WHY DO COMPANIES GO PUBLIC?
EVIDENCE FROM NAIROBI STOCK EXCHANGE

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D61/7301/2006

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MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL
FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE
DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA) SCHOOL OF
BUSINESS, UNIVERSITY OF NAIROBI

SEPTEMBER 2008
Declaration

This management project is my original work and has not been presented for a degree in any other university.

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This management project has been submitted for examination with my approval as the university supervisor.

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Dedication

I dedicate this work to Dad, Mum, sis and my brothers for their invaluable support, understanding and encouragement during my entire academic period. Their words of wisdom were of great help. Thanks to you all.
Acknowledgements

I thank the Almighty for the abundant blessing and the Gift of patience that has seen me to this end. Much appreciation goes to all those who offered me moral and practical support in the production of this work. I am very grateful to my supervisor Mr. Lishenga for the guidance and advice he gave me.

To my classmates for sharing with me in the struggle, Margaret for the constant encouragement, my colleagues for bearing it all and of course all my instructors for enlightening me.
Abstract

The study sought to find out the reasons that drive firms to go public. The study analysed fifteen companies which went public between 1990 and 2008. Exploratory survey was used as it enabled the researcher to obtain information from broad category of firms. The study used structured questionnaires to obtain the necessary information.

The data was analysed using Microsoft Excel and the Statistical package for social sciences (SPSS) which were utilized to perform the various statistical analysis. The findings showed that the major reasons why companies go public are the capital raising aspects and the implementation by the government of its divestiture policy. The main problems encountered are the high listing cost and the stringent market regulations by the Capital market authority (CMA) and the Nairobi stock exchange (NSE) who are the main players. Minimization of cost of capital and broadening the ownership base of the companies were cited as the main motivating factor for conducting an Initial public offering. In conclusion, companies either private or public corporations should go public so as to tap the vibrant market and enjoy the benefits that come with being public.
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CHAPTER ONE: INTRODUCTION

1.1 Background
The lifecycle and development of a firm is very diverse and difficult to predict. One of the decisions that has a major influence on the development and lifecycle of a firm is the decision to go public. Going public involves having the shares in a company quoted on a stock exchange, and companies usually go public via an Initial Public Offering (IPO) (Jenkinson and Ljungqvist, 2001). Also known as "going public," an Initial Public Offering transforms a small business from a privately owned and operated entity into one that is owned by public stockholders.

Firms usually go public through the stock market. The Stock market, or equity market, is a private or public market for the trading of company stock and derivatives of company stock at an agreed price. Security issuances in the stock market can either be by initial public offerings (IPOs) or seasoned equity offerings (SEOs). Most public offerings involve the issuing of shares, notes or debentures to the public.

A Seasoned equity offering is a new equity issue by a company after its IPO. Usually, the offering will include the issuance of new shares, intended to raise new capital, as well the secondary sale of existing shares. However, certain regulatory restrictions and restrictions imposed by the lead underwriter are often placed on the sale of existing shares.

IPO's can either be issued by private companies or through privatizations by governments while divesting from state owned enterprises. IPO's on the Nairobi stock exchange (NSE) have been characterized by both privatizations as well as private IPOs. Most of the public offerings at the NSE have been successful having been characterized by oversubscriptions. Weche (2005) notes that Kenya has had highly successful publics share offering of privatized enterprises.
Firms decide to go public through IPO because they want to enjoy the benefits that they would not experience if they stayed private. Access to new finance, motivation of management and employees, enhanced company image and publicity and enhancement of business relationship are some of the reasons why firms go public (Roell, 1996). Privatization through Initial public offering has an advantage because by targeting a large segment of the investors, they help meet the goal of an equitable transfer of capital from the government to the private sector (Thambu, 2006).

With the benefits of public trading come associated costs. These ongoing costs can be categorized as direct and indirect costs. Direct costs include legal, auditing and underwriting fees. The indirect costs are the management time and effort devoted to conducting the offering and the dilution associated with selling shares at an offer price that is, on average, below the price prevailing in the market shortly after the IPO. These direct and indirect costs affect the cost of capital for firms going public.

The conventional wisdom on ‘going public’ is that it is a rational decision for a growing firm looking for new capital to fund investment. However, many successful companies have chosen to stay private and it can be argued that some developed countries have benefited from having fewer publicly quoted companies, (Pagano et al., 1998).

The role therefore of raising capital by going public cannot be underplayed since a public offer if properly executed has the potential of raising large sums that would otherwise not be possible through borrowing. Going public offers a relatively cheap source of capital for investment and working capital requirements compared to the traditional sources of funds like retained earnings and bank loans. This study therefore will find out the reasons that make companies go public.
1.2 Statement of the Problem

The reason why initial Public offerings have recently been the focus of much research is the worldwide trend towards privatizations. Companies can be privatized in a variety of ways, such as through an outright sale to another company or even via the distribution of shares to members of the public (Jenkinson and Ljungqvist, 2001).

However, despite the voluminous literature on public offerings, research on the reasons why companies go public has largely been unexplored. Pagano et al., (1998) studied a large sample of Italian companies to find out why some companies decided to go public while others did not. They compared the characteristics of companies before and after their IPO with those of a large sample of private companies of similar size. The study finds that a company’s size significantly affects the probability of listing for previously independent companies and that there are few young start-up companies that go public to finance their expansion.

Of the recent theoretical papers on the decision of going public, Chemmanur and Fulghieri (1999) focus on the capital-raising aspect of an IPO while Zingales (1995) and Mello and Parsons (1998) emphasize the sale of executives’ shares and eventual change of control. The extent to which these various explanations explain actual firms’ reasons for going public is largely unexplored.

Previous Research in Kenya has focused on the under pricing of IPO’s (Jumba, 2002), (Maina, 2005) and performance of initial public offerings at the NSE (Weche, 2005), (Maina, 2006), (Kiilu, 2006). The study by Jumba and Maina looked at changes in Share prices after the IPO and concluded that IPO’s are followed by Initial high returns hence are underpriced. Weche (2005) studied the pre and post privatization financial performance of companies privatized through the Nairobi stock exchange.

