AN INVESTIGATION INTO THE FACTORS HINDERING THE DEVELOPMENT OF THE COMMERCIAL PAPER MARKET IN KENYA.

KINYUA H.W.

THIS PROJECT WAS PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTERS OF BUSINESS ADMINISTRATION OF THE UNIVERSITY OF NAIROBI

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DECLARATION

This MBA Research Project is my own original work and has not been submitted for a degree at the University of Nairobi or any other University.

Signed ____________ Date 27/11/2006

KINYUA HELEN WAIRIMU

This MBA Research Project has been submitted for examination with my approval as a University of Nairobi Supervisor.

Signed ____________ Date 27/11/06

MOHAMED MWACHITI

Lecturer,

Department of Accounting

University of Nairobi

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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background

Commercial paper is a short-term unsecured promisory note issued by creditworthy issuers. It is a low cost alternative to bank loans and overdraft (Fischer & Jordan 2001). It is a short-term capital market instrument that provides a cost effective and flexible source of funding. Like corporate bonds, commercial paper is an instrument issued for the purpose of raising funds directly from investors without intermediation of banks. Commercial paper is generally used to finance the working capital requirements of a company, the same way a bank overdraft would do. This is in contrast to bonds that are used by companies to meet their long term financing needs.

Commercial paper offers businesses a cheaper source of financing their current expenditures. Many companies have been put into receivership and many more wound up due to their inability to service their loans. An opportunity for such companies to source cheaper funds by issuing commercial paper can be explored. Businesses need money in order to grow, expand to new locations, upgrade equipment, or any of a thousand uses of capital (Fidelity Investment Guidelines,2000).

Commercial paper has its origin in the United States of America in the early 19th century. There existed legal restrictions preventing banks form operating in more than one state, resulting in a scarcity of funds in some states, and surplus in others. Corporations that found themselves in "deficient" states could not borrow from commercial banks competitively and they resorted to borrowing from the open market so as to meet their financing needs. Investors in commercial paper earn competitive, market determined yields in notes whose maturity and amounts can be tailored to their specific needs (Wells, 1994). The USA commercial paper market is very active with commercial paper outstanding totaling to $538 billion at the end of 1991 (Hatton, 1991).

Commercial paper in Kenya is a very recent development compared to other developed nations. Commercial paper issuance in Kenya can be traced to 1994 when Brookbond made the first issues in the corporate sector. In 1996, the Capital Market Authority (CMA) moved to regulate the issuance of both corporate bonds and commercial paper in a market that had been dominated by trade in equities (The CMA Annual Report, 1996/1997). Since 1994, the number of companies that have issued commercial paper has risen to 24 (Appendix I).

1.2 The Kenyan Commercial Paper Market.

Commercial paper in Kenya is very recent compared to major and developed economies like the USA and European countries. The first issue was in 1994 and it was not until 1997 however, that activity increased. Prior to this, the Central Bank of Kenya (CBK) limited the issuance of Commercial paper to companies listed in the Nairobi Stock Exchange (NSE). In the absence of credit rating agencies in Kenya, the CBK undoubtedly reasoned that investors could assess the creditworthiness of the issuers themselves as those listed published their financial statements periodically.

The CMA issued revised rules in April 1997, and these allowed a wider range of companies to issue commercial papers irrespective of their listing status, subject to meeting rules and regulations laid out in the CMA guidelines (The CMA Annual Report, 1996/1997). The Central Bank's role is currently limited to the issuance of the letters of no objection to the placing agents after assessing their financial status with the CMA as the regulatory body. Since the issuance of debt instruments by corporate sector is traditionally a Capital Market activity, the CMA regulates the Kenyan commercial paper market. The CMA gives reason behind this as the need to ensure proper and appropriate, disclosure of information for the benefit of investing companies. As a regulator, the CMA prescribes the minimum conditions that are considered protective to the investors in commercial paper market.

In Kenya, the issuers of commercial papers use dealers, who are called placement agents or arrangers. They provide the issuing company a comprehensive service in two main ways; arranging and placement. Arranging includes the preparation of a prospectus and detailed financial analysis, seeking approval of the CMA on behalf of the issuer; and explaining to prospective investors how the funds to be raised will be used, as well as providing information on the issuing company. Placement on the other hand is the actual sale of the paper to institutional investors for the agreed amount and interest rate.

As in the case of international commercial paper markets, the paper is normally issued on discounted basis. The investors buy the notes at less than their face value, with the difference representing the value of the effective interest. The investor receives the full face value amount on maturity. There is no secondary market for commercial paper in Kenya at present, unlike the corporate bonds. The commercial papers are not listed at the NSE and their maturities range from 30-270 days (Business week, Daily Nation, 3rd June 2003).

The principal advantage of Commercial paper as a source of short-term financing is that it is generally cheaper than a short-term business loan from a commercial bank as it may be several percentage points lower than the prime rate of bank loan to a high quality borrower (Van Horne, 1995). Njogu (2003) found that an issuer of commercial paper in Kenya stood to gain on average 5.85% on interest savings. The incremental interest savings should result in increased cash flows for the firm possibly translating to higher dividends, more investments etc for the investor. In recent years, many firms have also used commercial papers to finance major construction undertakings (Kidwell, 1990).

The Kenyan commercial paper programs have combination of European and USA features. For example, they are authorized by the CMA for working capital purposes, just like in the USA. However, they are sold to investors only through dealers who must be registered with the CMA as investment advisors. This is similar to European issues, where companies do not issue their papers directly to the investors. The unsecured nature of commercial papers needs the intervention of the dealer to help in contacting investors and in placing the paper.

1.3 Statement of the Problem

Today's business environment is very competitive and firms must strategize in order to be able to remain competitive and profitable. Cost cutting measures is the language in today's business circles, hence it has become inevitable for companies to source for the cheapest source of finance available. In Kenya, commercial banks continue to charge punitive rates up to 20% for their loans and advances.

Commercial paper offers a more attractive financing option than bank loans and bank overdrafts. Njogu (2003) found that companies in the NSE that substituted short term bank loan with a commercial paper experienced some significant interest savings of between 2.85% and 13.85% with an average of 5.85%. Commercial paper is interpreted as good news by investors as the stocks experienced positive abnormal returns due to the interest savings, which increased the firm's net cash flows (Njogu, 2003).

The Kenyan commercial paper market has not grown rapidly despite the advantages accruing for companies raising short term funds through the issue of commercial papers. Many companies in Kenya today continue to rely on bank overdrafts and commercial bank credit for financing their working capital. This can be seen with only 24 companies having issued commercial papers since the first commercial paper was issued in the market in 1994 against a total population of over 400 companies as at December 2004. This has resulted in huge financing costs, shrinking down their profits and dividends to shareholders. Hence there is need to investigate the factors hindering the development of the commercial paper market in Kenya. This study will therefore seek to find out the factors hindering the development of commercial paper market in Kenya.

1.4 Objective of the Study

The objective of this study is to determine factors hindering the development of commercial paper market in Kenya.

1.5 Importance of the Study

Credit borrowers: Use the information to explore cheaper financing options instead of depending on the traditional bank loans and overdrafts.

The management and employees of companies: The study gives managers insights into opportunities of financing their working capital expenditure cheaply though the commercial paper issues, which would translate to more profits hence remuneration.

Shareholders: The study will enlighten shareholders on cheaper services of financing available in commercial paper market, freeing more funds for dividend pay-outs.

Investors: The study offers investors a variety of alternative investments to bank deposits and government securities.

Researchers and academicians: The study provides reference into little known Kenyan commercial paper market, it could be extended to other related products like mortgage related securities, municipal bonds, asset backed securities, etc.

Regulators (CMA and NSE): The study will highlight impediments experienced by issuers when dealing with regulators, who in turn will seek to put up framework which entices the would be issuers.

The intermediaries (Stockbrokers and Investment Advisors): The intermediaries have a role to play in realization of vibrant commercial paper market. The research will make recommendations on key areas that need to be explored to expand the commercial paper market.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 The History of the Commercial Paper

Commercial paper has its origin in the United States of America in the early 19th century. The initial issuers of commercial paper in the US were textiles, utilities and the railroads, which were the developing industries at the time. However, the advent of the automobile and other consumer goods like electronics introduced finance companies into the commercial paper market. Commercial paper was used to finance the hire purchase operations of these companies. A 1997 survey in the US showed the distribution of commercial paper issuers as industrials at 42.0%, utilities at 21.9%, finance companies at 17.6% and others at 18.5% (Van Horne, 1997).

