

Human Rights and Multinational Firm Returns

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SOM theme A: Intra-firm coordination and change

Abstract

Corporate social responsibility receives increased attention in economic analysis and research, but the knowledge of the effect of ethical issues on company performance is still in its infancy. In this paper we attempt to measure the impact of the human rights issue with an event study. In particular the consequences of press releases of Amnesty International on the returns of multinational firms operating in Indonesia were analyzed. It proved that press releases did not influence the stock returns of these multinational companies significantly. We then discuss potential reasons for the absence of significant findings.

Introduction

In economic, managerial and investment research corporate social responsibility issues receive increased attention. This results in a multitude of approaches which range from essays on the relevance of moral philosophy to economists [Hausman and McPherson, 1993] to measuring attitudes and values of (future) managers [Brief, Doran and Dukerich, 1991; Gorman and Kehr, 1992]. Other researchers analyze corporate policy [Nicholson and Robertson, 1996; Schlegelmilch and Robertson, 1995] or study fund or corporate financial performance [Cochran and Wood, 1984; Cowton, 1994; Gregory, Matatko and Luther, 1997; Mallin, Saadouni and Briston, 1995; Pava and Krausz, 1996]. The ethical issues addressed also vary widely. Cowton [1994] and Pava and Krausz [1996], for example, present both negative and positive social responsibility screens used by mutual funds.

The negative screens refer to not investing in South Africa, in weapons, nuclear power or tobacco producing companies or in firms which pollute, etc. The positive screens are related to companies which address i.a. environment protection, employee relations, corporate citizenship, product quality, alternative energy, care for the elderly. As far as we know, however, until now no explicit attention is given to the impact of the human rights issue. With this we mean that governments disregard rights of individual beings by implicitly or explicitly allowing various forms of (sometimes brutal) force to be exercised. The authors' appraisal is that this issue will get increasing attention as the corporate world is rapidly changing its orientation from local to global.

In this paper we therefore present the results of an empirical investigation into the relevance of the human rights issue on the economic performance of multinational companies. Moreover, 50 years after the Universal Declaration of Human Rights (at December 10th, 1948), it may be useful to evaluate the results of this declaration for corporate behavior.

In the next sections we present the methodology, the data and the technique used. We then present the results of our empirical work, a discussion of our findings and the conclusions.

Methodology

In their presentation on the literature of measuring the impact of ethical issues Pava and Krausz [1996, p. 326] indicate that one of the most relevant problems in measuring economic performance is often the fact that "...socially-responsible investing is often a vague and ill-defined concept". In order to reduce vagueness we decided to use a rigorous procedure for focussing at the economic performance of companies. Four reasons caused us to choose for analyzing the financial returns of companies at stock exchanges. First, stock exchange data are not easily manipulated by company managers, as they represent prices actually paid by investors. Secondly, shareholders receive the residual cash flows of the company. Any effect of an ethical issue on company performance will more clearly be represented in the returns to the residual stakeholders, than in the returns to other

interest groups¹. Thirdly, data on the prices of shares listed at stock exchanges are abundant. Fourthly, a technique for analyzing these data is well described and well known among financial professionals [MacKinley, 1997]. This is the technique of event studies.

We thus used the technique of an event study for analyzing the impact of the issue of human rights. An event study avoids the drawbacks of traditional procedures used in analyzing the impact of ethics on economic performance, like Corporate Social Responsibility or Content Analysis as discussed by Cochran and Wood [1984]. An event study avoids both subjective measures related to Corporate Social Responsibility based on rankings of knowledgeable observers as well as the subjective choice of variables and window dressing problems related to Content Analysis of e.g. annual reports.

Operationalizing the Human Rights Issue

After having defined the method of analysis, we had to delineate the human rights issue. Because the issue of human rights is internationally regularly addressed by Amnesty International, we decided to analyze actions of this organization. A very special feature of the human rights issue is that it is a case against governments and not against individual companies. If human rights are violated by an individual company, the ethics involved would be classified as “employee-related” or more specifically as e.g. “child labor”. The government related definition of the human right issue implies that several, or even many, companies can be involved if a government disregards fundamental individual rights.

