THE EFFECT OF CORPORATE SOCIAL RESPONSIBILITY ANNOUNCEMENT ON STOCK RETURNS AT THE NAIROBI SECURITIES EXCHANGE

BY

STACEY PHILOMENA MWAMBURI

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DECLARATION

I declare that this is my original work and has not been submitted for a degree in this
or any other University for examination.

Signed: ________________  __________________
Stacey Philomena Mwamburi  Date

D61/81312/2012

This Research Proposal has been submitted for examination with my approval as the
University Supervisor

Signed: ________________  __________________
Dr. Cyrus Iraya  Date

Department of Finance and Accounting

School of Business

University of Nairobi
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DEDICATION

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<tr>
<td>CAPM</td>
<td>Capital Assets Pricing Model</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>EMH</td>
<td>Efficient Market Hypothesis</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>KCB</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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<td>USA</td>
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This study was undertaken with a view of establishing whether Corporate Social Responsibility announcements affect the stock prices of firms listed at the Nairobi Securities Exchange. The objective of study was to determine whether the Corporate Social Responsibility announcements generate abnormal returns of firms listed at the Nairobi Securities Exchange. These objectives were achieved by studying a sample of 8 firms listed at the NSE having made CSR announcement in the period of the study. The study adopted a descriptive research design, an event study methodology was performed where the Market Model was used to determine abnormal returns on a firm’s stock returns from the year 2011 to 2014, the daily adjusted prices for the sample stocks were recorded during the event window of 11 days, 5 days before and after the announcements. Data was extracted from the NSE Daily stock and NSE Handbook 2011-2014 and analyzed using Microsoft EXCEL. The study conclude that cumulative abnormal returns are associated with CSR announcement. CSR thus have a meaningful impact on the stock returns and any abnormal returns are just a result of chance.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The concept of Corporate Social Responsibility (CSR) is gaining prominence within policy debates in Kenya, it is not applied widely and is usually associated with philanthropy, although there are many private sector-related initiatives and business activities which can be described as expressions of CSR and there are also emerging specialist CSR organizations (Chepkwony, 2008). CSR concerns a corporate strategy, operations and governance structure that create environmental and social values in addition to maximizing enterprise value for the benefits of its shareholders by monitoring and ensuring compliance with the spirit of the law, ethical standards and international norms. The goal of CSR is to encourage a positive impact through its activities on the environment, consumers, employees, communities, future generations, shareholders and other stakeholders (Bartov & Li, 2015).

CSR therefore is not just a goodwill gesture by organizations wanting to look good to the public in order to increase their profits. It is a prerequisite for good corporate leadership and governance as well as sustained operation and profitability. CSR is in fact a corporate competitive marketing strategy that ensures high organizational and product visibility thereby branding the business as an organization that cares about its consumers, the community it does business with and other stakeholders. That is why in many cases, an organization will prefer to sponsor a CSR activity with one of the company's products such as Tusker Project Fame or the Dettol Heart Run in Kenya (Kamau, 2014).
Businesses are giving their CSR activities a lot of publicity through favorable media coverage in order to achieve competitiveness (Luo and Bhattacharya, 2006). Corporate communication is modeled to be homogenous in that the same message is communicated to all its stakeholders in order to transmit coherence, credibility and ethics (Dolphin, 2000). Through corporate communications, organizations are able to explain their mission and package their various values and visions into a cohesive message to stakeholders (Dolphin, 2000). The concept of corporate communication is founded on the integrative communication structure that links the organization and its stakeholders.

According to Patrick (2014), the essence of Signaling Theory is that strong form efficient market hypothesis do not hold and insiders in a firm have information the market and outsiders do not have. It assumes that information is not equally available to all parties at the same time and thus there exist information asymmetry. This theory states that corporate financial decisions and communications are signals sent by company managers to investors in order to minimize information asymmetry and to facilitate rational investment decision (Elton et al., 2009). These signals are the basis of financial communication policy. Signaling Theory is constructed on the premise that information is not evenly available to all parties at the same time. Usually, managers are privy to consistent, accurate and relevant information that inform their decision, which in turn signals the market. Having that investor’s intention is to maximize their returns, they will be willing to invest only in a company projected to have stable future performance (Quiry et al., 2011).
The primary role of the capital market is allocation of ownership of the economy’s capital stock. In general terms, the ideal market is a market in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production-investment decisions, and investors can choose among the securities that represent ownership of firms’ activities under the assumption that securities prices at any time ‘fully reflect’ all available information (Fama, 1970).

1.1.1 Corporate Social Responsibility Announcement

Scholars and managers have recently devoted greater attention to the strategic implications of CSR (McWilliams et al., 2006). According to McWilliams and Siege (2001), CSR is defined as situations where the firm goes beyond the interest of the firm and that which is required by the law. CSR activities go beyond the firm’s legal and contractual obligations. As such it involves a wide range of activities such as being employee-friendly, environment-friendly, mindful of ethics, respectful of communities where the firms’ plants are located and being investor-friendly (Bénabou and Tirole, 2010). CSR not only improves the satisfaction of all stakeholders, but also positively enhances the corporate image. Many companies tend to embrace CSR only after being surprised by public response to what was not previously thought to be a part of their business responsibility (Jones III & Jonas, 2011).

Several studies have investigated the relationship between a firm’s degree of CSR and its reputation (see for example Charles, 2005 and Sitaoja, 2006). Enhanced corporate social performance may lead to improved stock returns either directly through cost reductions and productivity improvements, or indirectly through an improvement in the firm’s overall standing that makes analysts more willing to recommend the stock
and investors more willing to hold it irrespective of the firm’s costs and revenues (Brammer et al., 2005). Socially responsible corporate performance can be associated with a series of bottom-line benefits. Socially responsible companies have enhanced brand image and reputation. Consumers are often drawn to brands and companies with good reputations in CSR related issues. Companies perceived to have a strong CSR commitment often have an increased ability to attract and to retain employees (Turban and Greening, 1997) which leads to reduced turnover, recruitment and training costs.