The recent study by Kiilu (2006) made a comparison of the financial performance of companies before and after going public through the Nairobi stock exchange. He observed that profitability first drops in the initial years after companies go public but
starts rising after the third year. He concluded that generally profitability improved after companies went public.

It is evident that most of the research studies in this area have been done in developed markets with very little evidence for emerging markets particularly in Kenya. This study therefore tries to bridge the gap by analyzing the factors driving the Kenyan companies to go public via the Nairobi Stock Exchange.

1.3 Objective of the Study
This study aims at determining the reasons why companies go public.

1.4 Importance of the Study
There are various stakeholders who attach importance to going public. Such stakeholders include:

The Government
The government as a regulator will be able to monitor the performance of the company as well as the stock market, as a signal of economic stability of a country.

Investors
Investors are very keen on the day to day performance of the company going public. The findings of this study will guide investors on whether or not to invest in a company.

Company Executives
The study will enlighten executives of companies which have opted to remain private make informed decision as to whether they should make their companies public.

Financial Analysts
Financial analysts offer advice to investors. Findings from the study will help them give sound information that will lead investors to make informed decisions.
Fund Managers
Fund managers are charged with the responsibility of identifying and investing in viable projects. Findings from the study will help them gauge the performance of the companies going public and hence know where to commit funds.

Academicians
Academicians want to contribute to the body of knowledge; this research will help in opening up opportunities for doing further research.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction
Little empirical research exists on why companies go public. Perhaps surprisingly, the vast majority of empirical literature has instead focused on the under pricing, the long-run performance, and the time clustering of IPO's (Jenkinson and Ljungvist, 2001) and has ignored the underlying reasons why firms go public.

2.2 Initial Public offerings
An initial Public offering occurs when a security is sold to the general public for the first time, with the expectation that a liquid market will develop. Earlier research done by Ibbotson and Ritter (1995), Ritter (1998) and Ritter Welch (2002) survey the IPO literature, focusing on the short-run underpricing, cycles in the number of IPOs and long-run under performance. Studies have shown that the volume of IPOs varies substantially from country to country.

Pagano et al., (1998) report that the industry market-to-book ratio is the single most important determinant of the decision to go public for Italian firms. Subrahmanyam and Titman (1999) argue that the ease of going public depends upon the costs of acquiring information in an economy. They argue that each publicly traded firm creates a positive externality by making it easier to value comparable firms.

Benveniste et al., (2002) also view information spillovers as an important reason for industry clustering in IPO volume. La Porta et al., (1997) report that the number of IPOs varies systematically across countries, with countries having a legal system based upon British law having more IPOs. Holmen and Hogfeldt (2003), show that in Sweden firms typically issue shares with inferior voting rights in the IPO, and if the shares with superior voting rights are eventually sold, they are always sold as a block.
2.3 Pricing of IPOs

The underpricing of Initial Public Offerings (IPOs) is one of the most extensively investigated empirical subjects in the financial literature. Empirical studies show enormous differences between countries and time periods. For example, the underpricing of IPOs in Denmark between 1984 and 1998 is only 5 percent, while the underpricing of IPOs in China in the period 1990 to 2000 is more than 250 percent (Ritter et al., 2006). The variation in countries between different years is also very large. Ljungqvist (2005) indicates these differences to be at least partly related to differences in the institutional framework in which IPOs are priced and allocated.

Literature on pricing of initial public offering suggests that on average most IPO are priced at subscription significantly below the price at which they first trade allowing initial subscribers to earn abnormal positive returns (Brealey and Myers, 2002).

In every country with a stock market, IPOs are underpriced. Loughran, Ritter and Rydvist (1994) and Chowdhry and Sherman (1996) document that the average first-day return varies systematically with the mechanism used to price and distribute IPOs.

Similarly, Purnanandam and Swaminathan (2002) examine the pricing of IPOs using comparable firms, and find that on average IPOs have an offer price 50% higher than predicted on the basis of industry peers. In Kenya, under pricing of IPOs has been documented by Jumba (2002) and Maina (2005). They looked at the changes in share prices after the IPO and concluded that IPO’s are followed by initial high returns hence are under priced.

2.4 Performance of IPOs

Large volume of literature has documented that IPOs underperform in the long run. Ibbotson and Ritter (1995) provide international evidence of long run underperformance. Ritter (1991), analyzed the performance of US IPOs issued between 1975-84 and reported that they underperformed the benchmark (NASDAQ and AMEX-NYSE) by about 29% in the three year period after their launch.
In UK, Levis (1993) and Espenlaub et al., (1998) have documented the existence of long-run underpricing using the IPOs on the London Main Market from 1991-95. They document a long-run underperformance of 17.81%.

Work in other countries has shown that long-run market adjusted returns are negative with notable exceptions of Korea (Kim et al., 1995) and Sweden (Loughran et al., 1994) where IPO companies outperformed the market. The degree of underperformance has been highest in Australia (Lee et al., 1994) followed by Brazil (Aggarwal et al., 1993).

In Kenya, long run IPO performance has been documented by Weche (2005) who studied the pre and post privatization financial performance of companies privatized through the NSE for the period 1989 to 2003. The study analyzed six state owned enterprises drawn from the Finance and Investment sector and the industrial and allied sectors. Results showed an increase in profitability and decrease in leverage. He concluded that overall financial performance in the pre and post privatization era is not significantly different.

Kiilu (2006) made a comparison of the financial performance of companies before and after going public. He studied fourteen companies which went public between 1984 and 2000. Findings showed that profitability declined after IPO the increased gradually after the first two years. Liquidity was stronger in the post that in the pre-period. He concluded that profitability improved after companies went public.

### 2.5 Reasons why companies go Public

The likely reason why there has been so little empirical work addressing the reasons for going public is that the most straightforward way to study the issue would be to compare the characteristics of firms that choose to go public with the firms that remained private. However, such a study would require extensive data on private firms, which generally are not available.
One such paper by Pagano et al., (1998) directly tests for factors that contribute to a firm's decision to go public by using proprietary database of private Italian firms and comparing it to Public Italian firms. They concluded that firms choose to go public not to finance future investments and growth but rather to rebalance their leverage and allow managers to liquidate their positions. In a less direct approach, Brau, Francis, and Kohers (2003) compare firms that choose to conduct an IPO versus private firms that choose to be acquired by a public firm.

