullins (1986) found out that a positive and significant relationship between the magnitude of initial dividends and the abnormal returns on the announcement day thus suggesting that, the size of dividend changes may also matter. Michaely, Thaler and Womack (1995) research showed that, the market reactions to dividend omissions are greater than for dividend initiations implying that, the market reacts optimistically toward dividend initiations. Bali (2003) work showed that, the market reacts optimistically toward dividend initiations. Mulwa (2006) established that, at least in the year a weak relationship exists between dividend payment and stock returns.

Odhiambo (2009) concluded that there was a weak relationship between dividend changes and future earnings per share. Kimathi (2009) tested the applicability of constant dividend model by companies listed at the Nairobi stock exchange and the research established that the dividend model was not employed by the companies listed in the

NSE. Bitok (2004) found that, there is a weak relationship between the dividend payout ratio and the value of the firm.

These studies produced mixed results on effects of dividends announcements and performance of securities. Moreover, studies on effects of dividends announcements on the performance of socially screened portfolio are quite scarce.This study therefore seeks to determine the effect of dividend announcement on the performance of socially screened portfolios in Nairobi Securities Exchange.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter gives a description of the research methodology employed in achieving the objectives of this study. The chapter presents the research design, target population and sampling procedure, data collection procedures and data analysis.

3.2 Research Design

The study adopted a descriptive research design in determining the effect of dividends announcement on the performance of socially screened portfolio. Descriptive research design is a study designed to depict or describe the participants in a more accurate way.

Event study methodology was used. It is a statistical method to asses the impact of an occurrence of an event. This methodology is useful because it studies the effects of dividend announcement on the returns of a socially screened firm.

3.3 Target Population

A research population is generally a large collection of individuals or objects that is the main focus of a scientific query or study. The population is broken down into small samples which is easy for the researcher to conduct his study on and thereafter infer the result to the whole population.

The target population for this study consisted of the ten (10) socially screened firms listed on the Nairobi Securities Exchange. The firms were selected from Commercial and Services, construction and allied, energy and petroleum, insurance and

telecommunication and technology. The companies were selected based on consistency in announcing dividends and trading actively during the forty one (41) days window period.

3.4 Sample

The study employed stratified random sampling. In this case the population is divided into groups in such a way that units within each group are as similar as possible in a process called stratification. The groups are called strata. Simple random samples from each of the strata are collected and combined into a sample.

In the case of our study the stratification is by sector in which the firm operate in at the NSE. A random sample from each stratum was taken in proportion to the stratum's size in comparison to the population. The portfolio sample consisted of ten socially screened firms listed at the NSE that announced dividends consecutively and traded actively during the 41 days window period.

3.5 Data Collection

This is the actual collection of research material from the field. It involves the observation of the behavior of sample units and recording of data. The sample units here are the listed firms and the daily in stock prices are the data to be collected.

This study used secondary data only. This was obtained from the firm's annual reports most of which were publicly available in NSE daily and annual reports. The data collected were the stock prices before announcement of dividends, stock prices after

dividends announcement and the dates when the dividends were announced. All the prices collected were within the window period of 41days.

3.6 Data Analysis: Event Study

To analyze the effect of dividend announcements on socially screened portfolios, event study approach was used. The following steps were followed to perform event study: The first step was to find out the dividend announcement dates for each of the selected screened firms from the year 2010 to 2014. The event window of 20 days before the event and 20 days after the event i.e. 41 days were taken. For calculating expected returns daily adjusted closing prices were taken. Cumulative abnormal returns were calculated with the help of average abnormal returns to see the reaction over a period of time. To estimate the stock price response to dividend announcements, Returns (Rt) which is the time t return on security were calculated as (Pt – Pt-1)/Pt-1 where Pt is the adjusted closing price of the stock on day t .Pt-1 is the adjusted closing price of stock i on day t-1.

The daily abnormal return for a security was computed as follows:

$A\ R_{it} = R_{it} - E(R_m)$

Where:

R_{it} =Security return

$E(R_m)$ =Market expected return (NSE)

The expected market return was calculated using the following formula:

$E(R_{it}) = \alpha_i + \beta_i R_{mt} + \varepsilon$

Where:

$E(R_{it})$ = The expected return for company *i* for period *t*

α_i = The intercept term

β_i = Regression constant

R_{mt} = Return on the market for period *t*

ε = Error term

The cumulative abnormal return (CAR) was calculated as follows:

$CAR_{it} = \Sigma A\ R_{it}$

Where:

CAR_{it} =Cumulative abnormal return for a security over the window period

The following hypothesis was tested:

H0: There is no significant difference between the returns of socially screened portfolios before and after the announcement of dividends.