Although it is rather straightforward to identify the above benefits as being socially responsible for businesses, it is an arduous task to quantify and measure them. Since CSR is integrated into the business practices, it is by definition complicated to try to measure its effects separately. Ideally, it should be possible to keep all other factors constant and measure a company’s financial performance and volatility of cash flows before and after adopting the CSR principles. However, empirical methods are used to identify the relationship between a company’s socially responsible conduct and its financial performance (Tsoutsoura, 2004).

1.1.2 Stock Returns

Stock market return is the yield an investor obtains over a specified period of time. It is sometimes considered to be synonymous to stock prices. Stock return reflects aggregate investor expectations of the change in long-term future cash flows. A strong market can be seen as one that incorporates new information to stock prices and hence making the stock prices for the firms stable and accurately valued (Greenwood and Shleifer, 2013). Investors expect stock prices to react to some special events such as
CSR announcement as a matter of course. They are rarely certain however about the timing and magnitude of that reaction and sometimes are not even sure of the direction. Stock markets quickly digest all new public information about firms and transit rapidly into stock prices (Schweitzer, 1989).

According to Vuolteenaho (2002) a firm’s stock returns are driven by shocks to expected cash flows (i.e., cash-flow news) and/or shocks to discount rates (i.e., expected-return news). Cash-flow news is positively correlated with shocks to expected returns for a typical stock. Good news about cash flows is typically accompanied by higher expected returns. Stock prices are determined by supply and demand forces and there is no foolproof system that indicates the exact movement of stock prices. However, the factors behind increase or decrease in the demand and/or supply of a particular stock could include company fundamentals, external factors, market behavior, size of the firm, profitability of the firm and company announcements such CSR practices. Moreover, the behavior of market participants could be an important influencing factor of stock prices (Molodovsky, 1995).

1.1.3 Effect of Corporate Social Responsibility Announcement on Stock Returns

In practice, CSR has proven to be of significant interest to organizations of all kinds (commercial, not-for-profit, public), as well as communities and policy makers (Burn-Callander, 2015; Cameron, 2012; Jones, 2012). CSR activities have the potential to create stronger relationships between firms and stakeholders (Peloza and Shang, 2011). The linkage between CSR and financial performance has remained unclear with literature showing contradicting information. Literature available can be grouped into three: those which find positive relationship, for example Stanwick and Stanwick
(1998) and Posnikoff (1997) suggesting that CSR improves firms’ value; those which find negative relationship, for example Wright and Ferris (1997) adopting the idea that firm must use its resources only to maximize its profits and otherwise it will have adverse results; and those which find neutral relationship, for example studies by Welch and Wazzan (1999).

While commenting on the top ten factors affecting stock market, Gordon (2014) states that formal company announcements and news can also affect a market trend analysis. Good news or bad news can cause a rise or a fall in stock prices. Company layoffs can reduce consumer trust in the future of a company and result in less-valuable stock. However, positive CSR activities and initiatives are an indication of growth and can lead to better stock performance. The relationship between CSR announcement and stock returns can be analyzed by the use of event study methodology to assess the short-run financial impact (abnormal returns) when firms engage in either socially responsible or irresponsible acts. Generally, the greater the uncertainty as to the content and timing of the corporate information release, the higher the potential for the release to cause a revision in security prices (Osei, 2002).

1.1.4 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) has a long history that can be traced to the 1920’s when it started trading in shares while Kenya (IFC/CBK, 1984). While share trading was initially conducted in an informal market, there was a growing desire to have a formal market that would facilitate access to long-term capital by private enterprises and also allow commencement of floating of local registered Government loans (Ngugi, 2003). In July 2011, the Nairobi Stock Exchange Limited changed its
name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments.

Stakeholders in any firm listed in Nairobi Securities Exchange include employees, providers of finance, government, community and environment, consumers of the firm's products and special interest organizations or groups. CSR demands that good corporate leadership and governance should therefore strive to maintain a balance between the organizational interests and those of stakeholders in order for the organization's business to be conducted in a profitable and sustainable manner. This requirement transcends across both for profit and not-for-profit organizations whether public or private. Many organizations in Kenya such as the Kenya Commercial Bank (KCB), Safaricom and the East African Breweries have formed foundations to help them implement their respective CSR programs (Kamau, 2014).

The NSE currently has 64 listed companies. These have been grouped into 8 main segments namely, agricultural, automobiles, banking, commercial and services, construction, energy and petroleum, insurance, investment, manufacturing and telecommunications.

1.2 Research Problem

The primary hypothesis for capital market efficiency is that stock prices accurately and quickly reflect all available information in such a way that no one can earn abnormal return. The time for the adjustment of any new information is considered a
critical factor. If the market adjusts more rapidly and accurately, it is considered more efficient (Imafidon and Arowoshegbe, 2015). Several studies have empirically been done on the release of new information in the market that affects the prices of market securities, changing expectations of investors and fund users and thus alters expected returns on a stock based on new anticipated information, for example, Ball and Brown (1968) on earning announcements; Fama, Fisher, Jensen and Roll (1969) on stock splits; Mandelker (1974) on mergers; Aharony and Swary (1980) on dividend changes; and Asquith and Mullins (1986) on common stock issuance.

In the last five years, companies in Kenya have taken CSR with a different perspective, with CSR programmes ranking high on the corporate plans of most organizations. These CSR programmes include improving staff welfare and work environment, embracing transparency and accountability and implementing community development initiatives. However, it is the community component that is highly visible to most people and gives companies that much sought public image. For many organizations, CSR was once a purely philanthropic activity to arouse public goodwill with no consequence on profitability.