Most of the businesses go public when they want to obtain some additional resources to finance their activities and projects. Additionally, if you have some innovative and potentially profitable business initiative, but you lack the resources to realize it going public is one of the possibilities you can consider. In this way you will gain money to acquire the necessary equipment and other factors you need for the execution of the business (Ritter, 1998).

Pagano et al. (1998) found that going public enables companies to borrow more cheaply. They established that around the Initial public date, the interest rate on the short-term credit falls and the number of banks willing to lend increases. The reduced cost of credit may stem from the improved public information, associated with stock exchange listing or from the stronger bargaining position vis a vis banks determined by the availability of an outside source of funds. They also assert that, a listed company is subject to a tighter set of controls both from the regulators and from institutional investors. Listed companies are forced to a greater transparency, comprehensiveness and timeliness of their financial reports.

Ritter (1991) argues that an IPO is generally perceived as one of the most important milestones in a firm's lifecycle. Going public allows the firm access to the public capital markets for the first time in its life and hence may have important implication for its ex ante characteristics such as profitability, leverage and liquidity. It not only satisfies the immediate capital requirements of the firm, but also paves the way for the firm to make unseasoned offerings.
Gaia and Davide (2001) combine evidence from a series of preliminary case studies, with the results of a survey of 74 Italian IPOs, to investigate important implications of going public like improved visibility and reputation that are usually neglected or presented as side benefits and glossed over. Evidence from their research indicates instead that an increasing number of companies see going public as a way to improve their reputation and social capital, with beneficial effects on their capacity to access external resources and opportunities for new entrepreneurial ventures.

Roell (1996), documents that the real reasons why firms go public include; an informative stock price, a more liquid stock, and increased competition among providers of finance. Their study reveals that besides the usual financial motives, the decision to go public is increasingly stimulated by search for a higher visibility and is seen as an important step in the expansion and reinforcement of the network of relationship that sustains entrepreneurial activity.

A review of the past literature on family-owned companies going public leaves the impression of an underlying assumption that going public is something to do either when family assets can no longer finance growth (Maherault, 2000) or in order to guarantee continuity of the company when no family members can or want to succeed the previous generation (Jovenitti, 1998).

According to Kikeri et al., (1994) IPO’s are mechanisms used by governments that are pursuing privatization of previously public institutions. Public share offering is among the most popular methods of privatization because they allow more people to be shareholders of entities created by public resource.

Similarly, (Holmstrom and Tirole, 1993) argue that the stock market provides a managerial discipline device both by creating the danger of hostile takeovers and by exposing the markets assessment of managerial decisions. Additionally, the shareholders of public companies can use the information embodied in stock price to design more efficient compensation schemes for their managers.
Going public facilitates mergers and acquisitions because of the increase in companies valuation. Zingales (1995) concludes that by selling the company by first going public the initial owners facilitate the acquisition of their company for a higher value than they would get from an outright sale.

Lastly, business relationships are expanded and enhanced due to closer scrutiny of a listed company. In meeting the stringent disclosure and reporting requirements, the level of prospective suppliers, distributors, potential partner companies for joint venture is enhanced. Corporate governance requirements are also followed leading to less corruption, tax compliance and maximization of shareholders wealth.

2.6 Motivation for Going Public

According to Scott (1976) and Modigliani and Miller (1963) firms conduct IPO when external equity minimizes their cost of capital thereby minimizing the value of the company. Further advancement was done by Myers and Majluf (1984) and Myers (1984) who argued for a pecking order of financing: internal equity, debt financing, and then external equity. Zingales (1995) and Mello and Parsons (2000) argue that an IPO allows insiders to cash out while Ang and Brau (2003) demonstrate that insiders opportunistically sell shares in the IPO for personal gain. Additionally, Black and Gilson (1998) argue that the IPO gives Venture Capitalists the opportunity to exit, providing an attractive harvest strategy.

Zingales (1995) argues that an IPO can serve as a first step toward having a company taken over at an attractive price. Braul et al. (2003) argue that IPO's may be important because they create public shares for a firm that may be used as "currency" in either acquiring other companies or in being acquired in a stock deal.

Chammanur and Fulghieri (1999) argue that IPO's broaden the ownership base of the firm. Similarly, Maksimovic and Pichler (2001) assert that firms conduct IPO's to capture a first-mover advantage. They also suggest that an IPO can increase the publicity or
reputation of the firm going public. Bradley, Jordan, and Ritter (2003) show that analyst recommendations are often biased upward after an IPO. Analyst coverage may thus motivate a firm to conduct an IPO.

2.7 Factors affecting the Probability of an IPO
Pagano et al., (1998) argue that market-to-book ratio as well as the size of the company affects the success of the company going public. They find out that larger companies as well as companies that grew faster and were more profitable before the IPO are more likely to go Public.

Chemmanur and Fulghieri (1999) say that, firms that are older and have a longer operating history should be easier to value; hence old firms are likely to go public. Ritter (1987) documents that, firms with more revenue and cash flow maybe easier for potential investors to value. Firms with negative earnings and lower levels of sales present more uncertainty about the level of future cash flows and even about future survival. These arguments imply that, firms with higher current profits are more likely to go public because of the listing requirements. Boehmer and Ljundavist (2001) argue that earnings are proxy for risk and that firms with higher earnings are more likely to go public.

A firm with a high debt ration may want to carry out an IPO to relieve borrowing constraint; hence firms’ capital structure may also play a role in the decision to sell the firm (Brau, Francis and Koher, 2001)

2.8 Requirements before Going Public
The process of going public is relatively straight forward. In Kenya, IPO’s are regulated under the Capital markets Act, Cap 485A (Capital markets securities, Public offers, Listing and Disclosures) regulations. A company wishing to sell its stock to the public has first to apply for listing on the stock exchange. A company must submit an information memorandum or a prospectus to the Capital Markets Authority for approval and a copy to the Nairobi Stock Exchange through the Sponsoring stock broker.
Once the CMA grants approval for listing, the NSE approves the listing without any other conditions save the attainment of the prescribed minimum shareholding following a public offering or offer for sale, attainment of minimum subscriptions (if any) as disclosed in the information memorandum or prospectus, payment of listing fees and signing of the memorandum listing. The floatation of a company’s stocks is usually made through an underwriter who guarantees the issue or the company may underwrite the issue directly. The shares and stocks are then sold to the public through stock brokers, banks and other financial institution (Kihumba, 1993).