H1: There is significant difference between the returns of socially screened portfolios after the announcement of dividends. Tests of significance shall be carried out at the 5% level of significance using the T-test.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The objective of this study was to determine the effect of dividend announcement on the performance of socially screened portfolios in the Nairobi Securities Exchange. The portfolio sample consisted of ten (10) socially screened firms listed at the NSE that announced dividends consecutively and traded actively during the forty one days window period. In this section findings have been presented over the study period and event window. It is followed by a presentation of the results and a detailed discussion of the results.

4.2 Sample Characteristics

These are the screening criteria that were used to build a sample of socially screened firms at the NSE. These firms had adopted rules and regulations to totally discourage in their work places alcoholism, smoking, environmental pollution, employment inequality, community investment and human right violations.

4.2.1 Socially Screened Portfolio

Table 4.1 below shows the companies that met the screening criteria employed.

Table 4.1: Socially Screened Portfolio

		No alcohol	No smoking	No Environment pollution	Labour relations	Employment equality	Community investment and rights	Human rights violation
1.	Express Ltd	Y	Y	Y	Y	Y	Y	Y
2.	Nation Media Group	Y	Y	Y	Y	Y	Y	Y
3.	Scangroup Ltd	Y	Y	Y	Y	Y	Y	Y
4.	TPS Eastern Africa	Y	Y	Y	Y	Y	Y	Y
5.	Standard Group Ltd	Y	Y	Y	Y	Y	Y	Y
6.	Access Kenya Grp	Y	Y	Y	Y	Y	Y	Y
7.	Safaricom Ltd	Y	Y	Y	Y	Y	Y	Y
8.	Barclays Bank Ltd	Y	Y	Y	Y	Y	Y	Y
9.	Equity Bank Limited	Y	Y	Y	Y	Y	Y	Y
10.	Kenya Commercial Bank Ltd	Y	Y	Y	Y	Y	Y	Y
11.	NIC Bank Ltd	Y	Y	Y	Y	Y	Y	Y
12.	Standard Chartered Bank Ltd	Y	Y	Y	Y	Y	Y	Y
13.	The Cooperative Bank	Y	Y	Y	Y	Y	Y	Y
14.	Kenya Orchards	Y	Y	Y	Y	Y	Y	Y
15.	Unga Group Ltd	Y	Y	Y	Y	Y	Y	Y
16.	Pan Africa Insurance	Y	Y	Y	Y	Y	Y	Y
17.	Kenya Re Insurance	Y	Y	Y	Y	Y	Y	Y
18.	CFC Insurance	Y	Y	Y	Y	Y	Y	Y
19.	British American Insurance	Y	Y	Y	Y	Y	Y	Y
20.	Olympia Holdings	Y	Y	Y	Y	Y	Y	Y
21.	Centum Investment	Y	Y	Y	Y	Y	Y	Y
22.	Unga Group Ltd	Y	Y	Y	Y	Y	Y	Y
23.	Crown Berger	Y	Y	Y	Y	Y	Y	Y
24.	E. A. Cables	Y	Y	Y	Y	Y	Y	Y

Source: Research Findings (2016)

4.2.2 Descriptive Statistics

Out of the 24 companies a portfolio of 10 companies which had consistently declared dividends over the study period was constructed. Table 4.2 shows the descriptive statistics on the rates of dividends paid out by the companies between 2010 and 2014.

Table 4.2 Descriptive Statistics on Dividend pay-out rates

Company		Minimum Payout	Maximum Payout	Average Payout
1	Nation Media Group	30.7%	50.0%	40.6%
2	Barclays Bank Ltd	77.2%	93.5%	85.4%
3	Safaricom Ltd	38%	70%	54%
4	The Cooperative Bank	23%	31%	27%
5	Trans-Century Ltd	45.4%	79.5%	62.45%
6	Equity Bank Limited	29%	42%	35.5%
7	Unga Group Ltd	14.8%	62.9%	38.85%
8	E. A. Cables	23.6%	48.0%	35.8%
9	Kenya Commercial Bank Ltd	41%	54%	47.5%
10	Pan Africa Insurance	10%	67.9%	39%
	Mean	33.27%	59.88%	46.57%
	Standard Deviation	19.04%	18.61%	16.96%

Source: Research Findings (2016)

According to the NSE Handbook (2015), the dividend payout ratio is calculated by dividing dividend declared per share (DPS) by earning per share (EPS) in that particular year and the result expressed as a percentage (%).