¹Companies from the United States usually consider good relationships with governments as contributing to Corporate Social Responsibility. Whether this is the case in countries where governments are violating human rights can be questioned. Stead, Worrell and Stead [1990, p. 236], for example, indicate that executives consider the competitiveness induced by the multinational business environment as a threat to American business ethics. Managing a multinational in a competitive global market may create a mental dilemma (or a trade-off) between cooperating with foreign governments and/or blaming these governments for violating human rights. If research would indicate that cooperation with a questionable governments reduces company value, it might assist managers to resolve the dilemma by abstaining from involvement.

In order to delineate the issue of human rights further, we should mention that human rights can be disregarded in a variety of ways. In particular the example of “apartheid” in former South-Africa can be considered to be an infringement on fundamental human rights. As indicated in the introduction we define the human rights issue as one where there is an implicit or explicit government allowance of (brutal) force to be used against individual beings.

The authors then had to choose a country in which human rights were at stake and by choosing a country, they also might implicate any companies investing there. The authors therefore like to remark that they do not want to extend cultural relativism to the point where they would become indifferent to the human rights issue, but they also do not advocate the idea that all governments addressed by Amnesty International could easily do better. The authors, moreover, would like to stress that they do not mean to say that multinational companies operating in these countries necessarily harm the people. The authors know that multinationals usually not only create employment opportunities, but that they usually also offer better employment quality than local producers (can) offer. Having said this, the authors, nevertheless, searched a country which in recent times violated human rights according to Amnesty International. As a target country we chose Indonesia. We then tried to define events which might affect shareholder value of multinationals dealing in that country.

Data

During the research the authors were confronted with several data restrictions. Firstly the London head-office of Amnesty International did not want to cooperate in providing data on their actions. We therefore decided to use modern technology. Through the Internet we searched the home page of Amnesty International and found information on press releases of Amnesty International on Indonesia. We then defined an action of Amnesty International as a situation where it issued a press release on Indonesia. That home page, moreover, indicated at what day a message was sent to the press. We therefore had an indication of the exact date that such a press release (an event) occurred. In order to delineate our research period, we decided to take 1996 as our reference year. By this

choice we discarded 1997 and the beginning of 1998, as that was a turbulent period caused by the forthcoming presidential elections and the financial crisis in South-East Asia. During 1996 we found six press releases of Amnesty International on Indonesia, namely April 12th, May 8th, July 23rd, July 30st, November 27th and December 9th.

We then searched for data from multinationals at the New York Stock Exchange which were known to have relations in South East Asia in the period involved [Leger, 1995/1996]. From the resulting 90 companies it was, however, not known whether they were trading with or had a subsidiary or a major investment in Indonesia. Again, we used the Internet for searching the home pages of these companies for relations with Indonesia. This resulted in eight multinationals (9%) which indicated to be involved in Indonesia. The companies for which we found relationships with Indonesia are presented in Table 1.

Having defined in this way both “actions” as well as “country involvement” and having found the event dates at which “actions” took place, we looked for time series of dividend reinvested daily returns at the New York Stock Exchange of each individual company. The data we used were provided for by Datastream®.

Event study technique

Measuring shareholder returns on a specified event day is, however, not adequate when other events at that day influence share prices too. It is therefore usual in event studies to correct as much as possible for these other influences, and in particular for changes in the overall index. For the year 1995 we therefore calculated for all relevant companies (i) the individual alpha (α_i) and beta (β_i) from daily (dividend reinvested) percentage returns (R_{it}) trading days according to the Market Model of equation (1).

$$R_{it} = \alpha_i + \beta_i R_{St} + \epsilon_{it} \quad \text{with } E(\epsilon_{it}) = 0 \text{ and } \text{Var}(\epsilon_{it}) = \sigma_{\epsilon_i}^2 \quad (1)$$

where: R_{St} = the “market rate of return” calculated from the dividend reinvested S&P 500 index (S) at trading day t.

The results of our SPSS-estimates of α_i and β_i are presented in Table 1, as well as the concomitant t-values and the estimated standard deviation of the residuals. The t-statistics indicate that the alpha’s never differed significantly from zero, while the beta’s always were highly significant.