The Capital Market Authority is concerned with full disclosure of material information which should be contained in the prospectus. In preparation for going public, a company must supply audited financial statements. The level of detail required depends upon the size of the company, the amount of money raised and the age of the company.

In the United Kingdom, before a company goes public it must first register with the Financial Services Authority (FSA) while in the United States it must register with the Securities and Exchange Commission (SEC) and prepare a public offering. This offering includes a prospectus and a number of other legal documents.

The company contracts with an investment bank or banks to underwrite or handle distribution of the shares it wants to sell. The underwriters and the company agree on an opening price of the stock based on earnings or potential earnings and growth, but also what they think the market will bear. The underwriter then offers bundles of the stock to major broker clients who then offer first chance purchase rights to their big retail and institutional customers, with everyone along the way taking a markup of some degree.

Firms issuing stock use either a firm commitment or best efforts contract. After the issuing firm and its investment banker have conducted a marketing campaign and acquired information about investors’ willingness to purchase the issue, a final offering price is set. The final prospectus is then issued, and when S.E.C clears the offering, the IPO goes “effective”.

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2.9 The Benefits of Going Public

2.9.1 Overcoming Borrowing Constraints
According to Pagano et al. (1998) gaining access to a source of finance alternative to banks (and, in the United States, to venture capital) is probably the most cited benefit of going public. The opportunity to tap public markets for funds should be particularly appealing for companies with large current and future investments, high leverage, and high growth.

2.9.2 Greater Bargaining power with Banks
Rajan (1992) finds that a potential problem with bank loans is that banks can extract rents from their privileged information about the credit worthiness of their customers. By gaining access to the stock market and disseminating information to the generality of investors, a company elicits outside competition to its lender and ensures a lower cost of credit, a larger supply of external finance, or both.

2.9.3 Liquidity and portfolio Diversification
According to Pagano et al. (1998), the decision to go public affects the liquidity of a company’s stock as well as the scope for diversification by the initial holders of the company. Shares of private companies can be traded only by informal searching for a counterparty, at considerable cost for the initiating party. Share trading on an organized exchange is cheaper, especially for small shareholders who want to trade on short notice. As a result, if the initial owners raise money from dispersed investors, they factor in the liquidity benefit provided by being listed on an exchange.

As shown by many market microstructure models, the liquidity of a company’s shares is an increasing function of their trading volume, so that this liquidity benefit may be effectively reaped only by sufficiently large companies. This creates another reason to expect a positive relationship between size and the likelihood of an IPO.

Similarly, taking a company public provides to its owners opportunities for diversification. This can be achieved directly, by divesting from the company and
reinvesting in other assets, or indirectly, by having the company raise fresh equity capital after the IPO and acquire stakes in other companies. If diversification is as important motive in the decision to go public, Pagano (1993), we should expect riskier companies to be more likely to go public, and controlling shareholders to sell a large portion of their shares at the time of the IPO or soon afterward.

2.9.4 Monitoring
The stock market also provides a managerial discipline device, both by creating the danger of hostile takeovers and by exposing the market's assessment of managerial decisions. Moreover, the shareholders of a public company can use the information embodied in stock prices to design more efficient compensation schemes for their managers, for instance by indexing their salaries to the stock price or by offering them stock options, as argued by Holmstrom and Tirole (1993) and documented by Schipper and Smith (1986).

By contrast, Pagano and Roell (1998) argue that private companies owned by more than one shareholder may be over monitored. If the scale of a planned expansion is very large and thus needs to be financed by many investors, the cost of this over monitoring becomes so large that it is preferable to go public.

2.9.5 Investor Recognition
It is well known that most investors hold portfolios that contain a small fraction of the existing securities; often because they simply ignore that a certain company exists. Listing on a major exchange can help to overcome this problem, by acting as an advertisement for the company. Merton (1987) has captured this point in a capital asset pricing model with incomplete information, showing that stock prices are higher the greater the number of investors aware of the company's securities.

This theory finds indirect support in the fact that when companies already listed elsewhere announce their decision to list also in New York, their stock yields a 5 percent abnormal return on average (Kadlec and McConnell, 1994).
2.9.6 Change of Control

In Zingales (1995a) the decision of a firm to go public is the result of a value maximizing decision by an initial owner who wants to eventually sell his company. By going public, the initial owner can change the proportion of cash flow rights and control rights which he will retain when he bargains with a potential buyer. If the market for corporate control is not perfectly competitive, but the market for individual shares is, this proportion will affect the total surplus he can extract from a potential buyer of the company.

By selling cash flow rights to disperse shareholders and still retaining control, the incumbent succeeds in extracting the surplus that derives from the buyer's increased cash flow, avoiding the need to bargain over it with the buyer. However, by retaining control, the incumbent succeeds in extracting some of the surplus deriving from the buyer's large private benefits in a direct negotiation. So the initial owner uses IPO as a step to achieve the structure of ownership in the company that will maximize his total proceeds from its eventual sell.

2.9.7 Windows of Opportunity

If there are periods in which stocks are mispriced, as suggested by Ritter (1991), companies recognizing that other companies in their industry are overvalued have an incentive to go public. To the extent that entrepreneurs manage to exploit the overvaluation of their companies by investors, one would also expect a company to be more likely to go public when the market for comparable companies is particularly buoyant.