The General Motors Acceptances Corporation (GMAC), a subsidiary of General Motors was the first company to issue commercial paper directly to the investors. Due to the large volumes of paper issued, finance companies have found it much cheaper to sell their paper directly to the investors, thereby saving on the dealers' commissions. Industrial companies, utilities and smaller finance companies sell their paper through dealers since their issue volumes do not justify establishment of in-house paper selling departments. On average, dealers get a commission or dealer spread of 0.125% on the placements they make (Horne et al 1997 pg 235). While historically commercial paper was bought by commercial banks and Money Market Mutual Funds (MMF's), the early 1950s saw other firms enter into the market as investors. These include insurance companies, non-financial business forms, pension funds, and university endowment funds. Individuals hold little commercial paper directly because of the large minimum denominations, but there are large indirect investors in commercial paper through MMF's and trusts (Hahn, 2003).

The USA commercial paper market is regulated by the Securities Act 1933. Whereas registration of the issue is a requirement, the Securities and Exchange Commission (SEC) can grant a company exemption. One requirement for exemption is that the maturity of commercial paper must be less than 270 days. A second requirement for exemption is that notes must be of a type not ordinarily purchased by the general public, usually minimum denominations of $100,000. A third requirement for exemption is that proceeds from commercial paper issues be used to finance "current transactions," which include the funding of operating expenses and the current assets such as receivables and inventories.

The secondary market in commercial paper is small. Partly the lack of a secondary market reflects the heterogeneous characteristics of commercial paper, which makes it difficult to assemble blocks of paper large enough to facilitate secondary trading. Partly it reflects the short maturity of the paper. Dealers will sometimes purchase paper from issuers or investors, hold the paper in inventory and subsequently trade it. The absence of an active secondary market and the ever-present risk of default have given commercial paper yields higher than treasury bills of similar maturity.

The commercial paper market in the USA grew exponentially in the 1960s, with the outstanding paper tripling between 1966 and 1968. Many companies were facing difficulties in accessing credit from commercial banks thereby resulting to issuing commercial paper. A series of bank failures and the Mexican debt crisis of 1982 shock the confidence of bank depositors, forcing them to find an alternative means through which to invest their funds.

The spread of commercial paper to other parts of the world is comparatively recent. USA companies went offshore in the 1970 due to congressional restrictions on "capital exports", the funding of offshore subsidiaries with dollars transferred from the parent company's domestic financing program. The subsidiaries had to tap dollars funding from the reserves held by non USA investors, and this led to the issue of US$ denominated commercial paper in Europe. In India, commercial paper was used in 1989, and works much the same way as the US paper (Tom Lowess, 1995).

An increasing amount of commercial paper is being issued in book-entry form in which the physical commercial paper certificates are replaced by entries in computerized accounts. Book-entry systems will eventually completely replace the physical printing and delivery of notes. The advantages of a paperless system are significant. The fees and costs associated with the book-entry system will, in the long run, be significantly less than under the physical delivery system. The expense of delivering and verifying certificates and the risks of messengers failing to deliver certificates on time will be eliminated. The problem of daylight overdrafts, which arise from uncoordinated issuing and redeeming of commercial paper, will be reduced since all transactions between an issuing agent and a paying agent will be settled with a single end-of-day wire transaction. (Hahn, 2003).

Since 1970, when the Penn Central Transportation Co. defaulted with $82 million of commercial paper outstanding, almost all commercial paper has carried ratings from one or more rating agency. Currently, the four major rating agencies in the US are Moody's, Standard & Poor's, Duff & Phelps, and Fitch. An issuer's commercial paper rating is an independent "assessment of the likelihood of timely payment of short term debt" (Standard & Poor's 1991). For example, Standard & Poor's gives an A-1 rating to issues that it believes have a "strong" degree of safety for timely repayment of debt, an A-2 rating to issues that it believes have a degree of safety that is "satisfactory," and an A-3 rating to issues that it believes have a degree of safety that is "adequate." Finally, a D rating indicates the issuer has defaulted on its commercial paper. Almost all issuers carry one of the two; highest prime or A ratings. Ratings are crucially important in the commercial paper market. Ratings are useful as an independent evaluation of credit risk that summarizes available public information and reduces the duplication of analysis in a market with many investors (Wakeman, 1981).

Backup Liquidity

Commercial paper issuers maintain access to funds that can be used to pay off all or some of their maturing commercial paper and other short-term debt. These funds are either in the form of their own cash reserves or bank lines of credit. Rating agencies require evidence of short-term liquidity and will not issue a commercial paper rating without it. Commercial paper issuers maintain backup liquidity through bank lines of credit available in a variety of forms. Backup lines of credit are intended to provide funds to retire maturing commercial paper when an event prevents an issuer from rolling over the paper (Hahn, 2003).

Credit Enhancements

Credit enhancements differ from backup lines of credit in that they provide a guarantee of support which cannot be withdrawn. Some smaller and riskier firms, which normally would find the commercial paper market unreceptive, access the commercial paper market using these enhancements. Some large firms with strong credit ratings raise the ratings of smaller and less creditworthy subsidiaries by supporting their commercial paper with outright guarantees or with less secure "Keepwell" agreements which describe the commitment the parent makes to assist the subsidiary to maintain a certain creditworthiness (Moody's, 1992). Slovin et al (1988) study found out that the announcement of a commercial paper program with a credit enhancement to have been associated with a significant increase in the value of the issuer's equity, but the announcement of a commercial paper program with no credit enhancement had no impact on firm value.

2.2 Innovations in the Commercial Paper Market

Asset-Backed Commercial Paper

A relatively new innovation in the commercial paper market is the backing of commercial paper with assets. The risk of most commercial paper depends on the entire firm's operating and financial risk. With asset-backed paper, the paper's risk is instead tied directly to the creditworthiness of specific financial assets, usually some form of receivable. Asset-backed paper is one way smaller, riskier firms can access the commercial paper market. The advantages of asset-backed securities have led large, lower-risk commercial paper issuers to also participate in asset-backed commercial paper programs. Asset-backed programs have grown rapidly since the first program in 1983. Standard & Poor's has rated more than 60 asset-backed issues (Kavanagh et al 1992, p. 109) with an estimated $40 billion outstanding.

Swaps

Interest rate swaps are one of a variety of relatively new instruments that have significantly increased the financing options of commercial paper issuers. Swaps provide issuers with flexibility to rapidly restructure their liabilities, to raise funds at reduced costs, and to hedge risks arising from short-term financing programs. Interest rate swaps are agreements between two parties to exchange interest rate payments over some specified time period on a certain amount of unexchanged principle. To appreciate the role of swaps it is necessary to understand that there are two interest rate risks associated with commercial paper borrowing (Eingzig et al, 2001).

First, the firm faces market interest rate risk; the risk that the rate it pays on commercial paper will rise because the level of market interest rates increases. A change in the risk-free rate, such as the Treasury bill rate, will cause a corresponding change in all commercial paper and borrowing rates. Second, the firm faces idiosyncratic interest rate risk; the risk that commercial paper investors will demand a higher rate because they perceive the firm's credit risk to have increased. With idiosyncratic risk, the rate on its commercial paper can rise without an increase in the risk-free rate or in other commercial paper rates.

A commercial paper issuer can eliminate market interest rate risk by entering into a swap and agreeing to exchange a fixed interest rate payment for a variable interest rate. Alternatively, the firm can fix the cost of its idiosyncratic risk by borrowing in the long-term market at a fixed rate and entering into a swap in which it pays a floating rate and receives a fixed rate. The swap effectively converts the long-term fixed-rate liability into a floating-rate liability that is similar to commercial paper (Eingzig et al 2001).

2.3 The Role of Capital Market Authority in Regulating the Commercial Paper Market in Kenya

The CMA has rules and guidelines that govern issuance and listing of commercial papers. It has the obligation of not only regulating but also in developing a vibrant commercial paper market. In this section, we look briefly at the regulations governing commercial paper issuers. The CMA requires that any potential issuer of commercial paper be; a public company registered under the company's Act or any other body corporate established or incorporated in Kenya under the provision of any written law. Issuers of commercial papers may be private companies.

The issuer other than the government of Kenya issuing treasury bonds or other government securities, must have published audited financial statements complying with IAS for an accounting period ending on a date not more than three months prior to the proposed date of the offer. Where not more than nine months have elapsed since the end of the financial year to which the last published annual accounts relate, the issuer shall prepare an interim audited financial statement covering at least the first months following the end of that financial year which must be included in or appended to the prospectus (CMA bulletin 2002).