Please put Table 1 here

We then assumed that the estimated characteristics of individual share prices would hold over 1996. With the daily returns on the S&P 500 index during 1996 and the estimated company alpha’s and beta’s (of Table 1) we revised the actual returns of individual companies during 1996. By this procedure we found the abnormal returns (AR_{it}) according to equation 2.

$$AR_{it} = R_{it} - \alpha_i - \beta_i R_{St} \quad (2)$$

where: α_i is the estimated alpha and β_i the estimated beta.

With market efficiency [Fama, 1970] the effects of a press release of Amnesty International will be incorporated in the share prices of the companies quickly. Because of time zone differences the press releases from the London head office of Amnesty International preceded the closing time of the New York Stock Exchange. The abnormal returns found at event days in New York may therefore (partially) be attributable to the press releases of Amnesty International. This means that we do not expect lead or lag times to exist. In this respect we deviate from many event studies which consider an event window of more than one day to be relevant. As a caveat we must therefore add that the forthcoming definitions of cumulative abnormal returns may differ from definitions used in other event studies.

Because individual companies may idiosyncratically be affected at the event day by

new information from other (non-index related) sources too, it may not be possible to infer from the abnormal returns of individual companies whether these are solely caused by the concomitant press release of Amnesty International. A negative AR_{it} may be attributable to other negative news on the multinational at the event day, while a negative effect of the press release may go unnoticed if it goes together with positive news on that specific company at the same day. In the latter case existing press-release effects may not be found.

The possibility of false inferences from such co-occurrences can be reduced in two ways. First, we may sum the abnormal returns of all (m) multinationals at the event date. This would mean that we expect that positive news (which is unrelated to the press release of Amnesty International) on a company at event day t might be compensated by negative news on another company at that same day or vice versa. Such cumulative returns are defined in equation 3.

$$CAR_t = \sum_{i=1}^m AR_{it} \quad (3)$$

where the summation is over the multinationals ($i = 1, \dots, m$) with $m=8$ at the event date (t).

This cumulation of abnormal returns could indicate the impact of individual events. The CAR_t defined in equation 3 can, unfortunately, not be tested on significance: because of the absence of covariance assumptions and a completely overlapping event window the standard deviation of CAR_t cannot be derived.

Second, we might cumulate the abnormal returns of each company at all press release days during 1996 according to equation 4.

$$CAR_{i,1996} = \sum_{e=1}^n AR_{ie} \quad (4)$$

where the summation is over the six event days ($e = 1, \dots, n$) with $n = 6$ in 1996.

This summation would be preferred if part of the abnormal returns at one particular event day could be attributed to news on the Indonesian economy unrelated to the situation of human rights, like announcements on interest rates, government spending or currency value. Moreover, this summation is open for significance testing, as with a large number

of observations in the estimation window (252) the variance of $CAR_{i,1996}$ is asymptotically approaching $n \cdot \sigma^2$; from above [see e.g. MacKinlay, 1997, p. 21 and 24].

Empirical results

The abnormal returns for the multinationals around a press release of AI on Indonesia at April 12th, 1996 ($t=0$) are presented in Table 2. As a potential interesting window we considered a period of two trading days before and two trading days after the event. We used a period of two days before and two days after the event date, because by taking a longer window the windows of the events of July 23rd and July 30st would overlap.

Please put Table 2 here

Table 2 indicates that five individual companies at the New York Stock Exchange showed negative excess returns and three showed positive returns at the event date. When we use the null hypothesis (H_0) that there will be no effect of the press releases of Amnesty International on abnormal returns, these returns will be distributed $N(0, \sigma_{ARI})$. We may now use the standard deviation of Table 1 as an approximation of the standard deviation of the abnormal returns. By doing this none of the companies showed significant abnormal returns at the event date. These outcomes imply that the null hypothesis cannot be refuted. Nevertheless, a cumulative abnormal return of minus 3.0% was found during the event date, which may indicate that combining more events might generate a null hypothesis which can be contradicted.

For this reason we also considered for all press release events during 1996 the abnormal returns. The individual abnormal returns of company i at each event date as well as the cumulative total over 1996 are presented in Table 3.