2.10 The Costs of Going Public

2.10.1 Adverse Selection

In general, investors are less informed than the issuers about the true value of the companies going public. This information asymmetry adversely affects the average quality of the companies seeking a new listing and thus the price at which their shares can be sold (Leland and Pyle, 1977), and also determines the magnitude of the under pricing needed to sell them (Rock, 1986).
As highlighted by Chemmanur and Fulghieri (1995), this adverse selection cost is a more serious obstacle to the listing of young and small companies, which have little track record and low visibility, than for old and large companies. So in the presence of adverse selection, the probability of going public should be positively correlated with age and/or the size of a company.

2.10.2 Administrative Expenses and Fees
Besides the initial underpricing, Pagano, Panetta and Zingales (1998) state that going public implies considerable direct costs: Underwriting fees, registration fees, etc. On top of the initial expenses, there are yearly layouts on auditing, certification, and dissemination of accounting information, stock exchange fees etc. Since many of these expenses do not increase proportionally with the size of the IPO, they weigh relatively more on small companies. Ritter (1987) has estimated that in the United States the fixed costs equal approximately $250,000 and the variable costs are about 7 percent of the gross proceeds of the IPO.

2.10.3 Loss of Confidentiality
The disclosure rules of stock exchanges force companies to unveil information whose secrecy may be crucial for their competitive advantage, such as data about ongoing Research & Development (R&D) projects or future marketing strategies. They also expose them to close scrutiny from tax authorities, reducing their scope for tax elusion and evasion relative to private companies. Campbell (1997) was first to point to confidentiality as a deterrent from getting funding in public markets. Yosha (1995) has shown that in equilibrium, these firms with more sensitive information are deterred from going public if the costs of a public offering are sufficiently high.
3.1 Research design
The research design used was an exploratory survey. The method was appropriate as it answers the Who, When, Where, Why and How of research questions (Nachmias and Nachmias, 1996). This study in particular was concerned with the “why” of companies going Public.

3.2 Population and sample
The Population of the study covered all public companies quoted at the Nairobi Stock Exchange between 1990 and 2008. During this period, there were 18 IPO’s which were used as the sample (See appendix III).

3.3 Data and Data Collection
The study used primary and secondary data obtained from the companies. Secondary data was collected by use of prospectus and annual report. Primary data was collected by use of structured questionnaires. This comprised both open-ended and closed questions. The questionnaire was divided into two parts. Part one was designed to obtain general demographic data of the company. Part two consisted of questions on factors driving the decision to go public.

Major issues identified from literature were listed for the respondents to select appropriately and this included: Motivation for going Public, Concerns arising by making the decision to go public, what influenced the timing of the IPO, and the criteria used in deciding on whether to go public. The respondents were required to use a likert scale to rank the various issues on a five point-scale ranging from ‘Not important’ to ‘Very important’ or ‘No concern’ to ‘Great concern’. To facilitate data collection, drop-and-pick method was used. In total 15 questionnaires were collected and subjected to data analysis. The research targeted the Chief Financial Officers (CFOs) of the firms since they play an active role in decision making in organizations.
3.4 Data Analysis and Presentation

Data was analyzed through a combination of both descriptive and inferential statistics. The data collected was edited for accuracy, uniformity, consistency and completeness and then arranged to enable coding and tabulation. The study provided data in both narrative as well as numeric form.

The data collected was analyzed and comparisons made by use of descriptive statistics such as means. Standard deviations and percentages to establish relationships amongst the different factors driving firms to go Public. Microsoft Excel and statistical package for social sciences (SPSS) were utilized to perform the various statistical analysis. The results were presented in form of graphs, charts and tables.
CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction
This section presents the analysis and findings from the primary data that was gathered from the respondents. All completed questionnaires were edited for completeness and consistency. Summaries of data findings together with interpretations have been presented by use of percentages, frequencies, pie-charts and bar graphs.

4.2 Preliminary analysis

4.2.1 Response Rate to questionnaires
A total of 18 questionnaires were issued to various companies for the research. Out of these, 15 questionnaires were completely filled while there was no response in some respondents and therefore were excluded from further analysis. This represented a responsive rate of 83%. This was considered sufficient for analysis.

4.2.2 Nature of Business
The firms in the study were analyzed based on the industry in which they operate to establish the various sectors in existence. As shown in fig 4.1., 33% of the companies were in Industrial and Commercial Services, 27% were in Finance and Investment while 7% were in Agricultural sector of business.

![Nature of Business](image)

Figure 4.1 Nature of business
4.2.3 Number of years in existence

The age of the companies (number of years in existence) was analyzed to highlight how established the firms have been operating in the industry. As shown in fig 4.2., 53% of the companies had been in existence for over 20 years, 27% between 11 to 20 years, 7% between 6 to 10 years and 13% between 1 and 5 years. This indicates that majority of the companies interviewed had been in existence for longer period and hence are consistent with Chemmanur and Fulghieri (1999) who argue that firms that are older and have a longer operating history are likely to go public.

![Number of years in existence](image)

Figure 4.2 Number of years in existence

4.2.4 Ownership of the firm

Majority of the firms under study were locally owned represented by 95% ownership while 5% were partly local-partly foreign. This indicates strong local ownership of the firms.

![Ownership of the company](image)

Figure 4.3 Ownership of the company
4.2.5 Turnover per annual reports before going public
When asked about turnover as per their annual reports before going public, 60% had above 1 billion and 40% had between 500 million to 1 billion.

![Turnover before going public](image)

Figure 4.4 Turnover before going public

4.2.6 Capitalization of the firm
The capitalization level of the firms was analyzed. Majority 60% had over 1 billion, 33% had between 501 M to 1 Billion and 7% had 251 M to 500M.

![Capitalization of the firms](image)

Figure 4.5 Capitalization of the firms
### 4.2.7 Other sources of Finance considered before public

It was found that majority of the firms had considered other sources of finance before deciding to go public via an IPO, 47% had considered Long-term loans, 20% corporate bonds, and 33% rights issue.

<table>
<thead>
<tr>
<th>Table 4.1 Other sources of finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frequency</td>
</tr>
<tr>
<td>Long-term loans</td>
</tr>
<tr>
<td>Venture capital</td>
</tr>
<tr>
<td>Corporate Bonds</td>
</tr>
<tr>
<td>Rights Issues</td>
</tr>
</tbody>
</table>

### 4.3 Decision to go public

Chemmanur and Fulghieri (1999) developed a model of the going-public decision of a firm and addressed the question. At what stage in its life should a firm go public rather than financing its projects through private placement of equity? They assert that most firms start out as small private companies and at some point in their growth go public with relatively little information about the trade offs underlying a firm’s choice between remaining private or going public.