In the case of issuers whose securities are listed at a securities exchange in Kenya but where not more than six months have elapsed since the end of the financial year, un audited financial statements covering the period preceding the six months must be included in or appended to the prospectus. The financial soundness of the issuer shall not be in any doubt and the issuer must have prepared financial statements for he latest accounting period on a going concern basis and the audit report must not contain any emphasis of matter or qualification in this regard. At the date of the application, the issuer must not be in breach of any of its loan covenants particularly in regard to the maximum debt capacity (CMA Bulletin 2002).

The issuer must have declared positive profits after tax attributable to shareholders in at least two of the last three financial periods preceding the application for the issue. Total indebtedness, including the new issue of fixed income securities shall not exceed 400% of the company's net worth (or gearing ratio of 4:1) as at the latest balance sheet.

The funds from operations to total debt for the three trading periods preceding the issue shall be maintained at a weighted average of 40% or more. The conditions as provided must be maintained as long as the fixed income securities remain outstanding (CMA Bulletin 2002).

2.4 Decisions on Business Financing

Business firms use many types of financing for their operations and investment projects. Finance may be generated internally, with residual profits after distribution of dividends to the owners constituting internal funds. External sources include debt and quasi-debt in its many forms, such as bonds, leases, debentures, preference shares, trade credit, commercial papers and bank loans and overdraft.

Due to the growth in size of the firm, owner's equity and accumulated reserves become inadequate to finance operations. This is what gives rise to the need for external capital. Even though the firm has the option to go public to raise additional equity, the desire of the present owners to retain control of the company makes debt the only avenue left for extra financing. Use of debt is to be approached cautiously because debt agreements sometimes contain certain restrictive covenants that curtail the company's operating flexibility in the future. This interferes with the very right of control of the company that shareholders would wish to retain.

The business expectations about future cash flows are a key determinant of whether a firm should use debt or equity financing. Where there is expectation of high and relatively stable cash flows, a firm can be optimistic and take on debt, with the comfort that it can manage to service the principal and interest cost payments. This means that a firm is able to make decisions on its financing mix based on its expectation of future cash flows. During a regime of high interest rates in an economy, the risk of the firm facing difficulties in servicing debt payments is high enough to have owners choose equity financing instead of debt.

In determining what type of debt financing to use, Morris J. R. (1976) suggested the use short term debt when there exists a positive covariance between the net operating income and the expected future interest rates. Use of short-term debt in such circumstances reduces the risk borne by shareholders, and increases the value of equity.

Another approach suggested by Myers S. C, 1977 uses agency costs. Shareholders of a company that has positive net present value projects to invest in will not get the maximum benefit accruing from such investments if the company has used long-term debt in its capital structure. This is because part of the benefits accruing from the investments will pass on to the debt holders in form of reduced default risk, since the positive NPV projects are expected to increase profitability and improve cash flows. If such a firm had used short-term debt, the likelihood is that such debt will have fallen due and be repaid by the time the company receives the benefits of investing in the positive NPV projects, whose full benefit is now enjoyed by the shareholders.

2.4.1 The Alternative views of Capital Structure

Modigliani and Miller in 1958 challenged the finance theory that was based on the traditional view that held that an optimal capital structure exists for a firm, and that the firm's cost of capital is dependent on its capital structure. Such an optimal structure can be achieved by the careful use of debt and equity, with the value of the firm being maximized as the cost of capital gets minimized. The cost of capital declines with leverage because cost of debt is lower than that of equity for a given range of debt There comes a point where the firm's weighted average cost of capital is at its lowest, and total value of the firm is at its highest. Use of debt beyond this point leads to the increase in the cost of equity, which more than offsets the cost of debt used in the capital structure, leading to the rise of the overall cost of capital.

Modigliani and Miller subjected the traditional view to serious analysis. They argued that total risk for all the security holders of a firm is not altered by changes in its capital structure. The total value of the firm remains the same irrespective of the financing mix used in the firm's capital structure. Assumptions of perfect capital markets, existence of homogeneous risk classes, absence of corporate taxes and the ability to borrow at the risk free rate were made in arriving at their proposition 1. The total market value is arrived at by capitalizing the expected net operating income by the capitalization rate applicable to the firm's risk class. Where two firms are identical in all respects except for their capital structures, they cannot have different market values or different cost of capital. If they were to have different market values, shareholders can benefit by selling shares of the lower value company so as to invest in an equivalent proportion of the one with higher value. Besides, shareholders in the firm that uses debt in its capital structure are better off divesting from the firm and by use of personal leverage, borrow in their own right and invest in the unlevered firm. This creates arbitrage opportunities.

The sole determinant of a firm's weighted average cost of capital is the investments the firm makes, with the source of financing for these investments being of no effect on their value. In his writings on optimality and capital structure, Myers S.C., 1790 notes that there has been a proliferation of the use of debt in take-overs, restructurings and leveraged buyouts. The use of junk bonds has gone up as well. These are indications that firms have become substantially levered. Myers advances three important theories of capital structure, two of which are important in understanding the reasons behind increased leverage that he alludes to earlier. The static trade off theory brings out the issue of the tax shield created by the use of debt, since interest on debt is taxable. By increasing debt in its capital structure, the firm gains a higher tax shield, which leads to the rise in the firm's market value. Use of more debt however brings with it other costs such as the agency costs of debt and the likelihood of financial distress. These costs eat into the benefits accrued from the tax shield, eventually leading to reduced market value of the firm.

The pecking order theory brings out the preference by firms for internal financing in favour of external financing. In the event that the positive net present value investments of a firm require funds to be sourced externally, the safest sources are preferred. The order starts from safer debt, riskier debt and finally to equity. There is no predefined debt ratio since use of debt is consequent upon the inadequacy of internal financing. The availability of investment opportunities spurs firms into using increasing amounts of debt without the risk of financial distress being a primary consideration. The pecking order theory has a linkage to the challenges posed by asymmetric information. The theory explains that if the firm acts in the interest of its existing shareholders, as indeed the shareholders expect management to, the announcement of a new equity issue is negative news that leads to the fall in share prices. This is in contrast to a repurchase of equity to issue debt. Since the market believes that management has superior information, this decision is considered a signal for optimistic future prospects, and the share prices rise.

2.4.2 Financial Structure Decisions and Financial Leverage

The financial structure of a firm refers to the manner in which assets of the firm are financed. It represents the entire capital and liabilities side of the balance sheet. The financial structure decision is about the financing mix, with the financial manager combining various sources of financing so as to maximize the market value of share. Capital structure decisions on the other hand, focus on the mix of long-term sources of finance, and this means that capital structure is apart of the wider financial structure. In many cases however, the terms are often used interchangeably.

Decisions about the long-term mix of assets cannot be made independent of decisions about short-term sources such as trade credit, bank overdraft and commercial paper. In practice there are many cases where short-term debts like bank overdrafts are used as substitutes for long-term debts to finance long-term activities. In such cases, the short-term debts provide leverage benefits to the equity holders of the company. Samuels 1980 argues that the legal form of bank overdrafts, that allows lenders to recall their funds at short notice, should not be enough justification for treating overdrafts as short term finance. Even long-term borrowing agreements also contain clauses that give the lender the right to recall the loaned funds at any time. If a firm makes use of bank overdrafts regularly and the borrowed amount remains fairly constant across periods, then such borrowing can be treated as long term from a practical perspective.

The presence of debt, both short and long-term, in the financial structure of a firm creates a commitment to pay interest. This causes the return on equity to be more variable than would be the case if no debt were used. By the same token, the use of debt increases the probability of insolvency, which is the financial risk of a firm. Financial risk due to the use of debt occurs because of, one, the increase in the variability of the shareholder's return, and, two, the probability of insolvency due to the failure to meet repayments of the principal and interest. A firm that has only equity in its financial structure will have neither the benefits of leverage nor financial risk. It follows therefore that the concept of financial leverage has significant bearing on a firm's decision regarding the composition of its sources of finance.

2.4.3 Financial Structure and Financial Distress

The advantages of debt financing lie in two areas. First, the interest tax shield arising from the fact that the interest costs are tax allowable deduction, and second, the control of the company remains in the hands of the existing shareholders. In spite of these advantages of using debt financing, companies in the real world do not use 100% debt in their financial structure. Financial distress is the term that accurately describes the disadvantage of using debt, and it occurs when the borrowing companies face difficulty in meeting their contractual obligations on debt. In the extreme, financial distress leads to insolvency. Heavy use of debt introduces inflexibility in raising of more funds in that the firm is unable to source funds on favourable terms, and this could adversely affect the firms operations and performance. The present value of financial distress reduces the value of the levered firm. For low to moderate amounts of debt, the present value of the interest tax shield is higher than that of financial distress, resulting in the increase of the value of the firm. When debt is used heavily, the costs of financial distress increase in excess of the value of the interest tax shield. This is clearly seen in (Myer's S. C 1970) static trade off theory that has been discussed earlier.