In Kenya, most studies on CSR examine the link between social responsibility and accounting-based indicators of financial performance. For example, Simon (2014) conducted a study on the effects of corporate social responsibility on performance of top 100 small and medium enterprises while Daniel (2013) looked at the effect of corporate social responsibility on financial performance of commercial banks. This study attempted to fill this gap by answering the following research question: What is
the effect of corporate social responsibility announcement on stock returns of listed firms at Nairobi Securities Exchange?

1.3 Objectives of the Study

The objective of this study is to establish the effects of corporate social responsibility announcement on stock returns of listed firms at Nairobi Securities Exchange.

1.4 Value of the Study

The results of this study will be of interest to investors and financial analysts who assess firm performance and policy makers who design and implement guidelines on corporate social responsibility.

The research will also inform managers on the importance of accurate and timely release of information on corporate social practices for decision making. In addition, the recommendations from this research will be beneficial to other firms willing to incorporate CSR practices in their various business operations.

Lastly, the study will also add value to the body of knowledge already available in this area, as well as providing opportunity for further research.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter focuses on the theoretical and empirical literature review. It contains theories and review of studies that have been done on CSR and financial performance. The chapter discusses relevant theories related to the study problem, the determinants of stock returns, empirical studies and thereafter provides a summary of the literature review.

2.2 Theoretical Review

In spite of the variety and complexity of approaches related to CSR, there are some proposals which have become mainstream theories on normative CSR. Among the theories are: the Signaling Theory, Efficient Market Hypothesis (EMH) Theory and the Stakeholder Theory.

2.2.1 Signaling Theory

The Signaling Theory was introduced by Ross (1977) and Bhattacharya (1979). The theory suggests that individuals use various clues dropped by the firm to draw conclusions about the firm’s intention or actions (Srivastava and Lurie, 2011). According to Connelly et al. (2011), Signaling Theory is used to describe behavior between two parties who have access to different information. Financial information acts as a means of passing information from managers to stakeholders.

The Signaling Theory states that corporate financial decision and communications are signals sent by company managers to investors in order to minimize information
asymmetry and to facilitate rational investment decisions (Elton et al., 2009). These signals are the basis of financial communication policy. Information asymmetry occurs when one group of participants has better or timelier information than other groups. A signal is an action taken by the more informed that provides credible information to the less informed. Typically, the source of the information asymmetry is the superior knowledge that managers have about the firm’s prospects, while the investors in the firms comprise the uninformed group (Black, 1998).

### 2.2.2 Efficient Market Hypothesis

The concept of efficient securities markets has gained prominence in both the academic and business world of today. The concept is now supported by empirical evidence from many of the world's markets (Muragui, 1990). Fama (1970) defines an efficient securities market as one in which prices fully reflect the available information. He categorizes market efficiency into three. First, the weak form of efficiency in which security prices reflect all historical information. Second, the semi-strong form of efficiency in which security prices reflect all publicly available information. Third, the strong-form of market efficiency in which, security prices include all private information.

The Efficient Market Hypothesis is associated with the idea of a “random walk,” which is a term loosely used in finance literature to characterize a price series where all subsequent price changes represent random departures from previous prices. The logic of the random walk idea is that if the flow of information is unimpeded and information is immediately reflected in stock prices, then tomorrow’s price change will reflect only in tomorrow’s news and will be independent of the price changes.
today. However, news is by definition unpredictable and therefore resulting price changes must be unpredictable and random (Malkiel, 2003). It is also important to note that capital markets react to various corporate announcements, such as CSR announcement. In an efficient market, if the announcement conveys vital information, then it is assumed that such information will be reflected by stock price movements as soon as the information is publicly released to the market. (Hussin et al., 2010)

2.2.3 Stakeholders Theory

Stakeholder Theory, which has been described by Edward Freeman and others, is the mirror image of CSR. Instead of starting with a business and looking out into the world to see what ethical obligations are there, Stakeholder Theory starts in the world. Stakeholder Theory suggests that management has to satisfy several groups who have some interest or stake in a firm and can influence its outcome (McWilliams et al., 2006). Regarding corporate financial performance, it can, therefore, be worthwhile to engage in CSR because otherwise these stakeholders could withdraw the support for the firm.

Stakeholders in an organization include employees, providers of finance, government, community and environment, consumers of the organization's products and special interest organizations or groups. CSR demands that good corporate leadership and governance should therefore strive to maintain a balance between the organizational interests and those of stakeholders in order for the organization's business to be conducted in a profitable and sustainable manner. This requirement transcends across both for profit and not for profit organizations whether public or private (Kamau, 2014).
2.3 Determinants of Stock Returns

Many factors can cause the price of a stock to rise or fall from specific news about a company’s corporate social responsibility practices to a change in how investors feel about the stock market in general. This section reviews some of the factors that determine stock returns.

2.3.1 Size of the Firms

The size of the firm is expected to influence stock returns positively as large firms are better diversified than smaller ones and therefore are less risky (Benishy, 1961). Atiase (1985) showed that as the size of the firm increases, their stock volatility declines. It has been noted that smaller firms tend to invest less in CSR than bigger firms. Bigger firms have greater visibility, engage in more and better social initiatives, have more resources that can be invested in CSR activities and attract more attention from different stakeholders whose needs are of primary importance (Waddock and Graves, 1997). For this reason, it is important to take into account the firm’s size when analyzing the relationship between CSR and stock returns.

2.3.2 Profitability of the Firm

One of the important criteria that is used to access a firm’s financial performance is the profitability of the firm. The profit that is left over with a firm after paying tax and preference dividend is the earnings available to equity shareholders of the firm. The firm utilizes these earnings to distribute dividends to shareholders. The higher the after tax profit the higher is the earnings available to equity shareholders and hence the scope for increased dividends payout. Higher dividends payout would in turn enhance the market price of the firm’s share and therefore a positive relationship
exists between share prices and profitability (Wanjiku, 2014). To examine the influence of profitability on share prices, Return on Assets (ROA), which is the ratio of profit after tax to total assets, is used (Nirmala, 2012).