The decision to go public data was analyzed by use of descriptive statistics. Some of the reasons given by companies for deciding to go public were to raise money capital for growth of their businesses and also due to Government divestiture policy. Others went public in order to reward their loyal depositors by being shareholders, for liquidity purposes, Price discovery and to enhance corporate governance structures, corporate image and disclosure standards.

The major problems encountered by the firms while raising funds from other sources include high cost of capital (interest rates) and tight lending conditions.
4.3.1 Motivations for conducting the IPO

The data was analyzed in terms of mean and standard deviation using SPSS. The findings were as shown in table 4.2. The mean values of the motivations for conducting an IPO varied from 1.8 to 4.333, standard deviations were high across all the motivating factors showing a high variation in opinion expressed by the respondents. The findings, consistent with Scott (1976) and Modigliani and Miller (1963), show that CFOs feel most strongly (mean = 4.33, 87% agreeing) that an IPO serves to minimize cost of capital. The other two reasons given strong support include; debt was becoming too expensive (mean =3.67, 53% agreeing) and to broaden the base ownership (mean =3.33, 47% agreeing) while to create public shares for use in future acquisitions received the least support (mean = 1.8, 20% agreeing).

Table 4.2 Motivations for conducting the IPO

<table>
<thead>
<tr>
<th>Motivation</th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>To minimize cost of capital</td>
<td>4.333</td>
<td>.72375</td>
</tr>
<tr>
<td>Debt was becoming too expensive</td>
<td>3.667</td>
<td>.72375</td>
</tr>
<tr>
<td>The company had run out of private equity</td>
<td>2.200</td>
<td>.41404</td>
</tr>
<tr>
<td>To create public shares for use in future acquisitions</td>
<td>1.800</td>
<td>.41404</td>
</tr>
<tr>
<td>To allow one or more principles to diversify personal holding</td>
<td>2.533</td>
<td>1.35576</td>
</tr>
<tr>
<td>To enhance the reputation of the company</td>
<td>2.867</td>
<td>.63994</td>
</tr>
<tr>
<td>To establish a market price/value for the firm</td>
<td>2.47</td>
<td>.915</td>
</tr>
<tr>
<td>To broaden the base of ownership</td>
<td>3.333</td>
<td>1.11270</td>
</tr>
</tbody>
</table>

4.3.2 Extent to which the following created concern in decision to go public

The CFOs were asked to indicate on a five-point scale (1 = No concern; 5 = Great concern), “To what extent did each of the following create concern in the decision to go public?” Table 4.3 reports the results. CFOs strongly believe that NSE reporting requirements (mean = 4.13, 87% agreeing) were of great concern when deciding to go public. Costs/fees (mean = 4.07, 80% agreeing) and Disclosing information to
competitors (mean = 3.07, 60% agreeing) also received great support while Low price of the stock (mean = 2.13, 13% agreeing) and to avoid ownership dilution (mean = 2.13, 13% agreeing) were of least concern.

Table 4.3 Extent of concern in decision to go public

<table>
<thead>
<tr>
<th>Descriptive Statistics</th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>NSE reporting requirements</td>
<td>4.1333</td>
<td>.35187</td>
</tr>
<tr>
<td>Costs/Fees of an IPO</td>
<td>4.0667</td>
<td>.25820</td>
</tr>
<tr>
<td>Desire to maintain decision-making control</td>
<td>3.0000</td>
<td>.65465</td>
</tr>
<tr>
<td>Already have enough capital</td>
<td>2.6667</td>
<td>.81650</td>
</tr>
<tr>
<td>Low price of the stock</td>
<td>2.1333</td>
<td>.35187</td>
</tr>
<tr>
<td>To avoid EPS dilution</td>
<td>2.1333</td>
<td>.35187</td>
</tr>
<tr>
<td>To avoid ownership dilution</td>
<td>2.2000</td>
<td>.41404</td>
</tr>
<tr>
<td>Acquisition by another firm</td>
<td>2.3333</td>
<td>.48795</td>
</tr>
<tr>
<td>Bad market/industry conditions</td>
<td>2.6667</td>
<td>.72375</td>
</tr>
<tr>
<td>Disclosing information to competitors</td>
<td>3.0667</td>
<td>.96115</td>
</tr>
</tbody>
</table>

4.3.3 Extent to which the following factors influence the Timing of the IPO

The CFOs were asked to indicate on a five-point scale (1 = not important; 5 = very important), “To what extent do the following influence the timing of a possible IPO?” Table 4.4 reports the response. Need for capital to grow was identified as the most important determinant of timing (mean = 4.47, 67% agreeing). Two other factors also perceived as strongly influencing the timing of an IPO included Overall stock market conditions (mean 4.40, 60% agreeing) and Industry conditions (mean = 4.06, 53% agreeing). First-day stock performance of recent IPO’s and other good firms were currently going public were viewed as relatively unimportant.
Table 4.4 Extent to which the following factors influence the Timing of the IPO

Descriptive Statistics

<table>
<thead>
<tr>
<th>Factor</th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall stock market conditions</td>
<td>4.4000</td>
<td>50709</td>
</tr>
<tr>
<td>Industry conditions</td>
<td>4.0667</td>
<td>25820</td>
</tr>
<tr>
<td>First-day stock performance of recent IPO's</td>
<td>2.1333</td>
<td>.35187</td>
</tr>
<tr>
<td>Other good firms were currently going public</td>
<td>3.4000</td>
<td>.73679</td>
</tr>
<tr>
<td>Need for capital to continue to grow</td>
<td>4.4667</td>
<td>51640</td>
</tr>
</tbody>
</table>