Use of debt financing should therefore be limited to the ability of the borrower to service the principal and interest payments so as to avoid increasing the likelihood of the firm encountering financial distress. In a situation of financial distress, conflicts of interest arise between the shareholders and the creditors, the effect of which is to increase agency costs as the debt ratio increases. The likely consequence of financial distress on companies is the loss of turnover and key personnel due to the uncertainty about the future of the company. This erodes the competitive edge that such companies enjoy in the market, resulting in reduction in profitability.

2.4.4 Financial Structure Issues in Kenya

Most of the studies done in the area of business financing are confined to long term financing decisions. However, short term debt can have risk implications for a firm if it is significant.

Mbogo (1983) found out that Kenyan public companies were barely managing to meet their obligations as indicated by their current ratios. The study covers the period 1971 to 1982, and it is described as a difficult period economically. This is similar to the economic situation currently prevailing, and what has also been the case for many companies for most of the 1990s due to the effects of the Gulf War and the liberalization of trade and the financial sector in Kenya. An interesting finding of the study is the proliferation of short term debt as represented by the bank overdraft, and the perpetuity of its use through annual renewals. For many of the companies in the study, bank overdraft should be treated as a long-term source of finance.

Kamere (1987) notes that the practice amongst Kenyan companies is to classify bank overdraft as a current liability to reflect its legal form as payable to the lender on demand, and within one year. The reality is as per Mbogo's study, and further that short term borrowing has been used to finance both working capital and fixed assets. Kamere also identified excess borrowing as a significant contributor to business failure.

Njogu (2003) found out that companies in the NSE that substituted commercial short term bank loan with a commercial paper experienced some significant interest savings of between 2.85% and 13.85% with an average of 5.85%. Njogu concluded that commercial paper is interpreted as good news by investors as the stocks experienced positive abnormal returns due to the interest savings, which increased the firm's net cash flows.

2.4.5 *Factors influencing the Development of Commercial Paper Market in Kenya*

Administrative & Legal Issues: The legal requirements for the companies issuing commercial papers in Kenya are as set out by the regulating body the CMA. These are that; The company must be a public company registered under the Company's Act Cap 486, hence this eliminates any other form of businesses that could be willing to issue commercial papers. In addition, these companies must publish their audited financial statements complying with the IAS. The financial soundness of the issuer should not be in any doubt, this reason alone contradicts the main objective of issuing the commercial paper as one would be deemed to have financial difficulties hence the need to look for external financing. The issuer is required to have declared positive profits after tax attributable to shareholders in at least two of the three financial periods preceding the issue, hence logically the firm must have been in operation for at least five years. It is a requirement that the firms must have capitalization of Kshs. 50million and above and net asset of Kshs. 100 million (CMA Bulletin 2002) and that the funds sought through issue of commercial paper must be used to finance working capital requirements of the firm (CMA: Guidelines for the issuance of Corporate Bonds and Commercial Papers, April 1997 pg. 11).

Other factors could include: Lack of awareness on the requirement to qualify to issue commercial papers by the key decision makers on sourcing of finances, it is also costly to the issuer to pay the services of the dealer on average the dealer spread is 0.125% of the amount of commercial paper issued, (Hahn, 2003). The process of arranging and listing commercial papers is quite long since the dealer must get a letter of no objection from the CBK after meeting the CMA requirements. This process takes longer compared to the bank overdraft which is quite a fast process taking only day in some cases. The issuing agent is also confronted with the problem of getting the buyer to take up commercial papers, this is partly because there is no secondary market for commercial papers and in the event the buyer would like to dispose off the paper before its maturity only the placing agent would buy the paper but at a discounted value.

Mbugua (2003) found out the following factors as hindering the development of corporate bonds market in Kenya. The long time taken for approval by the CMA and NSE, lack of information and high cost. High interest rates charged by the banks was attributed to the reason why approximately 32% of companies interviewed sourced for additional funds directly from shareholders. In his study, (Mbugua, 2003) concluded that the low level of awareness on the operations of the CMA and the NSE could be attributed to firms not knowing that they qualify to issue stocks at the NSE, and could access other source of financing like commercial papers to finance their working capital. His findings were that due to this lack of awareness, the companies seeking to raise funds through issuing corporate bonds faced problems of getting buyers to pickup the bond. The cost of arranging and listing was also viewed as a major problem. It would be of interest to find out whether the commercial paper issuers are faced by similar problems too.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Population of the Study

The study is an investigation into the factors hindering the development of the commercial paper market in Kenya for both quoted and unquoted companies. The population comprised of the firms with a minimum authorized, issued and fully paid up share capital of Ksh. 50 million and net asset of Ksh. 100 million as per the requirements of CMA (CMA Bulletin, 2002).

3.2 Sample Design

A sample size of 100 companies quoted and unquoted were picked. The sample compromised of all the 24 companies that have issued commercial papers in Kenya. These companies were deemed to have more information on factors hindering the development of commercial papers in Kenya given that they have experienced the issuing process. Stratified sampling method was used to select the remaining sample of 76 (100-24) companies. This is to allow equal representation of various sectors in the economy. The sectors used will be as per the NSE classification i.e. the manufacturing and allied sector, the banking and finance sector, and the parastatals and others (Appendix II gives the list of the population). This will enable the analysis and comparison, the research will give an indication as to which sector in the economy is more vibrant in the use of commercial papers as a source of financing their short term operations. Mbugua, 2003 in his study on factors influencing the development of corporate bonds market in Kenya used the same classification. Horne, (1997) in his survey for the USA found that the distribution of commercial paper issuers as industrials at 42.0%, utilities at 21.9%, finance companies at 17.6% and others at 18.5%.

3.3 Data Collection & Description

This study used 100 companies from the various industries, this was deemed to be a representative sample to enable us investigate factors influencing development of commercial paper market in Kenya. The data was collected by use of a structured questionnaire, which consisted of likert-type scale containing statement of opinion pertaining to various aspects of the commercial paper (Appendix III). The respondents were the finance managers and drop and pick later method was used, this was to give time to the busy finance managers to study the questionnaire. The finance managers are deemed to have a thorough understanding on the financing decisions of their company. An introductory letter briefly explaining the purpose of the study (appendix IV) accompanied the questionnaire.

3.4 Data Analysis and Findings

The data analysis sought to establish the factors hindering the development of the commercial paper market in Kenya. The data was analyzed using descriptive statistics such as percentages and frequencies. Factor analysis was also used to determine the factors hindering the development of commercial paper market in Kenya. Factor analysis is concerned with defining the patterns of common variation among a set of variables: component factor analysis in particular is concerned with patterning all the variation in a set of variables, whether common or unique; an algebraic model was used in this study as follows:

A traditional approach to expressing relationships is to establish the mathematical function f(X, W, Z) connecting one variable, Y, with the set of variables X, W, and Z. Such a function might be $Y = 2X + 3Z - 2W$, or $Y = 4XW/Z$. The variables on both the right and the left side of the equation are known, data are available, and it is only a question of determining the best function for describing the relationships. If assume that we have a number of variables, Y_1, Y_2, Y_3, and so on, but that we know neither the variables to enter in on the right side of the equation nor the functions involved. Moreover, we may not be able to measure well the characteristics, that is, we have data that we wish to explain mathematically but the variables that would give us this explanation are unmeasureable.

We assume that our Y variables are related to a number of functions operating linearly. That is, Equation 1:

$$Y_1 = \alpha_{11}F_1 + \alpha_{12}F_2 + \ldots + \alpha_{1m}F_m,$$

$$Y_2 = \alpha_{21}F_1 + \alpha_{22}F_2 + \ldots + \alpha_{2m}F_m,$$

$$Y_3 = \alpha_{31}F_1 + \alpha_{32}F_2 + \ldots + \alpha_{3m}F_m,$$

...

...

$$Y_n = \alpha_{n1}F_1 + \alpha_{n2}F_2 + \ldots + \alpha_{nm}F_m,$$

where:

Y = a variable with known data

α= a constant

F = a function, f ( ) of some unknown variables.

F stands for a function of variables and not a variable. For example, the functions might be $F_1 = XW + 2Z$, and $F_2 = 3X^2Z/W^{1/2}$. The unknown variables entering into each function, F, of Equation 1 are related in unknown ways, although the equations relating the functions themselves are linear.