Please put Table 3 here

Table 3 indicates that three absolute values (of the 48 abnormal returns found for 8 companies at 6 events) were larger than 1.96 standard deviations. Two of these significant findings had a positive sign and one a negative sign. These outcomes do not indicate a systematic abnormal return as 3 significant drawings might easily be found from 48 at random drawings of any Normal distribution.

Nevertheless, many small insignificant effects in the same direction may also be found. In total 28 abnormal returns were negative and 20 positive. Also five out of six CAR_i 's were negative and 6 out of 8 companies showed negative $CAR_{i,1996}$'s, of which the one of Mobil Oil was significantly negative. Moreover, all six press releases to all eight companies gave a total summed loss of 6.7%. We therefore tried to measure the significance of the returns at event days also in another way.

A non-parametric approach was chosen because the assumptions of the standard event study approach did not allow for a simple addition of all 48 events. The test statistic we used was the signed rank test for two means with paired observations [Kanji, 1994, p. 81]. In this test the absolute values of the differences in abnormal returns are ranked. We took, for example, the abnormal return generated by Colgate-Palmolive at the

event date of April 12th ($t=0$) minus the abnormal return generated by that same company two trading days before April 12th ($t=-2$). From Table 2 it can then be seen that the difference in abnormal return for these two dates ($t=0, t=-2$) is +1,7. We then ranked the 48 (of eight multinationals during six events) difference observations irrespective of sign and signed these ranks. The sum of the positive ranks then was +591 and the sum of the negative ranks -585. The smallest value of these summed signed ranks can then be used as the relevant statistic.

As a null hypothesis (H_0) we assumed that the abnormal returns at event dates ($t=0$) would be equal to those at $t=-2$. As we assume that the press releases of Amnesty International might affect the returns negatively, we used a one-sided test. With 48 observations the null hypothesis will then be rejected at 5% significance if the absolute value of the relevant statistic is smaller than 426 [Kanji, 1994, p. 189]. The outcome of the test statistic (-585) therefore implies no significant difference between the 48 returns generated at day $t=0$ and day $t=-2$. In fact none of the other paired days showed significant differences, as the statistics for ($t=0, t=-1$), ($t=0, t=+1$) and ($t=0, t=+2$) were respectively -538, +460 and -557. We therefore conclude that we did not find a significant negative relationship of press releases of Amnesty International on the returns of multinationals which had relationships with Indonesia.

Potential causes for the absence of impact

In empirical research non-significant outcomes are often considered to be disappointing. The authors have to confess that they also hoped to find significant (negative) effects. An elicitation of potential reasons for the absence of significant findings may, nevertheless, assist researchers in designing future research. We therefore discuss six potential reasons for the absence of significance.

1. Measurement errors

With our approach we deviated in several aspects from previous literature on the impact of ethics on economic performance. The use of the event study method, and in particular

the correction of the returns with the S&P 500 index may have introduced bias. In fact the companies of which we measured the performance are also part of the index. If the press release of Amnesty International affects the companies involved negatively, the index may then also be affected negatively. This negatively influenced index will then (according to equation 2) cause the calculated abnormal returns of each individual company to rise.

Moreover, the use of the Internet home pages for analyzing involvement in Indonesia may have created a bias. Companies which are involved in Indonesia do not necessarily present this commitment at their home pages. It is therefore likely that more companies will have been involved in Indonesia. A simultaneous effect of the press release (if any) on companies which do not report involvement also affects the index and increases the index related measurement bias indicated in the previous paragraph. This latter bias may, nevertheless, be mitigated, if companies which are more heavily involved in Indonesia are more inclined to report this on their home page.

In order to cross-validate our findings and to avoid the aforementioned biases, we tested whether the company returns in 1996 might have been systematically affected at the six event days. We therefore performed an OLS regression analysis on company with a dummy which equaled 1 at each of the event days and zero otherwise. None of these regressions showed a 5% significant coefficient for the dummy. From this we concluded that the aforementioned biases do not seriously seem to affect our conclusions and that the press releases indeed do not cause significant effects.