4.3.4 Importance of the following criteria in deciding whether to go public

The CFOs were asked to indicate on a five-point scale (1 = not important; 5 = Very important. “How important were the following criteria in deciding on whether to go public?” Table 4.5 reports the results. To allow dispersion of ownership (mean = 3.07, 40% agreeing) and to minimize cost of capital/ Optimal capital (mean = 3.00, 33% agreeing) were identified as the single most important criteria in deciding to go public. According to Zingales (1995), the establishment of a market price may serve as the first step in the going public process, however to establish a market price/value for the firm received the least support (mean 2.13, 13% agreeing)

Table 4.5 Importance of the following criteria in deciding whether to go public

Descriptive Statistics

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>To minimize cost of capital/ Optimal capital</td>
<td>3.0000</td>
<td>92582</td>
</tr>
<tr>
<td>Pecking order of financing</td>
<td>2.4000</td>
<td>50709</td>
</tr>
<tr>
<td>To create public market so firm has the currency of shares for acquisitions</td>
<td>2.2667</td>
<td>.45774</td>
</tr>
<tr>
<td>To increase the reputation of the company</td>
<td>2.4667</td>
<td>.51640</td>
</tr>
<tr>
<td>To establish a market price/Value for firm</td>
<td>2.1333</td>
<td>.35187</td>
</tr>
<tr>
<td>To allow dispersion of ownership</td>
<td>3.0667</td>
<td>1.03280</td>
</tr>
</tbody>
</table>
4.3.6 Reasons for Going Public in preference to other similar sources of finance

The CFOs were asked to indicate on a five-point scale (1 = not important; 5 = very important), “For what reason was going public chosen in preference to other similar sourcing of finance?” Table 4.6 reports the response.

Table 4.6 Reasons for going public in preference to other similar sources of finance

<table>
<thead>
<tr>
<th>Descriptive Statistics</th>
<th>Mean</th>
<th>Std dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>No security required</td>
<td>3.2000</td>
<td>1.20712</td>
</tr>
<tr>
<td>Cost of funding is lower</td>
<td>3.4000</td>
<td>1.18322</td>
</tr>
<tr>
<td>Needed money urgently</td>
<td>4.0667</td>
<td>1.09978</td>
</tr>
<tr>
<td>Convenience in terms of arrangement</td>
<td>3.6667</td>
<td>1.34519</td>
</tr>
</tbody>
</table>

CFO responses show that the principle reason why going public was chosen in preference to other sources of finance is the urgent need for money (mean = 4.07, 73% agreeing). Other reasons which received mean scores greater than 3.0 indicating that they are important include: Convenience in terms of arrangement (mean = 3.67, 60% agreeing). Cost of funding is lower (mean = 3.4, 40% agreeing), No security required (mean = 3.2, 33% agreeing)
CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary
The objective of the study was to establish the reasons for going public by Kenyan companies. The study examined the reasons that make companies go public and the problems encountered. The study also analyzed the motivations for conducting the IPO, the concerns that occur in making the decision, the factors influencing the timing and the reasons for going public in preference to other similar sources of financing. In a nutshell, most firms had been in existence for many years. 53% have been operational for over 20 years while 13% were less than 5 years old. Most companies were from the Industrial and commercial services (33%) while the least was from the agricultural sector (5%). 93% of the companies studied were locally owned while 7% were partly local-partly foreign. 60% of the companies had capitalization level of above 1 Billion, 33% had 501 M – 1 billion while 7% had 251M to 500M.

The major reasons identified for going public include: Capital raising aspects and implementation of Government divestiture policy. The key challenges faced by the companies while going public are high expenses (listing fees) and stringent market regulations required by the regulatory authorities. The major motivating factor identified for conducting the IPO is to minimize the cost of capital while the NSE reporting requirements and costs/fees were of great concern. The study also examined that the need for capital to grow, overall stock market conditions as well as industry conditions influenced the timing of a possible IPO. Allowing more dispersion of ownership and minimizing the cost of capital were very important in choosing the criteria while establishment of a market price of the firm was of least importance.

Most companies preferred going public because they needed money urgently, the cost of funding is lower and very convenient in terms of arrangement. The funds raised through
the public offering is mainly being used to facilitate expansion (growth) in regional and local business.

5.2 Conclusion
The stock market has increasingly become an avenue for bridging the requirements of both investors and borrowers. Trading on the stock exchange has become a fashionable tool for raising capital and investors have become increasingly aware of the potential of the NSE. As an instrument for privatization, the exchange has provided an avenue of liberalization of sectors previously dominated by the government and facilitated public divestiture of its shares in public enterprises.

Based on the study, companies seek to minimize their cost of capital and in the process maximize the gains by raising capital through the stock market. One of the key drivers identified for private firm’s decisions to IPO is the need to access large amounts of capital, amounts in excess of what private equity markets can provide. Going public encourages the broader ownership of firms by according the general public ownership rights. Improved corporate governance is one of the advantages that accrue to public companies because of the improvement of management standards and efficiency so as to meet the demands of shareholders and the NSE under its corporate governance rules. In conclusion therefore, the study shows firms go public for various reasons despite the high listing costs encountered.

5.3 Limitations
Since the population of the study was small, it may be necessary to do a study with a large sample to see if these results can be confirmed.
Questionnaires did not allow for probing to get further information. Face to face interview could be considered in future.
Because of the time frame factor, some of firm’s had not returned the questionnaires by the deadline resulting to 83% response rate.
5.3 Suggestion for further research

Given the time frame, the researcher was restricted to companies that went public only. The researcher recommends a further research that will capture companies that did not go public.

The study dealt with the companies irrespective of the sectors. The researcher recommends that further research be done to analyze firms based on the sectors.
REFERENCES


Holmen, M., and P. Hogfeldt (2003), A law and finance analysis of initial public offerings”, working paper (Stockholm University)


Kiilu, M (2006), A comparison of the financial performance of companies before and after Going Public Quoted at the NSE, Unpublished MBA project, University of Nairobi.


Myers, S.C., and N.S. Majluf, (1984), Corporate financing and investment decisions when firms have information that investors do not have. Journal of Finance Economics 13, 187-221.