Within this algebraic perspective, what does factor analysis do? By application to the known data on the Y variables, *factor analysis defines the unknown F functions.* The loadings emerging from a factor analysis are the a constants. The factors are the F functions. The size of each loading for each factor measures how much that specific function is related to Y. For any of the Y variables of Equation 1 we may write

Equation 2:

$$Y = \alpha_1F_1 + \alpha_2F_2 + \alpha_3F_3 + \ldots + \alpha_mF_m,$$

with the F's representing factors and the α's representing loadings.

We may find that some of the F functions are common to several variables. These are called group factors and their delineation is often the goal of factor analysis. Alker and Russett (1965) in their study for UN voting with each Y variable being a UN roll-call, found "supernationalism" and "cold war" as group factors, among others, related to voting. Besides determining the loadings, α, factor analysis will also generate data (scores) on each of the F functions. These derived values for each case are called factor scores. The factor scores, along with the data on Y and Equation 1 give a mathematical relationship among data as useful and important as the classical equations like $Y = 2X + 3Z$. For the purpose of this study, the equation formed was used to give a mathematical relationship among data collected on factors hindering the development of commercial paper market in Kenya.

CHAPTER FOUR

4.0 DATA ANALYSIS AND FINDINGS

This chapter consists of the analysis of data and presentation of findings. The analysis was done using descriptive statistics by taking frequencies and percentages of different responses.

(a) Respondents Characteristics

Table 1:

Sectors	Frequency	Percentage
Manufacturing and allied	12	36.4
Government/Parastatals	7	21.2
Finance and Insurance	10	30.3
Other	4	12.1
Total	**33**	**100.0**

The respondents were divided into three categories as shown on table 1 above, 100 questionnaires were circulated. Only 33 questionnaires were filled representing a response rate of 33%.

(b) Firm's Capitalization

Table 2:

Capital	Frequency	Percentage
Kshs. 20m to 50m	8	24.2
Kshs. 51m to 100m	5	15.2
Ksh 101m to 250m	3	9.1
Ksh. 251m to 500m	3	9.1
Ksh. 501m to 1b	3	9.1
Above Ksh. 1b	11	33.3
Total	**33**	**100.0**

The respondents were to indicate their capitalization levels. More than 76% of the respondents met the CMA requirement of capitalization of Kshs. 50m and above to be eligible for commercial paper issuance. Table 2 above shows the results of respondents' capital sizes.

(c) Sources of Funding

Table 3

Finance source	Frequency	Percentage
Sale of stock	1	2.1
Bank loans	12	25.5
Bank overdraft	14	29.8
Shareholder's capital injection	15	31.9
Others	5	10.6
Total	**47**	**100.0**

Respondents were asked to give their various sources of finance. 2.1% of the respondents used additional funds directly from the shareholders, this could be as a result high interest rates charged on bank loans and overdrafts. 29.8% of the respondents used bank overdrafts; this can be attributed to the ease at which commercial banks arrange for overdraft facilities for their customers due to the high interest charged. 25% of the respondents sourced finance through commercial bank loans. 10.6% used other forms of financing the three mentioned include; commercial paper, corporate bonds and donations. 72.7% of the respondents are keen to explore other financing options available if economically viable. 27.3% are quite content with their current arrangement; these are firms that have already issued commercial papers and those that are borrowing on long term basis.

(d) Debt Tenure

Table 4:

Period to Maturity	Frequency	Percentage
1 month to 6 months	2	8.70
3 months to 1 year	9	39.13
1 year to 3 years	8	34.78
3 years to 5 years	1	4.35
Above 5 years	3	13.04
Total	**23**	**100**

The respondents were asked to indicate the outstanding period to maturity of their current debt. 47.83% of the respondents debts were below 1 year; meaning commercial papers would be ideal for them at this stage. 52.17% of the respondents' debts were above 1 year. These firms are potential corporate bond issuers.

(e) Purposes for seeking finance

Table 5:

Purpose	Frequency	Percentage
For expansion of business	18	50.0
To pay of debtors	7	19.4
For day to day expenses	4	11.1
Others	7	19.4
Total	**36**	**100.0**

Respondents were asked to give their current major cash obligations. 50% of respondents needed funds to expand their businesses e.g. manufacturers to buy plant and equipment. 19.4% of the respondents needed funds to clear off their debt most of these were paying high interest rates to their banks. 11.1% needed funds for their daily operations. 19.4% needed funds for other various activities. Table 8 below shows the responses.

(f) Current (previous) Debt rate

Table 6:

Rate	Frequency	Percentage
1% to 5%	7	28.0
10% to 15%	14	56.0
15% to 20%	4	16.0
Total	**26**	**100.0**

Respondents were asked the rate at which their current (previous) debt is accruing. 56% of the respondents' current (previous) debt was accruing 10% to 15% interest per annum. 28% of the respondents current (previous) debt was accruing 1% to 5% interest per annum while 16% of the respondents debts accrued between 15% and 20%. Table 6 shows various rates charged on respondents' outstanding debts.

(g) Financial products that respondents were aware of

Table 8:

Finance Source	Frequency	Percentage
Commercial paper	24	25.5
Corporate bond	26	27.7
Off show borrowing	25	26.6
Sale of stock	18	19.1
Other	1	1.1
Total responses	**94**	**100.0**

The respondents were asked to list financial products that they had some knowledge about Corporate bond is the most known financial product with 27.7% of the respondents having some knowledge of the product. 26.6% of the respondents are aware of offshore borrowing. 25.5% of the respondents know about commercial paper. 19.1% of the respondents know about sale of stocks, perhaps the low level of awareness can be attributed to firms not knowing that they qualify to issue stocks at the Nairobi Stock Exchange, there is a general feeling that only big companies issue stock. The table below shows the results.

(h) Source of information on financing alternatives

Table 9:

Information Source	Frequency	Percentage
My bank	14	24.1
My stock broker	9	15.5
Investment adviser	16	27.6
Internet, media	15	25.9
Other	4	6.9
Total expenses	**58**	**100.0**

The respondents were asked the source of information on how they got to learn about different forms financing. Investment advisers have informed 27.6% of the respondents of alternative forms of financing, this is due to the fact that investment adviser's core business is to market cheap forms of financing to their clients, so they make a deliberate effort to reach to the market. 25.9% of the respondents knew about alternative funding through the media. 24.1% of the respondents learnt about alternative finance options from their bank, due to the regular contact of many respondents with their banks many had been introduced to many forms of financing option offered by the banks. A few had been introduced to commercial paper and corporate bonds by the bank, several of whom went ahead and issued. Only 15.5% of the respondents had learnt about other financing options from their stockbrokers.

(i) Interest in issuing commercial papers

Table 10:

Response	Frequency	Percentage
Interested	9	27.3%
Not interested	21	63.6%
Undecided	3	9.1%
Total	**33**	**100.0%**

Respondents were asked whether they would consider issuing commercial papers 27.3% of the respondents would consider seeking funds through commercial papers issues despite many having some knowledge about them. 63.9% of the respondents would not consider issuing commercial papers as a way of raising funds; this can be attributed to lack of aggressive marketing effort by the market players. Table 10 shows the results.

(j) Commercial Paper issuers

Table 11:

Response	Frequency	Percentage
Issued	4	23.5%
Did not issue	13	6.5%
Total	**17**	**100.0%**

Respondents were asked whether they eventually issued commercial papers, thee are the 27.3% who expressed interest as per table 10. 76.5% of the respondents did not issue. 23.5% of the respondents who had considered issuing commercial papers did issue as shown in the table above.

(k) Reason for not issuing commercial papers

Table 12:

Reasons	Frequency	Percentage
Better rate offered by bank	1	3.2
Cost of issuance	10	32.2
Lack of more information	3	9.7
Management lack of enthusiasm	8	25.8
We needed money urgently	1	3.2
Other	8	25.8
Total responses	**31**	**100.0**

The respondents who did not issue commercial papers were asked for their reasons; 32.2% of the respondents were limited by cost of issuance. Management lack of support of the commercial paper idea can be attributed to 25.8% negative response to commercial paper. This can be due to lack of understanding on technicalities of commercial paper. Lack of additional information prevented 9.7% of the respondents from issuing commercial papers. Other reasons accounted for 27.8% The results are on table 12 above.

(l) Hindrances encountered in issuing commercial papers

The 24 firms that had successfully issued commercial papers were asked to list major impediments encountered while arranging for the issue(s).