4.3 Cumulative Abnormal Returns (CAR)

Cumulative abnormal returns is the summation of abnormal returns for a specific firm based on returns of (t=0) for the 20 days before and after the event date.

4.3.1 CAR for 2010

Table 4.3 shows CAR_t findings for the 41-day window period in 2010 for a sample of 10 firms which paid dividends. The findings indicate that the market cumulative abnormal return improved significantly for all companies after the announcement of dividend payout. This is evidenced by the significant gains in the values of CAR_t for the period between (t=0) and (t=+20).

Table 4.3 Cumulative Abnormal Return (2010)

Company	CARt (t=-20 days)	CARt (t=day 0)	CARt (t=+20day)	CARt 41 days
Nation Media Group	-0.056	0.123	0.915	0.982
Barclays Bank Ltd	0.0244	0.0981	0.9943	1.1168
Safaricom Ltd	-0.016	0.044	0.0104	0.0384
The Cooperative Bank	-0.019	-0.012	0.011	0.22
Trans-Century Ltd	-1.106	0.023	0.11	0.973
Equity Bank Limited	-0.0044	0.215	0.31	0.5206
Unga Group Ltd	-1.106	0.023	0.11	0.973
E. A. Cables	-1.082	0.012	0.015	1.055
Kenya Commercial Bank Ltd	-0.011	0.224	0.432	0.645
Pan Africa Insurance	-0.046	-0.01	1.2311	1.1751

Source: Research Findings (2016)

4.3.2 CAR for 2011

Table 4.4 shows CARt findings for the 41-day window period in 2011 for a sample of 10 firms which paid dividends. The findings indicate that the market cumulative abnormal return improved significantly for all companies after the announcement of dividend payout except for three companies. This is evidenced by the significant gains in the values of CARt for the period between (t=0) and (t=+20).

Table 4.4 Cumulative Abnormal Return (2011)

Company	CARt (t=-20 days)	CARt (t=day 0)	CARt (t=+20day)	CARt 41 days
Nation Media Group	-0.011	0.415	1.5112	1.9152
Barclays Bank Ltd	-0.026	-0.069	0.915	0.82
Safaricom Ltd	-0.036	0.6171	0.9171	1.4982
The Cooperative Bank	-0.056	0.116	1.1112	1.1712
Trans-Century Ltd	-0.012	0.225	1.234	1.447
Equity Bank Limited	0.0046	0.219	1.211	1.4346
Unga Group Ltd	-0.009	-0.013	0.001	-0.021
E. A. Cables	-0.01	-0.015	0.0112	-0.0138
Kenya Commercial Bank Ltd	-0.014	0.566	0.0109	0.5629
Pan Africa Insurance	-1.116	0.026	0.115	-0.975

Source: Research Findings (2016)

4.3.3 CAR for 2012

Table 4.5 shows CAR_t findings for the 41-day window period in 2012 for the sample of 10 firms which paid dividends throughout the study period. The findings indicate that the market cumulative abnormal return improved significantly for most of the companies after the announcement of dividend payout. However four companies experienced a fall in the market cumulative abnormal returns. This is evidenced by the values of CAR_t for the period between (t=0) and (t=+20).

Table 4.5 Cumulative Abnormal Return (2012)

Company	CARt (t=-20 days)	CARt (t=day 0)	CARt (t=+20day)	CARt 41 days
Nation Media Group	-0.0244	0.0226	1.1106	1.1088
Barclays Bank Ltd	0.0184	0.5162	0.6139	1.1485
Safaricom Ltd	-0.0012	0.0675	0.0276	0.0939
The Cooperative Bank	-0.0105	0.0105	0.01142	0.01142
Trans-Century Ltd	-1.0124	0.0026	0.0139	-0.9959
Equity Bank Limited	-0.0246	-0.0652	0.031	-0.0588
Unga Group Ltd	-0.0156	-0.0869	-0.0145	-0.117
E. A. Cables	-1.116	0.026	0.115	-0.975
Kenya Commercial Bank Ltd	-0.0212	0.0145	1.1216	1.1149
Pan Africa Insurance	-0.0032	0.1115	1.1226	1.2309

Source: Research Findings (2016)

4.3.4 CAR for 2013

Table 4.6 shows CARt findings for the 41-day window period in 2013 for the sample of 10 firms which paid dividends throughout the study period. The findings indicate that the market cumulative abnormal return improved for most of the companies after the announcement of dividend payout. However two companies experienced a decline in the market cumulative abnormal returns. This is evidenced by the values of CARt for the period between (t=0) and (t=+20).