DATE: 22/09/05

TO WHOM IT MAY CONCERN

The bearer of this letter, Lucy J. Boi7, is a Master of Business Administration (MBA) student of the University of Nairobi. He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist him/her by allowing him/her to collect data in your organization for the research.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

Dr. W.N. Iraki
Co-Ordinator, MBA Program
Appendix II: QUESTIONNAIRE

Research Questionnaire on why companies go public in Kenya.

PART 1: GENERAL INFORMATION ON THE COMPANY

1. Name of the Company: ......................................................

2. Date of incorporation: .....................................................

3. What Industry is your company operating in? (Tick one)
   (i) Agricultural
   (ii) Finance and investment
   (iii) Industrial
   (iv) Commercial and Services
   (v) Manufacturing
       Others (Specify)

4. For how long has your firm been in operation (Tick one)
   i) 1 to 5 years
   ii) 6 to 10 years
   iii) 11 to 20 years
   iv) Over 20 years

5. What is the ownership of your company?
   i) Locally owned
   ii) Multi-National subsidiary
   iii) Partly local-Partly foreign
       Others (Specify)

6. Who are the current major owners of the company and in what percentages?

<table>
<thead>
<tr>
<th>Owner</th>
<th>Percentage of ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td></td>
</tr>
</tbody>
</table>
7. What was the turnover of your company as per annual reports before going public?
   
i) Below 500 Million
   
   ii) 500 Million to 1 billion
   
   iii) Above 1 billion
   
8. What is the capitalization of your firm?
   
i) KSh 20 M to 50 M
   
   ii) Ksh 51M to 100M
   
   iii) Ksh 101M to 250M
   
   iv) Ksh 251M to 500M
   
   v) KSh 501M to 1Bn
   
   vi) Over 1 Bn

PART II: DECISION TO GO PUBLIC

1. When did your company go public?.................................

2. Why did your company decide to go public?(Please specify)
   
i)
   
   ii)
   
   iii)
   
   iv)

3. What problems did your company encounter while raising funds from other sources? (Tick one)
   
i) Lack of adequate security
   
   ii) High cost of capital (Interest rate)
   
   iii) Tight lending conditions
   
   iv) Credit period not long enough

   Others (Specify)

   (v) ........................................................
   
   (vi) ........................................................
   
   (vi) ........................................................
4. What was the total amount of shares floated?

5. What other sources of Finance were considered before deciding to Go Public? (Tick appropriately)
   - Long-term loans
   - Venture Capital
   - Corporate Bonds
   - Rights Issues
   - Others

6. What problems did your company experience while raising funds through an initial public offering?

7. How important were the following motivations for conducting the IPO? (Please rank them by indicating the extent of importance)

   (i) To minimize cost of capital
   (ii) Debt was becoming too expensive
   (iii) The company had run out of private equity
   (iv) To create public shares for use in future acquisitions
   (v) To allow one or more principles to diversify personal holdings
   (vi) To enhance the reputation of the company
   (vii) To establish a market price/value for the firm
   (viii) To broaden the base of ownership
8. To what extent did each of the following create concern in the decision to go Public?(Please rank them by indicating the extent of concern)


(i) NSE reporting requirements
(ii) Costs/fees of an IPO
(iii) Desire to maintain decision-making control
(iv) Already have enough capital
(v) Low price of the stock
(vi) To avoid EPS dilution
(vii) To avoid ownership dilution
(viii) Acquisition by another firm
(ix) Bad market/industry conditions
(x) Disclosing information to competitors

9. To what extent did the following influence the timing of your possible IPO?(Please rank them by indicating the extent of importance)


(i) Overall stock market conditions
(ii) Industry conditions
(iii) First-day stock performance of recent IPO’s
(iv) Other good firms were currently going public
(v) Need for capital to continue to grow

10. How important were the following criteria in deciding on whether to go public?(Please rank them by indicating the extent of importance)


(i) To minimize cost of capital/Optimal capital
(ii) Pecking order of financing
(iii) To create public market so firm has the currency of shares for acquisitions
(iv) To increase the reputation of the company
(v) To establish a market price/value for firm
(vi) To allow more dispersion of ownership

11. Did your company benefit from the exposure that it received from becoming public? Yes ☐ No ☐

12. For what reason was Going Public chosen in preference to other similar sourcing of Finance? Please rank them by indicating the extent of importance


i) No security required
ii) Cost of funding is lower
iii) Needed money urgently
iv) Convenience in terms of arrangement

Others
v) ............................................................
vi) ............................................................

13. What amount of capital were you seeking from the Public offering?

14. How are you using the funds raised though the public offering?

15. What is your projected revenue before going public?

<table>
<thead>
<tr>
<th>Year 1 (Kshs)</th>
<th>Year 2 (Kshs)</th>
<th>Year 3 (Kshs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>...............</td>
<td>...............</td>
<td>...............</td>
</tr>
</tbody>
</table>

v
16. Who approved the decision to go public?

i) Special resolution by Board of Directors

ii) Management

iii) Shareholders through AGM

Others

iv) ......................................................................................................................

Thank you for your co-operation
<table>
<thead>
<tr>
<th>YEAR</th>
<th>COMPANY</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>KCB</td>
</tr>
<tr>
<td>1992</td>
<td>Uchumi</td>
</tr>
<tr>
<td>1992</td>
<td>Crown Berger</td>
</tr>
<tr>
<td>1992</td>
<td>HFCK</td>
</tr>
<tr>
<td>1994</td>
<td>Firestone (Sameer)</td>
</tr>
<tr>
<td>1994</td>
<td>NBK</td>
</tr>
<tr>
<td>1996</td>
<td>Rea Vipingo</td>
</tr>
<tr>
<td>1996</td>
<td>KQ</td>
</tr>
<tr>
<td>1997</td>
<td>ARM</td>
</tr>
<tr>
<td>2001</td>
<td>Mumias</td>
</tr>
<tr>
<td>2006</td>
<td>Kengen</td>
</tr>
<tr>
<td>2006</td>
<td>Scan Group</td>
</tr>
<tr>
<td>2006</td>
<td>Equity</td>
</tr>
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<td>2006</td>
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<td>2007</td>
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</tr>
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<td>Kenya Re</td>
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<td>2008</td>
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