Major Hindrances encountered include;

1. Listing period and requirements of CMA
2. Buyers to take up the commercial papers
3. Cost of arrangement and listing
4. Management lack of interest

All the 14 respondents who have issued commercial papers had a problem with the listing requirements of CMA and the high costs of arranging and listing. One of the respondents had resistance from the board of directors to issue the commercial papers.

All the respondents with outstanding commercial papers would consider seeking additional funds by issuing more and recommending others to issue the commercial papers, showing their level of satisfaction with their current placements.

(m) **Recommendations**

Table 13:

	Most Important	Important	Not Important	Not sure
Approval time	9	9	4	11
Marketing effort	6	9	9	9
Cost	4	20	2	7
Publicity	7	7	9	10

Respondents were asked the importance they attach to various factors affecting the commercial paper market and which they would recommend improvement. 72.7% of respondents view cost of arranging and listing being of vital importance for the development of commercial paper market. They believe lower listings and arranging fees would lure more issuers to the debt market. 54.5% of the respondents would want a reduction in the commercial paper approval time by CMA. 44.5% of the respondents attach some level importance to marketing effort being intensified to increase of commercial papers awareness. 42.44% of the respondents would want a more active role by the regulators. Table 13 gives a summary f the respondents' recommendations.

CHAPTER FIVE

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions and Policy Recommendations

The research found that there are many factors that have had an impact on the development of the commercial paper market in Kenya, these include;

Approval time by CMA and NSE; most respondents want a reduction in time taken to approve commercial paper proposal.

Lack of information; many respondents were keen to pursue the idea of commercial paper but could not get comprehensive information on how to go bout it. The regulators and intermediaries i.e. CMA, NSE, investment banks, stock brokers and commercial banks need to market commercial papers to potential issuers and investors more aggressively.

Competition from lenders; a few respondents who were keen to issue commercial papers did because banks matched the rate of interest they were to incur in the commercial papers issue. Most of these companies are the high quality AAA type whose risk of default is low.

Cost of issuance; most of the respondents felt the cost of listings and arranging are far too high to attract new entrants to the commercial paper market. They would want a reduction in the fees

Management lack of enthusiasm; some respondents indicated lack of willingness from the management as a major reason for not pursing a commercial paper program.

Time constraint; due to the long time it takes to successfully complete a commercial paper issue some respondents ruled it out because f the urgency of their needs for funds.

Concerted efforts by the policy makers; NSE and CMA, Stock brokers and investment advisors and commercial Banks will be the only solution to realize a vibrant commercial paper market in Kenya.

5.2 Recommendations for Further Research

From the research findings it is evident that many organizations are keen to issue commercial papers. The research was a survey covering different sector of the Kenyan economy however there is need for further detailed studies to be conducted on specific sectors of the economy.

5.3 Limitations of the study

1. The response rate was 33% with the manufacturing sector accounting for the lowest response of 20%, government owned / Parastatals Corporations 23%, Finance and Insurance 33%. The reason of the poor response rate was due to the sensitive nature of the information sought. This is because the study touched on financial positions of companies most of which is considered to be confidential.

2. Some companies were reluctant to fill in the questionnaire. They citing the sensitive nature of the information sought, their company policy prohibited them from making such information public, these mostly are the unquoted companies.

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APPENDIX - AP I: Companies that have issued Commercial Paper

COMMERCIAL PAPER PROGRAMME DATA 1997 TO DEC 2004

Name of Issuer	Date of issue	Max. face value (Kshs)	Expiry date
1. Mabati Rolling Mills Limited ✓	September	500,000,000	Sept 1998
2. Athi River Mining Company Limited	June 1998	100, 000,000	June 1999
3. Agip (Kenya) limited ✓	January 1999	350,000,000	January 2000
4. East African Industries Limited	February 1999	500,000,000	February 2000
5. Industrial Promotion Services Limited	February 1999	100,000,000	February 2000
6. CMC Holdings Limited	February 1999	250,000,000	February 2000
7. General Motors (K) Limited	March 1999	500,000,000	March 2000
8. Nation Media Group	March 1999	500,000,000	March 2000
9. Caltex Oil (Kenya) Limited	March 1999	500,000,000	March 2000
10. Kenya Shell Limited	April 1999	1,000,000,000	April 200
11 Crown Berger	July 1999	200,000,000	July 2001
12. KPLC	Nov 1999	1,500,000,000	Nov 2000
13. Pan Africa Paper Mills	July 1999	500,000,000	July 2000
14. Lonrho Motors	June 1999	1,500,000,000	August 2000
15. Total (Kenya)	August 1999	1,200,000,000	October 2001
16. Kenya Hotel Properties	October 2000	1500,000,000	October 2001
17. Ecta (Kenya)	October 2000	50,000,000	September 2000
18. Express (Kenya)	September 1999	150,000,000	October 2000
19. TPS Serena	October 1999	100,000,000	February 2002
20. Kenya Oil Company	February 2001	500,000,000	May 2002
21. Bidco Oil Company	May 2001	200,000,000	May 2002
22. Crown Berger	November 2003	200,000,000	November 2004
22. Kenya cil company	December 2002	1,000,000,000	December 2003
23. Cooper Kenya	January 2004	100,000,000	January 2005
24 Athi river mining	November 2004	200,000,000	November 2005
		11,850,000	

Source: Capital Market Authority

APPENDIX - AP II: Population

POPULATION

INSURANCE COMPANIES AND INSURANCE BROKERS

1. A.A.R Health services
2. Alico Kenya ltd
3. Apollo Insurance Co. Ltd
4. Blue Shield Insurance Co. Ltd.
5. British American insurance Co. ltd
6. Cannon Assurance (K) Ltd.
7. Concord Insurance Ltd.
8. Co-Operative Insurance Co. Kenya.
9. Cooperato Insurance Co. Ltd
10. Equitas Insurance Brokers Ltd
11. Fidelity Insurance Brokers Ltd.
12. First Assurance Co. Ltd
13. Gateway Insurance Co. Ltd
14. Gemina Insurance Co. Ltd
15. General Accident Insurance Co. Ltd
16. Heritage A.I.I Insurance Co. (K) Ltd
17. Insurance Co. Of EA Ltd
18. Intra Africa Assurance Co. Ltd
19. Invesco Assurance Co. Ltd
20. Jubilee Insurance Co. Ltd
21. Kenindia Assurance Co. Ltd
22. Kenya Commercial Insurance Co. Ltd
23. Kenya Insurance SACCO Ltd
24. Kenya Orient Insurance Co Ltd
25. Kenya Alliance Insurance Co Ltd
26. Lion Of Kenya Insurance Co. Ltd
27. Madison Insurance Co. Ltd.
28. Mercantile Life And General Assurance Co. Ltd.
29. Monarch Insurance
30. Norwich Union Life Insurance Society.
31. Accidental Insurance Co Ltd.
32. Old Mutual Life Insurance.
33. Pan African Insurance Co Ltd.
34. Phoenix Of East Africa Assurance Co. Ltd.
35. Pioneer Assurance.
36. Prime Insurance Co. Ltd
37. PTA Reinsurance Co.
38. Royal Insurance Co. Of Ea Ltd

39. Standard Assurance (K) Ltd.
40. Sun City Insurance Co. Ltd.
41. Tausi Assurance Co. Ltd
42. Trident Insurance Co. Ltd.
43. UAP Provincial Insurance Co. Ltd.
44. United Insurance Co Ltd.

Banks And Finance.

45. ABN-AMRO Bank
46. African Banking Corporation Ltd.
47. African Mercantile Banking Co. Ltd
48. Akiba Bank
49. Bank Of Baroda (K) Ltd
50. Bank Of India
51. Bank Of Tokyo Mitsubishi Ltd.
52. Barclays Bank Of Kenya Ltd.
53. Biashara Bank Of Kenya.
54. Cfc Bank Of Kenya.
55. Charter Bank Ltd
56. Chase Bank (K) Ltd.
57. Citibank N.A
58. City Finance Bank Ltd
59. Commercial Bank Of Africa Ltd.
60. Consolidated Bank Of Kenya Ltd.
61. Co-Operative Bank Of Kenya Ltd.
62. Credit Agricole Indosuez.
63. Credit Bank Ltd.
64. East African Development Bank.
65. Eastern And Southern African Trade And Development Bank (PTA)
66. Fina Bank.
67. Equatorial Commercial Bank Ltd.
68. First American Bank Of Kenya Ltd.
69. First National Bank Of Kenya (City)
70. Giro Commercial Bank.
71. Goldern Credit Ltd.
72. Guardian Bank Ltd.
73. Habib Bank Ag Zurich.
74. Habib Bank Ltd.
75. Imperial Bank Ltd
76. Industrial Development Bank Limited.
77. Internal Finance Corp (IFC)
78. Investments And Mortgages Bank Ltd.
79. Middle East Bank (K) Ltd.
80. National Bank Of Kenya Ltd.
81. National Industrial Credit Bank Ltd.
82. Paramount Universal Bank Ltd.