Table 4.6 Cumulative Abnormal Return (2013)

Company	CARt (t=-20 days)	CARt (t=day 0)	CARt (t=+20day)	CARt 41 days
Nation Media Group	0.0846	0.0779	0.0182	1.0482
Barclays Bank Ltd	0.0326	-0.0204	0.0144	0.9761
Safaricom Ltd	-0.0303	-0.0130	0.0132	1.0133
The Cooperative Bank	-0.0105	-0.0105	0.0134	0.9543
Trans-Century Ltd	-1.0124	-0.0026	0.0139	-1.0432
Equity Bank Limited	1.0163	0.0316	0.1402	0.8024
Unga Group Ltd	-0.0224	-0.0903	0.0321	1.1196
E. A. Cables	-1.116	-0.126	0.115	-0.753
Kenya Commercial Bank Ltd	0.0210	-0.0438	0.0298	0.9208
Pan Africa Insurance	-0.0224	0.0902	0.0881	1.0924

Source: Research Findings (2016)

4.3.5 CAR for 2014

Table 4.7 shows CARt findings for the 41-day window period in 2014 for the sample of 10 firms which paid dividends throughout the study period. The findings indicate that the market cumulative abnormal return improved significantly for all the companies after the announcement of dividend payout. This is evidenced by the values of CARt for the period between (t=0) and (t=+20).

Table 4.7 Cumulative Abnormal Return (2014)

Company	CARt (t=-20 days)	CARt (t=day 0)	CARt (t=+20day)	CARt 41 days
Nation Media Group	0.0917	0.0371	1.0811	1.2099
Barclays Bank Ltd	0.0135	0.0743	1.0472	0.9678
Safaricom Ltd	-0.0133	-0.4501	0.0132	1.3426
The Cooperative Bank	-0.1123	-0.1234	0.3041	0.9543
Trans-Century Ltd	0.0124	1.0026	0.0139	1.0432
Equity Bank Limited	0.1342	0.0316	1.0163	0.8024
Unga Group Ltd	-0.0894	-0.0357	0.0128	1.1364
E. A. Cables	-1.324	-0.124	-0.115	0.753
Kenya Commercial Bank Ltd	-0.0671	0.0702	0.0092	1.0946
Pan Africa Insurance	0.0456	0.0634	0.0346	0.9411

Source: Research Findings (2016)

4.4 Test of Hypothesis

The study sought to test the following hypothesis:

H0: There is no significant difference between the returns of socially screened portfolios before and after the announcement of dividends.

H1: There is significant difference between the returns of socially screened portfolios after the announcement of dividends.

The results of t test at 5% level of significance for tables 4.3 through to 4.7 were 0.003, 0.002, 0.009 and 0.025 for the years 2011, 2012, 2013 and 2014 respectively. This indicated that Cumulative Abnormal Return (CAR) on the day of dividend announcement (day t=0) had significantly improved as compared to the values obtained 20 days before the day of announcement for most companies. The CARt statistics were found to be statistically significant at 95% levels of confidence over the 41-day period for all the years. The improvements could be due to the fact that information of dividend payment often leaks out to the market a few days before the announcement made by the company.

This is a clear indication that different market segments react differently to information. Therefore, the null hypothesis is rejected and the conclusion can thus be drawn to the effect that, there is significant difference between the returns of socially screened portfolios after the announcement of dividends.

4.5 Discussion of Results

The objective of this study was to determine the effect of dividend announcement on the performance of socially screened portfolios in the Nairobi Securities Exchange. The significance of CARt after dividend announcement indicates that stock prices for the socially screened portfolios reacted positively to these announcements. This generally shows that, the prices of stocks appreciates in the market as it reacts to higher demand from investors who would wand to invest in such dividend announcing firms and hence performance of such firms improving after the announcements. These findings are consistent with previous finding where NSE had been found to be semi efficient without considering different segments. Bali (2003) presented evidence consistent with the preceding results. He reported an average 1.17 percent abnormal return for dividend increases and -5.87 percent for decreases.