2.3.3 Corporate Social Responsibility

When you get positive news about a company then it can increase the buying interest in the market. On the other hand, when there is a negative press release, it can ruin the prospect of a stock. CSR is aimed at maximizing shareholder value measured by profitability. CSR activities are also viewed as strategic goal of achieving competitive advantage by investing in philanthropic activities, identifying strategic social and ethical resources and capabilities and through disruptive innovations, which would produce long term profits. CSR is also viewed from marketing perspective in which, it is the process of formulating and implementing marketing activities that are characterized by an offer from the firm to contribute a specified amount to a designated cause when customers engage in a revenue-providing exchanges that satisfy organizational and individual objectives (Okwoma, 2012). This implies the role of CSR is a determinant of firms’ stock returns.

2.4 Empirical Review

Arya and Zang (2009) looked at institutional reforms and investor reactions to CSR announcements for emerging economies. The scholars conducted an event study methodology to demonstrate how the timing of CSR announcements by firms that have aligned their strategies to newly instituted social regulations in South Africa have influenced stock prices. Using a unique dataset of publicly listed South African enterprises that undertook CSR initiatives during the ten year period from 1996 to
2005, the study found that investor reactions to CSR announcements concluded during the late phase of institutional reforms were viewed positively by investors. Furthermore, CSR announcements of substantive monetary value result in significantly higher shareholder returns. While the South African and Kenya share comparable in many contexts, there is need for a research in Kenya since the market value of CSR in emerging economies varies as institutions evolve.

Cellier and Chollet (2011) studied the European markets by looking at the impact of CSR rating announcement on stock prices. Using an event study methodology, the study analyzed the influence of Vigeo CSR rating announcements from 2004 to 2009 on short term European stock returns. The results showed a positive significant effect of the announcement on stock returns over two days prior and two days following. The study concluded that CSR provides additional financial information taken into account by markets, modifying investors’ beliefs and firms’ valuation. Whereas the study used CSR rating of firms, it is argued that poor social and environmental ratings can harm a company’s performance and reputation. Furthermore, social ratings are rarely evaluated and have been criticized for the lack of transparency.

Ramchander et al., (2011) sought to establish the informational relevance of CSR. This study examined the informational and competitive effects of CSR on shareholder wealth. The informational attribute of CSR is measured by considering public announcements of reconstitutions to the DS400 index. The Index is a widely recognized stock index that comprises companies that have positive environmental, social and governance performance relative to their industry and sector peers. The results of the study indicated that firms that engage in effective and credible
stakeholder management are rewarded with a positive share price reaction surrounding the CSR announcement. Actions that improve relationships among primary stakeholder groups, for example, strengthening employee ties, developing sustainable practices, creating reputational links with customers and other stakeholders, among others, are a signal to outside investors that the firm is investing in those stakeholder-related CSR activities that build competitive advantage and create long-term value for shareholders. The findings of this study apply to publicly held firms and do not necessarily extend to privately held companies, which may face a different set of constraints and objectives.

Lacher and Hagendorff (2012) in the study on CSR announcements and shareholders wealth in the UK investigated the stock market reaction to the announcement that a firm has been included in the UK FTSE4Good Index of socially responsible firms. The study used the announcement of firm inclusion in the index to estimate the stock market reaction to a firm being classified as socially responsible. The sample consisted of announcements of firms traded on the London Stock Exchange which were included in the FTSE4Good Index over the period July 2001 to March 2008. The study did not find strong evidence in favor of a positive market reaction. However, the study finds a large cross-sectional variation in the market reaction to this announcement – indicating that investors appear to react to the event.

Arx and Ziegler (2013) analyzed the effect of CSR on stock performance by measuring the environmental and social activities of a firm compared with other firms within the industry. The study provided new empirical evidence by examining two different regions, namely the USA and Europe, and disentangled firm and sector
specific impacts. The results showed that the stock markets and particularly the US stock market rewarded investments in stocks of corporations with a high intensity of environmental and social activities compared with other firms within the industry. Regarding the management of a firm, these results imply that such measures could be increased since they do not lead to worse financial performance. This study applied different asset pricing models for the explanation of stock performance: the three-factor model according to Fama and French (1993) and the four-factor model according to Carhart (1997), besides the simple Capital Asset Pricing Model (CAPM). Whereas Arx and Ziegler’s study compared firms from the same industry in two regions, it is also important to compare their results with a study of firms from different industries in two regions.

Kamau (2012) looked at the relationship between corporate social responsibility and cost of capital for companies listed in Nairobi Securities Exchange. The study adopted a descriptive research design and was based on multiple linear regression analysis of secondary data. Data was collected from five companies which were listed in Nairobi Securities Exchange under Agricultural, Construction and Manufacturing and Allied Segments. The results indicated the existence of a negative relationship between the independent variable (corporate social responsibility score) and the dependent variable (cost of capital). The findings of this research revealed that both efficiency and capital intensity had a direct relationship with cost of capital while CSR had an inverse relationship with cost of capital. However, the study used only financial spending as a measure of CSR.
Daniel (2013) analyzed the effect of CSR on financial performance of commercial banks in Kenya. Data was obtained from commercial banks audited financial statements, websites, publications and annual reports. Commercial institutions that did not participate in CSR activities or that had not kept data pertaining to CSR were excluded. Secondary data from the year 2009 to 2013 was used for analysis. Using descriptive research design, the study tested for linear relationship between financial performance and corporate social responsibility. The study used multiple regression analysis and the five years secondary data to analyze the effect of corporate social involvement on financial performance. The study revealed that CSR has a positive and significant effect on firm’s financial performance. The nature of CSR activities also determined the level of profitability.

Simon (2014) investigated the effect of CSR on financial performance of 100 top small and medium enterprises in Kenya. The study used descriptive survey research design with data obtained from secondary sources such as published financial statements, chairman’s statement and notes to the financial statements for five years period from 2009 to 2013. The study revealed that CSR has significant positive effect on financial performance of small and medium sized enterprises in Kenya. The study also found that the size of SME has significant effect on profitability where bigger SMEs have better financial performance than small ones. However, the study did not capture all the aspects of CSR activities in the SME. It only focused on the amount spent on CSR activities.