83. Prime Bank.
84. Prudential Bank Limited.
85. PTA Bank.
86. Southern Credit Banking Corp. Ltd.
87. Stanbic Bank (Kenya) Ltd.
88. Standard Charted Bank Ltd.
89. Transnational Bank Ltd.
90. Victoria Commercial Bank.
91. Development Bank Of Kenya.
92. Diamond Trust Bank Of Kenya. Ltd
93. Dubai Bank Of Kenya Ltd.
94. East African Building Society
95. Equity Building Society.
96. Estate Building Society.
97. Kenya wide Building Society
98. Pioneer Building Society.
99. Prudential Building Society
100. Agricultural Finance Corporation
101. Family Finance Building Society.
102. First African Capital Ltd.
103. Guider Interventional Finance Co. Ltd.
104. Housing Finance Co. Of Kenya.
105. Industrial And Commercial Development Corporation
106. Mercantile Fiancé Co. Ltd.
107. Prime Capital And Credit Ltd.

Manufacturing And Allied.

108. 3m Kenya Ltd.
109. Ace Communications
110. Added Performance (K) Ltd.
111. African Highlands Produce Co. Ltd
112. Alba Petroleum Ltd.
113. Alliance Hotels Ltd.
114. Amazon Motors Ltd.
115. Apex Paints (K) Ltd.
116. Associates Battery Manufacturing (EA Ltd.
117. Associates Motors Ltd.
118. Athi River Mining Ltd.
119. Atlas Copco (K) Ltd.
120. Aventis Cropscience Kenya Ltd.
121. Aventis Pasteur Sa (Ea)
122. Avon Group Of Companies
123. Bamburi Cement Ltd.
124. BASF
125. Bata Shoes. (K) Ltd.
126. Baumann Engineering Ltd.

127. Bayer East Africa Ltd.
128. Berger Paints (K0
129. Bidco (K) Ltd.
130. Bitumen Products Ltd.
131. BOC (Kenya) Limited.
132. Booth Manufacturing (Africa) Ltd.
133. British American Tobacco (K) Ltd.
134. Brook side Diary Ltd.
135. Brooke Bond Kenya
136. Bulk Medicals Ltd.
137. Cabroworks (Ea) Ltd.
138. Cadbury Kenya Ltd.
139. Caltex Oil (K) Ltd.
140. Car And General
141. Carbacid (CO20) Ltd.
142. Carton Manufactures.
143. Cat Tech Spares Co. Ltd.
144. Central Glass Industries.
145. Chandaria Industrials Ltd.
146. Chemilil Sugar Co. Ltd.
147. Chermagro Ltd
148. China Road And Bridge Corp (K) Ltd.
149. CMC Holdings Ltd.
150. Coals (Ea) Ltd.
151. Coast Blanket Factory Ltd.
152. Coca-Cola Africa Ltd.
153. Colgate Palmolive (Ea) Ltd.
154. Come Cons Africa Ltd.
155. Continental Builders Ltd.
156. Cooper Kenya (K) Ltd.
157. Cosmos Ltd.
158. Crown Cock Co. (Ea)
159. Crown Paints.
160. Cyanamid Transnational Corp.
161. D.H.L Internal (K) Ltd.
162. Dawa Pharmaceutical
163. Divers lever Ea Ltd.
164. Dothia Packaging Ltd.
165. DT Dobie And Co. Ltd.
166. Dunlop
167. Dura Coat Paints.
168. Ea Packaging Industries Ltd.
169. East African Cable.
170. East African Portland Cement Company Ltd.
171. Eastern Produce (K) Ltd.
172. Ecolab Ea (K) Ltd.
173. Elf Oil (K) Ltd.

174. Ely's Chemicals Industries Ltd.
175. Engen (K) Ltd.
176. Epco Builders Ltd
177. Eveready Batteries (K) Ltd.
178. Farmechem Ltd.
179. Farmer's Choice Ltd.
180. Firestone Ea (1969)
181. Gal sheet (K) Ltd.
182. Galaxy Paints And Coating
183. General Motors
184. George Williamson
185. Gestetner (K) Ltd.
186. Giloil Co. Ltd.
187. Glaxosmithkline
188. Global Telecom Ltd.
189. Golden Biscuits (K) Ltd.
190. Govinda And Sons Ltd.
191. Grand Regency Hotel
192. H Young Group Of Companies.
193. H.Z And Co Ltd.
194. Haco Industries Kenya Ltd.
195. Harambee Co-Op. Savings And Credit Society Ltd.
196. Hardi Kenya Ltd
197. Hayer Bisham Sngh And Sons Ltd.
198. Hebatullah Brothers Ltd.
199. Heidelberg E.A Ltd.
200. Henkel Kenya Ltd
201. Heritage Hotels
202. High hem. Ea Ltd.
203. Highland Canners.
204. Hilton Nairobi
205. Hotel Inter-Continental Nairobi
206. Hutching Biemer.
207. I.C.L Kenya Ltd.
208. Iberafrica Power) EA) Ltd.
209. IBM (EA) Ltd.
210. ICN Toshiba Ltd.
211. Impala Glass Industries
212. Insteel
213. International Casino.
214. Interocean (EA) Ltd.
215. Intex Construction Ltd.
216. Jambo Biscuits (K) Ltd.
217. Juma Construction Co. Ltd.
218. Kakuzi
219. Kamco Steel Stainless Works Ltd.
220. Kappa Oil Refineries Ltd

221. Karume Investments Ltd.
222. KATE Freight And Travel Ltd.
223. Kay Construction Co. Ltd.
224. Ken cell Communications Ltd.
225. Kenbro Industries Ltd.
226. Kencargo Airlines International Ltd.
227. Kenol (K) Ltd.
228. Kensat.
229. Kensta.
230. Kenya Aerotech Ltd.
231. Kenya Airways.
232. Kenya Breweries Ltd.
233. Kenya Building Society Ltd.
234. Kenya Bus Services Ltd.
235. Kenya Litho
236. Kenya Oil Co, Ltd.
237. Kenya Orchards Ltd
238. Kenya Power And Lighting Co. Ltd.
239. Kenya Shell Ltd.
240. Kenya Sweets Ltd.
241. Kenya Tea Packers Ltd.
242. Kenya Times Media.
243. Kenya Wine Agencies Ltd.
244. Kenya Women Finance Trust.
245. Kepchorua Tea Co. Ltd.
246. KFCL- Softa Bottling Co. Ltd.
247. Kilimanjaro Construction Ltd
248. Kimberly Fay (Ea) Ltd.
249. King Plastics Industries Ltd.
250. Kirinyaga Construction (K) Ltd.
251. Kirloskar Kenya Ltd.
252. Knight Frank (K) Ltd.
253. Kobil Petroleum Ltd.
254. Kodak (Kenya) Ltd.
255. Konoike Construction Co. Ltd.
256. Kordes Roses Africa Ltd.
257. Korean Automobile (K) Ltd.
258. K-Rep Holdings Ltd.
259. Kundan Singh Construction Ltd.
260. Kwality Candies And Sweets Ltd.
261. Landmark Hotel.
262. Laxmanbhai Construction Ltd.
263. Lima Ltd
264. Limuru Tea Co. Ltd.
265. Logitee Contractors Ltd.
266. Loita Asset Management.
267. London Distillers (K) Ltd.