2. Amount of involvement

We may not have found significant results because our event study did not discern the character and the amount of country involvement. Ideally it would have been interesting to distinguish between effects of various kinds of involvement: does the company only have a sales office or a minor daughter or does it have a large green field investment or an important joint venture. It would, moreover, be worthwhile to know how much these various forms of involvement would contribute to total profits or to company value. The absence of a significant impact may for example be caused by effects which might be too small for each individual company to measure. If ten percent of company value originates from Indonesia and if one press release of Amnesty International would cause the

Indonesian value to decline with one percent, the combined effect of all six press releases would amount to approximately $6 * 0.1 * -1\% = -0.06\%$. This overall decline in company value is still small, which may imply that it will be considered to be significant.

3. Human rights are (still) a non-issue

Another possible reason for the absence of results may be that human rights are not a corporate ethics issue yet. Our assumption that human rights would become an issue of increasing relevance does not mean that it already is an issue of relevance. In fact we did not find in the literature any indication on human rights. The issue even seems to be out of the traditional framework of analysis. In a recent paper on the ethical issue emphasis of companies Nicholson and Robertson [1996] specify within four domains of ethical interest 15 issues among which that of the human rights is absent.

4. Length of the causation chain

If we would have found a significant relationship, it would have indicated that investors negatively evaluate a company which is involved in a country of which the government violates human rights. This is a long causation chain, where at least three groups may have different perceptions. First, *host country officials* may know that infringements in human rights are allowed, but they then may hold the utilitarian idea that it is good to do some bad things in order to avoid very large evil to happen to the country. In fact the Suharto administration in Indonesia regularly uses these kinds of arguments in referring to the “communists” and aiming at the coup of 1965 (blamed to the communist party) in which aftermath 300.000 or 400.000 people were killed [Schwarz, 1994, p. 19 ff.]. Also *managers* of multinationals might hold the position that the involvement of the multinational in a country does not enable the government to violate human rights. And even if they would consider such a relationship, they may also hold the utilitarian view, and they may address the potential of their company in providing for better labor, wage and environmental qualities in comparison with local companies. The managers of multinational companies may be responsive to the idea that they should adopt a proactive view in their interactions with the host governments [Amba-Rao, 1993, p. 565] and they may therefore (at least be inclined to) address issues related to human rights in the host country. Finally,

investors may not evaluate investments in these multinationals as generating “blood money”.

From Irvine [1987] at least three reasons can be inferred for that neglect of investors. Firstly, investors do not necessarily have to consider investing as an issue which is involved with ethics. This means that they may not spend time or costs in detecting involvement of a company in a country where human rights are violated. Secondly, ethical behavior of individuals (in organisations) is a complex issue [Stead, Worrell and Stead, 1990]. Personality, socialization, ethical philosophy, ideology, decision history as well as past reinforcements in ethical issues may be relevant. This means that various individual investors usually will show a variety of reactions to multinationals which work in countries where governments violate human rights. Institutional investors might -in addition to these individual perceptions and history- also be influenced by external factors. In particular the necessity to compete on investment returns as external and top-management behavior and reinforcement as organisational factors may be mentioned [See also Brief, Doran and Dukerich, 1991]. Thirdly, investors may have false perceptions on investment ethics, phrased in ideas that they buy second hand shares or only a small number of them and therefore (incorrectly) consider their behavior to be irrelevant. The length and complexity of the causation chain means that the human rights issue might only become relevant to investors if the violation of the rights is clearly visible.

5. Relevance of press releases of Amnesty International

Absence of significant results can also be attributed to the fact that press releases of Amnesty International cannot be considered as a massive and fierce action. The press releases analysed were not aimed at specific companies. Moreover, press releases are not a fierce form of action. If it is successful, it affects public awareness but it may last to affect investments in specific companies in specific countries. It is here not the place to discuss the policy of Amnesty International, but it seems that Amnesty International is not playing its cards the hard way. One of the major exceptions may be the case of Heineken which abandoned an investment in Birma because of public -Amnesty International backed- pressure. The previous discussion on the length of the causation chain may, in fact, make Amnesty International reluctant to aim at smaller returns of multinationals in countries where human rights are at stake.