Matheka (2014) sought to establish whether there is relationship between socially responsible investment and sustainable financial performance of commercial banks in
Kenya. The study adopted a descriptive correlation design and targeted all the forty four commercial banks in Kenya. The study found that there is a positive relationship between social responsible investment and financial performance of commercial banks in Kenya.

2.5 Summary of Literature Review

The literature reviewed three theories on CSR. These are Signaling Theory, Efficient Market Hypothesis Theory and Stakeholders Theory. Stakeholder Theory involved balancing interests of various groups of stakeholders. The concept of market efficiency when used with respect to speculative markets means that market prices should fully and instantaneously reflect all information available to market participants. Information, in this sense includes everything that is currently known about the stock and the future expectations such as social responsibility practices. Signaling Theory suggests that individuals use various clues dropped by the firm to draw conclusions about the firm’s intentions or actions. In spite of these different approaches, all theories integrate social demands and want to contribute to the society.

There is little doubt that CSR is now a global concept and a prominent feature of international business, with its practice localized and differing across countries. The general problem is that the literature presents inconsistent findings on the relationship between CSR and financial performance. Studies have found positive, negative and no relationships. However, there is a limited research on the effects CSR announcement and stock returns in Kenya. Most studies examine the link between social responsibility and accounting-based indicators of financial performance.
The specific focus of this study is therefore intended to fill the above gap by addressing the following concerns. First, instead of using perceptual or largely subjective ratings of corporate social responsibility, the study will use actual announcements of corporate practices proxies for social irresponsibility. Secondly, rather than using some variation of the typically employed accounting-determined profitability measures, which are inadequate when making large cross-sectional comparisons across industries and across time (Davidson, Worrell and Gilhertson, 1986; Merchant and Burns, 1986), this study will assess financial performance by means of stock returns.
CHAPTER THREE: RESEARCH

METHODOLOGY

3.1 Introduction

The purpose of this study is to establish the effects of CSR announcement on stock returns of companies listed in NSE. This chapter outlines the research methodology that was used in the study in terms of explaining the research design, study population and data collection and analysis techniques.

3.2 Research Design

This study design is descriptive in nature. Descriptive designs explain phenomena as they exist and are often used to obtain information on the characteristics of a particular problem or issue. Market trends and reactions will be analyzed in terms of changes in share prices and returns. Event study methodology will be used to measure the effects of an unanticipated event on stock prices. According to McWilliams, Siegel and Teoh (1999) the event study methodology was developed to assess the effect of an unanticipated event on stock prices. That is, it measures the average change in share price that occurs when a major event is announced.

An event study would quantify the relationship between firm specific events like CSR practices and stock return. The event window will be set at 11 days, comprising of five days before day $t=0$ (which is the announcement day) and 5 days after announcement day. This will capture any abnormal returns before and after the announcement or any information that might have leaked out before the
announcement date. Brown and Warner (1985; 1987) showed that using a long event window reduces the power of the test statistic. This reduction leads to false inferences about the significance of the event.

3.3 Population of the Study

CSR disclosure falls within the realm of voluntary reporting. This means, unlike financial reporting, CSR disclosure are currently subjected to very limited regulations (Dhaliwal et al., 2011). The study population comprise of all the 64 listed companies in the main market of NSE as at August 2015. These have been grouped into 8 main segments namely; agricultural, automobiles and accessories, banking, commercial and services, construction and allied, energy and petroleum, insurance, investment, manufacturing and allied, and telecommunication and technology (see Appendix 1). A census of the population was done, the study looked at companies which have had CSR announcements during the period of 2011 and up to 2014, which w the overall event window.

3.4 Methods of Data Collection

The study used secondary data obtained from Nairobi Securities Exchange. Share prices for each of the 64 listed companies in the main market of NSE as at August 2015 were recorded in a recording schedule – specifying the share price five days before the announcement day and 5 days after announcement day from 2011 to 2014.

3.5 Data Analysis

The returns on the individual stock \( R_{it} \) and the returns on the market stock \( R_{mt} \) were calculated. A regression analysis of the rate of return on share price of firm \( i \) on day \( t \), and the rate of return on a market portfolio on day \( t \), were used to obtain the residual
and parameter estimates which were recorded. The least square parameters $a$ and $b$ were obtained from the regression of $R_{it}$ and $R_{mt}$ over an estimation period (T). The market model was used to calculate the daily abnormal returns. The abnormal returns data was analyzed using SPSS and Excel. Further analysis was done using SPSS. Analyzed data was summarized using tables, charts and graphs. Inferences and conclusions were made based on the analysis.

### 3.5.1 Estimating the Normal and the Abnormal Return

According to Panayides and Gong (2002), an 11 day event window fully captures the effects of an event of interest. The window begins 5 days prior to the event date and ends 5 days after. The study intends to determine 70 days (30 days prior, 11 days event window and 30 days post event window) daily returns surrounding each stock around the CSR announcement. The standard approach is based on estimating a market model for each firm and then calculating abnormal returns. The market model is a statistical model which relates the return of any given security to the return of the market portfolio. These abnormal returns are assumed to reflect the stock market’s reaction to the arrival of new information.

The standard market model by Mackinlay (1997) is used:

$$R_{it} = \alpha_i + \beta_i R_{mt} + E_{it}$$

Where:

- $R_{it}$ is the rate of return on the share price of firm $i$ on day $t$;
- $R_{mt}$ is the rate of return on a market portfolio of stocks (NSE 20 share index) on day $t$;
\( \hat{\alpha}_i \) is the intercept term; 
\( \beta_i \) is the systematic risk of stock \( I \); and 
\( E_{it} \) is the error term with \( E_{it} \) = 0

Daily actual returns are defined as:

\[
R_t = \frac{P_{i_{t+1}} - P_{i_t}}{P_{i_t}} + \frac{D_i}{P_{i_t}}
\]

Where:

\( P_{i_t} \) and \( P_{i_{t+1}} \) is the price of stocks of day \( t_0 \) and \( t_1 \) respectively and \( D_i \) is the expected dividend.