Asquith and Mullins (1983) tested the average 26 daily excess stock returns, ten days before and ten days after the announcement of dividend initiation. For the two-day after the announcement period their results show that, there is an excess return of about +3.7 percent. However the findings differ from previous studies. Odhiambo (2009) found that, dividend changes provided around 0.3 percent information about the level and changes in

future earnings per share and leaves the 99.7 percent unexplained. He concluded that, there are other critical variables that determine the changes in the firms earning per share.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter provides the summary, conclusion and recommendations to the study based on the research findings. The summary briefly expounds the results of the study while under conclusion we explain the role of dividend announcement to behaviour of the firm and its returns. We also point out the areas of improvement particularly provision of information in NSE.

5.2 Summary

The study utilized the event study methodology to analyze data obtained from sample firms picked from a population of NSE listed firms and which had paid dividend during the period under study. Excess returns were calculated, cumulative abnormal returns determined and compared with the t-statistic at 95% level of confidence. The major finding of the study is that dividend announcement had greater impact on the stock prices of the socially screened portfolios. This is a clear indication that dividend announcement positively affects the returns of socially screened firms listed at the NSE.

5.3 Conclusion

In this study, a system that accounts for the interaction between firms` market share price and dividend announcement was presented and tested. The testing methodology considered the investors` total return over a period starting from 20 days well before the announcement of dividend to 20 days well after the dividend announcement day (using CAR). The study established that, for most of the companies quoted at the NSE, the market value of shares of the firms are sensitive to dividend announcement. This implies

that, the role of the dividend payout signal at the NSE is clear, a multiplication to investors` wealth thus resulting to price changes due to the confidence gains made.

5.4 Recommendations

The findings established that, the values of shares for firms listed at the NSE are sensitive to the dividend payout signals, particularly those in the socially screened portfolios. Therefore, institutional and retail investors wishing to make capital gains from their investment should peg their investment decisions on fundamental aspects of the firms especially on the basis of its dividend payout history.

Most socially screened firms in the NSE were found to be illiquid due to thin trading. This is associated with the fact that, most investors are poorly informed. To counter this problem, educational programmes should be implemented especially to the general public in order to increase awareness about stock market activity. This will attract an increased number of participants, but it will also boost liquidity (Mlonzi *et al*., 2011). The stock market should be encouraged to maintain a record of the various event dates in a way that they are easily accessible so as to aid event studies as opposed to the current way where these are not kept in a summarized form.

5.5 Limitations of the Study

The study was limited to observations based on the announcement of dividend payout by the socially screened listed firms. The study was not able to account for price behaviour that is influenced by the fundamentals of the company as opposed to speculation. This is due to the irrational behaviour that usually characterizes trading of shares at the Nairobi Securities Exchange.

The researcher had to go through huge volumes of data trying to get such information which is in itself time consuming and expensive. Moreover the use of a sample of ten firms is not adequate to produce robust findings.

5.6 Suggestions for Further Research

This study focused on one variable that affect stock prices that is, dividend announcement. Further research in this area is needed on other variables such as stock split announcement, political events and how different segment react to dividend information.

There is also need to conduct a similar research covering a longer period than 61 days with new data that is covering different periods to determine whether similar findings will be arrived at. The researcher sampled 10 out of 24 socially screened firms. A census study is recommended for any further empirical investigations into NSE dividend announcements.

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APPENDIX

List of Socially Screened Firms in the NSE

1) TPS Serena
2) Scangroup Ltd
3) Standard Group Ltd
4) Access Kenya Group
5) Safaricom Ltd
6) Equity Bank Ltd
7) Kenya Commercial Bank Ltd
8) NIC Bank Ltd
9) Standard Chartered Bank Ltd
10) Pan African Insurance Ltd
11) Kenya Re Insurance Ltd
12) CFC Insurance Ltd
13) Olympia Holdings Ltd
14) Centum Investment Ltd
15) Crown Berger Ltd
16) East African Cables Ltd
17) Unga Group Ltd
18) Express Ltd
19) Nation Media Ltd
20) Cooperative Bank Ltd
21) British American Insurance Ltd
22) Diamond Trust Bank Ltd
23) Barclays Bank Ltd
24) Kenya Orchards Ltd