6. The efficient market

A final cause for non-significant findings may be caused by efficient markets. In our approach we assumed efficiency of markets. This means that only new information will affect the shares of individual companies. Many investors may not note the press releases of Amnesty International, and -even if they do- the press releases may not have added to the available information on Indonesia. In the latter case the press releases are just a drop of water in the ocean. We confined our analysis to 1996, but the situation of human rights was already much longer known to outsiders. The violation of human rights may then not be a sudden occurrence, but may have more attributes of a never ending story. This means that a press release of Amnesty International does not generate new information relevant for multinational stock returns. Also for this reason the absence of significant effects may not be amazing.

Conclusions

We investigated whether economic performance of multinational companies was affected by the human rights issue. We tried to reduce vagueness often found in other publications on business ethics by using the event study technique. With this technique we measured the impact of press releases of Amnesty International on shareholders' returns of multinational companies involved in Indonesia. If we would have found a significant negative effect, we might have concluded that there was a negative relationship between economic performance of multinationals and involvement in a country where the government violates human rights. We, however, did not find significant effects. This may mean that the issue of human rights is not relevant or that the effects are hard to measure. From our discussion of the potential reasons for the absence of significant findings, we conclude that search for significant effects of the impact of human right violations might start to analyze gross and sudden infringements of human rights, which are widely covered in the press. Moreover, the companies to be analyzed should widely be known to be heavily involved in the country where a government violates these rights.

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Table 1 The estimated alpha and beta for multinational companies working in South-East Asia which indicate at their home pages to have relationships with Indonesia, as well as the concomitant t-values and estimated standard deviation of the residuals calculated from dividend reinvested daily returns (%) for 252 trading days during 1995.

Company	Alpha (t-value)	Beta (t-value)	σ_{ϵ_i}
Colgate-Palmolive	-0.02 (-0.35)	0.68 (4.36)	1.22
DuPont	-0.01 (-0.09)	0.90 (5.72)	1.23
Federal Express	-0.03 (-0.25)	0.94 (4.57)	1.61
General Electric	0.00 (0.04)	1.19 (9.70)	0.95
3M	-0.00 (-0.02)	0.85 (5.50)	1.21
Mobil Oil	0.04 (0.57)	0.75 (6.05)	0.97
Philips Electronics	-0.03 (-0.28)	1.04 (4.61)	1.76
Xerox	-0.01 (-0.07)	1.21 (7.33)	1.28

Table 2 The estimated standard deviation of abnormal percentage returns and the abnormal returns in an event window of two trading days before, at and after the event day of April 12th ($t=0$).

Company	$t=-2$	$t=-1$	$t=0$	$t=+1$	$t=+2$
Colgate-Palmolive	-1.3	0.6	0.4	-0.8	0.7
DuPont	1.2	-1.9	0.9	-0.7	0.2
Federal Express	0.8	-0.8	-0.6	3.7	-0.2
General Electric	-0.6	-0.9	0.6	0.7	-1.1
3M	1.0	0.1	-0.4	0.6	-1.1
Mobil Oil	-0.8	-0.4	-1.4	1.0	-0.2
Philips Electronics	0.7	1.9	-1.2	1.2	1.0
Xerox	2.6	0.0	-1.4	1.8	-0.9
CAR_t	3.5	-1.5	-3.0	7.6	-1.6

Table 3 Abnormal percentage returns at six event dates during 1996.

Company	April 12	May 8	July 23	July 30	Novem ber 27	Decem ber 9	CAR _{i,1} 996	• car i,1996
Colgate- Palmolive	0.4	0.8	1.8	0.5	-0.3	0.9	4.2	3.0
DuPont	0.9	0.9	-1.0	0.0	-0.9	-1.1	-1.3	3.0
Federal Express	-0.6	-0.8	1.2	-0.3	-2.4	-0.7	-3.6	3.9
General Electric	0.6	-0.4	-0.6	-0.7	0.6	-1.0	-1.4	2.3
3M	-0.4	-1.1	0.3	1.2	-0.3	1.0	0.7	3.0
Mobil Oil	-1.4	0.1	-1.2	-2.0*	-0.8	-0.2	-5.4*	2.4
Philips Electronics	-1.2	-0.3	0.7	3.4*	-1.7	-0.5	-0.5	4.3
Xerox	-1.4	-1.8	3.2*	-2.1	0.7	1.0	-0.4	3.1
CAR _t	-3.0	-2.6	4.5	-0.0	-5.1	-0.5	-6.7	-