Abnormal return is defined by taking the difference between the observed and the expected return, as follows:

\[
AR_t = R_t - ER_t
\]

Where:

\( AR_t \) is the flow of abnormal return; and 
\( ER_t \) is the expected return (normal return)

The expected return is calculated over all \( n \) sample data points, while the abnormal return will be calculated over the event period.

Following Dodd and Warner (1983) model the standardized abnormal return (SAR) was computed, where the abnormal return is standardized by its standard deviation as:
\[ SAR_t = \frac{AR_t}{\text{StdAR}} \]

Where

\( SAR_t \) = the standardized abnormal return for time \( t \) and

\( \text{StdAR} \) = standard deviation of abnormal returns of the event period.

The standardized abnormal returns (\( SAR_t \)) are then cumulated over the days, (event window) to get cumulated abnormal returns (\( \text{CAR} \)) for each firm.

\[ \text{CAR} = \sum_{i=1}^{t=2} AR_t \]

The standard assumption is that the values of \( \text{CAR} \) are independent and independently distributed.

\( \text{CAR} \) is then divided by its standard deviation.

\[ \text{SCAR} = \frac{\text{CAR}}{\text{StdCAR}} \]

Where \( \text{SCAR} \) is the standardized cumulative abnormal return and \( \text{Std CAR} \) is the standard deviation of cumulated abnormal returns.

The results for these are displayed on the findings and analysis in the next chapter.

3.5.2 Test of Significance

Testing the significance of the abnormal return was done using standard \( t \)-test statistics at 95% significance level. Using the model, the study determined the effects of the announcement of corporate social responsibility on stock prices for the companies listed at the NSE.
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The objective of the study was to investigate the effect of CSR announcement on stock returns of firms listed in Nairobi Securities Exchange. To meet this objective, data comprising adjusted share prices traded for eight companies listed in Nairobi Securities Exchange that had CSR announcement between 2011 and 2014 were collected in order to analyze the movement of prices of shares within the window period of 11 days.

This chapter presents the study findings and interpretations. The actual returns, expected returns, abnormal average abnormal returns and cumulated average abnormal returns are presented in form of charts. A t-test is carried out on the values to determine if the change is significant. A 95% confidence is used thus if t value is above 1.96 in absolute terms then it is significant.

4.2 Descriptive Statistics

Analysis in this chapter has been done by determining the mean abnormal returns of the security returns for the study period of 5 days before and 5 days after the announcement of CSR activity. The significant difference between the mean abnormal return before announcement and mean abnormal return after the announcement as tested by t-statistic at 95% significance level helped to describe the reaction of stock return when information about CSR activity reaches the security market. Cumulative abnormal average return is also used to describe the overall results. The results of the data analysis for each year are as are summarized below.
4.2.1 Actual Returns

The study sought to describe the actual returns for the event period. Data is presented in the figure 4.1 below.

**Figure 4.1: Actual Returns**

![Actual Returns Graph](image)

The findings show that in all the event period actual returns curve generally appear to be decreasing before the CSR announcement date, this implies that the market was not expecting the CSR news to have any positive impact. The curve shows growth after the announcement date which implies that investors received the information content they were not expecting.

4.2.2 Expected Returns

The study sought to describe the expected returns for the event period. Data is presented in the figure 4.1 below.
The findings show that the expected returns curve was low before the announcement date, on the day of the event the expected returns curve increased. The slope showed an upward movement from the second day after the announcement day. This implies that investors did not expect any good news during the CSR announcement but a day after the announcement the expected returns curve increased which showed that the market agreed with the information content.

4.2.3 Normality Test Results

The average abnormal returns were tested to determine whether they were significantly different from zero to derive conclusions about the semi strong form of efficiency of the NSE. Table 4.1 presents the findings.
### Table 4.1 Abnormal Returns Statistics

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<tr>
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<tr>
<td>Mean</td>
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<tr>
<td>Kurtosis</td>
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<tr>
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<tr>
<td>Maximum</td>
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<tr>
<td>Sum</td>
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<td>Largest(1)</td>
<td>0.009278011</td>
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<tr>
<td>Smallest(1)</td>
<td>-0.011462022</td>
</tr>
<tr>
<td>Confidence Level</td>
<td>0.004397132</td>
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</table>

Tests of normality were done for the abnormal returns and they revealed the results of Skewness test result of 0.483352323 and kurtosis test result of -0.326861968. The computation was symmetric since the Skewness was more than zero meaning that it was skewed to the right, most values are concentrated on left of the mean, with
extreme values to the right. This implied that there was a long right tail which for investors meant a greater chance of extremely positive outcomes. Kurtosis was used to show the degree of peak in the distribution. Since kurtosis was negative, the distribution had fatter tails and that there were lesser chances of extreme outcomes as compared to a normal distribution.

4.3 Performance of Average Abnormal Returns

The average abnormal returns were plotted against the event period. Data is presented in figure 4.3 below.

Figure 4.3: Average Abnormal Returns

The curve for average abnormal returns for slopes generally downwards for the 5 days before the CSR announcement date, and is generally upward sloping apart from day 2 of the announcement for the 5 days after the announcement. The curve for
average abnormal returns fluctuates both before the CSR announcement date and after, the curve is negative before the CSR announcement date and positive two days after the dividend announcement date. The increasing average abnormal returns around CSR announcements indicate the importance of the information content of the CSR announcement to the market.

4.3.1 Average Abnormal Returns T-Test

The study ran a T-Test for average abnormal returns in order to determine if it is possible to make profits or abnormal returns from the CSR announcement information in the NSE. Table 4.2 presents the findings.

**Table 4.2: Average Abnormal Returns T-Test**

<table>
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<tr>
<th>Variable 1</th>
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<td>Pearson Correlation</td>
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<tr>
<td>Hypothesized Mean Difference</td>
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</tr>
<tr>
<td>df</td>
<td>4</td>
</tr>
<tr>
<td><strong>t Stat</strong></td>
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<tr>
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<tr>
<td>t Critical one-tail</td>
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<tr>
<td>P(T&lt;=t) two-tail</td>
<td>0.695776053</td>
</tr>
<tr>
<td>t Critical two-tail</td>
<td>2.776445105</td>
</tr>
</tbody>
</table>

The t-statistic value is -0.420428306. The t-values are less than 1.96, this means that there is no significant change in stock returns as a result of CSR announcements,
meaning any abnormal returns associated with earnings announcement are therefore the result of chance.

4.4 Performance of Cumulative Average Abnormal Returns

By summing up the ARs of the announcements, the study obtain the cumulative abnormal returns across all announcements. Data is presented in figure 4.4 below.

Figure 4.4: Cumulative Average Abnormal Returns

The CAAR drifts before as well as after the announcement day (Day 0). This implies that the market does get some information about the occurring event some time before it is actually announced, and that there are market reactions that affects the stock returns after the event has been announced as well. The CAAR curve shows there is a drop in the stock returns right before the event and at day 0, followed by an incline the second day, the curve stabilizes and until it continues to drift downwards again.
4.3.1 Cumulative Average Abnormal Returns T-Test

The study run a T-Test for cumulative average abnormal returns in order to determine if it is possible to make profits or abnormal returns from the CSR announcement information in the NSE. Table 4.3 presents the findings.

**Table 4.3: Cumulative Average Abnormal Returns T-Test**

<table>
<thead>
<tr>
<th></th>
<th>Variable 1</th>
<th>Variable 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>-0.062878006</td>
<td>-0.078432664</td>
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<tr>
<td>Variance</td>
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<td>2.18613E-05</td>
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<tr>
<td>Observations</td>
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<td>5</td>
</tr>
<tr>
<td>Pearson Correlation</td>
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<td></td>
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<tr>
<td>Hypothesized Mean Difference</td>
<td>0</td>
<td></td>
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<tr>
<td>df</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td><strong>t Stat</strong></td>
<td><strong>4.740482655</strong></td>
<td></td>
</tr>
<tr>
<td>P(T&lt;=t) one-tail</td>
<td>0.004516992</td>
<td></td>
</tr>
<tr>
<td>t Critical one-tail</td>
<td>2.131846786</td>
<td></td>
</tr>
<tr>
<td>P(T&lt;=t) two-tail</td>
<td>0.009033984</td>
<td></td>
</tr>
<tr>
<td>t Critical two-tail</td>
<td>2.776445105</td>
<td></td>
</tr>
</tbody>
</table>

The t-statistic value is 4.740482655 the t-values are more than 1.96, this means that there is a significant change in stock returns as a result of CSR announcements, meaning any cumulative abnormal returns are associated with the CSR announcement.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the research conducted in this study. It also describes the theoretical contribution this research brings to the scholars and the managers in the field of corporate social responsibility. Last but not least, this section presents the limitations of this study and matters for future research.

5.2 Summary of findings

In today’s hypercompetitive and socially conscious environment, managers face ever growing pressures to balance shareholder value with societal welfare. Indeed, if CSR is seen to have a significant influence on the financial value, it can motivate companies to focus on maximizing the positive and minimizing the negative social implications of their actions and strategies. Unfortunately, the issue of whether there is a positive or negative CSR effect on the financial value of firm’s remains a topic of intense debate among scholars (Mishra & Modi, 2013). Scholars have failed to identify the definite relationship between CSR and financial performance of a company. Although, Becchetti et al., (2012) found mostly a positive effect, but the negative and neutral reactions are also observed.

Therefore, the goal of this research was to fill in this gap through conducting a quantitative study for analyzing the stock market reaction to the CSR announcements of companies listed at NSE. An event study methodology with a market Model was employed to find out whether the CSR announcements have any effect on stock returns.
This study examined the responsiveness of stock prices to CSR announcements on listed firms at the NSE. The study assessed the usefulness of CSR announcement to investors who trade at the stock exchange. A 71 day event window from (-35 to +35) was chosen in order to come up with normal market returns and to capture possible pre-event reaction. This is due to the abnormal nature of the information environment in developing stock markets, where there is a possibility for the markets to start reacting long before the actual announcements. Abnormal returns were calculated from the collected data capturing daily closing prices of individual firms. From the ARs the researcher obtained CARs through the summation of ARs that made it possible to make generalization and to draw overall conclusions.

Tests of normality were done for the abnormal returns and they revealed the results of Skewness test result of 0.483352323 and kurtosis test result of -0.326861968. The computation was symmetric since the Skewness was more than zero meaning that it was skewed to the right, most values are concentrated on left of the mean, with extreme values to the right. This implied that there was a long right tail which for investors meant a greater chance of extremely positive outcomes. Kurtosis was used to show the degree of peak in the distribution. Since kurtosis was negative, the distribution had fatter tails and that there were lesser chances of extreme outcomes as compared to a normal distribution.

By summing up the ARs of the announcements, the study obtain the cumulative abnormal returns across all announcements. The CAAR curve shows there is a drop in the stock returns right before the event and at day 0, followed by an incline the second day, the curve stabilizes and until it continues to drift downwards again. The CAAR drifts before as well as after the announcement day (Day 0) implies that the market does get some information about the occurring event some time before it is actually
announced, and that there are market reactions that affects the stock returns after the event has been announced as well.

The t-statistic value is 4.740482655 the t-values are more than 1.96, this means that there is a significant change in stock returns as a result of CSR announcements, meaning any cumulative abnormal returns are associated with the CSR announcement.

5.3 Conclusions and Recommendations

The objective of this study was to determine the effect of bonus issue announcement on share prices of listed banks at the NSE was tested and the results indicated that even in Kenya, bonus issue announcement impacts on stock returns. Based on the cumulative average abnormal returns of the companies this study concludes that the CSR announcement is information incorporated in stock prices, CSR announcement have an over-all significant positive impact on the stock market. Moreover, the stock prices react differently according to the component of corporate responsibility practice.

The world is dependent on massive CSR efforts from companies around the globe, and it is very beneficial for society that the study finds a positive relationship. The amount of CSR efforts in Kenya has grown in the last five years and most companies now have a well-established CSR programs.

Therefore, it seems that CSR efforts have become something that now is expected by the market, rather than something that companies do voluntarily. This positive relationship between CSR and a firms’ stock returns, makes it easier to motivate more firms to perform CSR. Thus, proving a positive relationship may contribute to increasing the overall CSR efforts that firms perform, which furthermore could help
improving various issues and challenges all over the world, therefore companies should maintain their CSR investments in the future.

5.4 Limitations of the study

The strength of the study would have increased if the sample size of the announcements was increased. Although a sample size of 32 CSR announcements is a decent amount, the trustworthiness of our results would increase with more announcements.

This study relied on data from a selected firms listed at the Nairobi securities exchange, making it difficult for the findings to be generalized to non-listed firms.

This study is limited in scope to one developing securities market (NSE), future work may be carried out for other developing markets in the Africa region to ascertain the extent to which the findings are generalizable.

Another limitation was on the event study methodology as pointed out by Wong (2013) is the assumption of an efficient market. This tends to be not valid in many of the situations. The length of time required for individual investors to respond to event signals is random and therefore, the implication is that markets could exhibit market inefficiencies because prices do not instantly or fully reflect all available information.

5.5 Areas for further research

A topic for future research would be to analyze the effects of finished CSR projects on the value of companies. Instead of looking at the effects of CSR announcements presenting a new CSR project, it would be interesting to know how the value of a company changes when the completion of a large CSR project is announced. Perhaps
the market would value the results of CSR projects positively, and hence suggest that CSR projects have a positive influence on the value of a company.

It would also be interesting to see a research that identifies companies that do not perform CSR activities, and analyze how these companies perform compared to firms that do perform CSR activities. Hopefully, for the greater good of our society, this study could prove that firms that do not perform CSR activities underperform compared to the firms that do perform CSR.

The results of this research only portray the short-run stock market reaction. Hence, future research should consider looking at how and if CSR announcements affect shareholder value and firm performance in the long-run. To examine this matter, one could regress long-run measures of firm value and firm performance such as return on assets and net profit margin against proxies for CSR.

Lastly, future studies can look at the effect of CSR announcements on the companies’ revenues in order to see customers’ perspective on corporate social responsibility.
REFERENCES


Atiase R., Pre-disclosure information, firm capitalization, and security price behavior around earnings announcements. *Journal of Accounting Research, 23*(1), 21-36.


## APPENDIX I

### Listed Companies in Kenya at the Nairobi Securities Exchange

#### AGRICULTURE
- Eaagads Limited
- Kapchorua Tea Company Limited
- Kakuzi Limited
- Limuru Tea Company Limited
- Rea Vipingo Plantations Limited
- Sasini Limited
- Williamson Tea Kenya Limited

#### AUTOMOBILES AND ACCESSORIES
- Car and General Limited
- Sameer Africa Limited
- Marshalls (E.A.) Limited

#### BANKING
- Barclays Bank Limited
- CFC Stanbic Holdings Limited
- I&M Holdings Limited
- Diamond Trust Bank Kenya Limited
- Housing Finance Co. Limited
- Kenya Commercial Bank Limited
- National Bank of Kenya Limited
- NIC Bank Limited
- Standard Chartered Bank Limited
- Equity Bank Limited
- The Co-operative Bank of Kenya Limited

#### COMMERICAL AND SERVICES
- Express Limited
- Kenya Airways Limited
- Nation Media Group
- Standard Group Limited
- TPS Eastern Africa (Serena) Limited
- Scangroup Limited
- Uchumi Supermarket Limited
- Hutchings Biemer Limited
- Longhorn Kenya Limited
- Atlas Development and Support Services

#### CONSTRUCTION AND ALLIED
- Athi River Mining
- Bamburi Cement Limited
- Crown Berger Limited
- E.A. Cables Limited
- E.A. Portland Cement Limited

#### ENERGY AND PETROLEUM
- KenolKobil Limited
- Total Kenya Limited
- KenGen Limited
- Kenya Power & Lighting Co Limited
- Umeme Limited

#### INSURANCE
- Jubilee Holdings Limited
- Pan Africa Insurance Holdings Limited
- Kenya Re-Insurance Corporation Limited
- Liberty Kenya Holdings Limited
- British-American Investments Company (Kenya) Limited
- CIC Insurance Group Limited

#### INVESTMENT
- Olympia Capital Holdings Limited
- Centum Investment Co Limited
- Trans-Century Limited
- Home Afrika Limited
- Kurwitu Ventures
- Nairobi Securities Exchange Limited

#### MANUFACTURING AND ALLIED
- B.O.C Kenya Limited
- British American Tobacco Kenya Limited
- Carbacid Investments Limited
- East African Breweries Limited
- Mumias Sugar Co. Limited
- Unga Group Limited
- Eveready East Africa Limited
- Kenya Orchards Limited
- A.Baumann CO Limited
- Flame Tree Group Holdings Limited

#### TELECOMMUNICATION AND TECHNOLOGY
- Safaricom Limited
## APPENDIX II

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<thead>
<tr>
<th>EVENT PERIOD</th>
<th>ACTUAL RETURN</th>
<th>EXPECTED RETURNS</th>
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