268. Longhorn (K) Limited
269. Lornhro Hotels (K) Ltd.
270. Mabati Rolling Mills
271. Mac's Pharmaceuticals Ltd.
272. Madhuresearch Kenya Ltd.
273. Maersk (K) Ltd.
274. Magadi Soda Co. Ltd.
275. Magana Flowers (K) Ltd.
276. Magic General Constructors.
277. Magnate Venture Ltd.
278. Mann Manufacturing Ltd.
279. Marshals (Ea) Td.
280. Mashariki Motors Ltd.
281. Master Platters.
282. Mastermind Tobacco (K) Ltd
283. Mauji Construction.
284. Mechanized Cargo Systems Ltd.
285. Metal Crowns Ltd.
286. Mid Oil Africa Ltd.
287. Mini Bakeries (Nairobi) Ltd.
288. Mobil Oil (K) Ltd.
289. Modern Business Comm. Ltd.
290. Morison Engineering Ltd.
291. Motorways Construction
292. Motorways Construction.
293. Mt. Kenya Safari Club.
294. Muguya Construction And Engineering.
295. Muhoroni Sugar Co. Ltd.
296. Multichoice (K) Ltd.
297. Multiconsult Engineers Ltd.
298. Mumias Sugar
299. Murphy Chemicals (Ea) Ltd.
300. Murphy Chemicals (Ea) Ltd.
301. Mwalimu Cooperative And Sacco Ltd.
302. N.K Brothers Ltd.
303. Nairobi Bottlers Ltd.
304. Nairobi Safari Club.
305. Nakumatt Supermarkets
306. NAS Airport Services Ltd.
307. Nation Media Group Ltd.
308. National Oil Corp Of Kenya.
309. NCR
310. Nestle Foods (K) Ltd.
311. Ngilu Associates.
312. Ngiyo Investments Ltd.
313. Ngong Hills Hotels Ltd.
314. Nice And Lovely Products.

315. Norfolk Hotel
316. Ocean Freight (EA) Ltd.
317. Ogilvy And Mather.
318. Orason Engineers Ltd.
319. Oserian Development Co. Ltd.
320. Osho Chemical Industries.
321. Oxford University Press.
322. Palmac Oil Refineries Ltd.
323. Pan African Research Mills (Ea) Ltd.
324. Patco Industries Ltd
325. Paw O Nedlloyd (Ea) Ltd.
326. Pelican Engineering And Construction.
327. Pembe Flour Mille.
328. Pfizer Laboratories Ltd.
329. Phillips Pharmaceutical Ltd.
330. Pinnacle Insurance Agency Ltd.
331. Pinnacle Paints Ltd.
332. Plastics And Rubber Industries Ltd.
333. Premier Flour Mills.
334. Premji Duncar And Sons Sarit Center.
335. Press masters Ltd.
336. Procter And Gamble (Ea) Ltd.
337. Proctor And Allan (Ea) Ltd
338. Protex (Ea) Ltd.
339. Rae Plywood's (K) Ltd.
340. Raw Constructions
341. Rea Vipingo
342. Reckitt BenKiser (Ea) Ltd.
343. Reli Co-Op Savings And Credit Society.
344. Removals Freight International Ltd.
345. Rentokil Initial Kenya.
346. Rilco Steel Fabricators Ltd.
347. Roche Products Ltd.
348. Rolmill (K) Ltd.
349. Roto Moulders Ltd.
350. Roy Spares And Haulers Ltd.
351. Rupra Construction Co. Ltd.
352. Ryce Group Of Companies
353. S.S Mehta And Sons Ltd.
354. Sachems Construction (K) Ltd.
355. Sadolin Paints (Ea) Ltd.
356. Safaricom Ltd.
357. Samani Construction Ltd.
358. Sameer Investments Ltd.
359. Samura Engineering Ltd.
360. Sara Lee Household And Body Care (K) Ltd.
361. Sarova Hotels Ltd.

362. Sasini
363. Savings And Loan (K) Ltd.
364. Sayani Brothers And Co. Ltd.
365. Schering Plough Corporation Ltd.
366. SDV Transami (K) Ltd
367. Sea forth Shipping (K) Ltd.
368. Securicor Security Services (K) Ltd.
369. Severin Sea Lodge (Ea)
370. SGS (Kenya) Ltd.
371. Sharp Electronics Technology Ltd.
372. Shell Chemicals (Ea) Ltd.
373. Shelter Afrique.
374. Sietico Construction Co.
375. Signode Packaging System Ltd.
376. Six Eighty Hotel
377. Solai Paints.
378. Spencon (K) Ltd.
379. Spin Knit Diary Ltd.
380. Sumitomo Construction Co. Ltd.
381. Supa Brite Ltd.
382. Super Contractors Ltd.
383. Swift Global (K) LTD.
384. Switch Gear And Gonhols Ltd.
385, Sygenta (EA) Ltd.
386. Technomed Ltd.
387. Tetra Pak Ltd.
388. The Standard.
389. The Stanley Nairobi
390. Tile And Carpet Center.
391. Tim sales
392. Tm-Am Construction Group (Africa)
393. TNT Internal Express.
394. Total Oil (K0 Ltd.
395. Toyota (Ea) Ltd.
396. Triple A Capital Ltd.
397. Trishul Constructions Ltd.
398. TSS spinning And Weaving Ltd.
399. Twiga Paints
400. U.K Construction Co. Ltd.
401. Uchumi Supermarkets
402. UDV (Kenya) Ltd.
403. Unga Farm care (Ea _ Ltd.
404. Unga Feeds Ltd.
405. Unico Manufacturing Co. Ltd.
406. Unilever (K) Ltd.
407. United Builders And Contractors.
408. Van Leer Industrial Packaging Ltd.

409. Vertex Builders.
410. Victory Construction Co. Ltd.
411. Wangu Investments Co. Ltd.
412. Webuye Research Mills.
413. Wilken Telecommunications (K) Ltd.
414. Windsor Golf And Country Club

Parastatals

415. Coast Development Authority.
416. Coffee Board Of Kenya.
417. Ewaso Nyiro North Development Authority.
418. Ewaso Nyiro South Development Authority.
419. Higher Education Loans Board.
420. Jomo Kenyatta Foundation.
421. Ken Gen.
422. Kenya Airport Authority.
423. Kenya Bixa Ltd.
424. Kenya Broadcasting Corporation Ltd.
425. Kenya Cashew Nut Ltd.
426. Kenya Cooperative Creameries Ltd.
427. Kenya Farmers Association
428. Kenya Industrial Estates Ltd.
429. Kenya Literature Bureau
430. Kenya Maltings Ltd.
431. Kenya Meat Commission
432. Kenya National Trading Corporation Ltd.
433. Kenya Nut Co. Ltd.
434. Kenya Ort Authority
435. Kenya Pipeline Co. Ltd.
436. Kenya Planters Cooperative Union Ltd.
437. Kenya Railways Corporation Ltd.
438. Kenya Seed Company Ltd.
439. Kenya Sisal Fiber.
440. Kenya Sugar Authority.
441. Kenya Sugar Authority.
442. Kenya Tea Development Agency.
443. Kenya Tourist Board.
444. Kenya Tourist Development Corporation
445. Kenya Wildlife Service.
446. Kenyan Fluorspar Co. Ltd.
447. Keriuo Valley Development Authority.
448. Lake Basin Development Authority.
449. National Social Security Funds
450. Pyrethrum Board Of Kenya.
451. Retirements Benefits Authority.
452. Tana River (And Athi) Development Authority.

453. Tea Board Of Kenya.

Source:

- Commissioner Of Insurance.
- Kenya Association Of Manufacturer
- Kenya Finance Directory
- Registrars Of Companies.

APPENDIX - AP III: Questionnaire

QUESTIONNAIRE ON FACTORS INFLUENCING THE DEVELOPMENT OF THE COMMERCIAL PAPPER MARKET IN KENYA

1. Tick the industry your firm belongs to:

   Manufacturing and Allied ☐

   Finance and Insurance ☐

   Government owned/Parastatal ☐

   Others, (specify) ______________________

2. Is your company

   Locally owned ☐

   Multinational subsidiary ☐

   Partly locally partly foreign ☐

   Parastatal ☐

   Others (Specify) ______________________

3. For how long has your firm been in operation?

   1 to 5 years 1 ☐

   6 to 10 years 2 ☐

   11 to 20 years 3 ☐

   20 to 40 years 4 ☐

   Over 40 years 5 ☐

4. What is the capitalization of your firm? (Please tick one)

   Ksh. 20m to Ksh. 50m 1 ☐

   Ksh. 51m to Ksh. 100m 2 ☐

   Ksh. 101m to Ksh 250m 3 ☐

   Ksh. 251m to Ksh. 500m 4 ☐

   Ksh. 501m to Ksh. 1b 5 ☐

   Above Ksh. 1b 6 ☐

5. Does your firm seek funds externally?

Yes ☐

No ☐

6. If yes, what is the source of your funding? Please rank the following in form preference.

1- Very high 2 - High 3 - Neutral 4 - Low 5 - Very low

Bank loans ☐

Bank overdraft ☐

Shareholders capital injection ☐

Sale of stocks ☐

Commercial paper ☐

Corporate bonds ☐

7. Please give other likely sources of your external funding

1
2
3
4
5

8. What is the maturity period of the last debt you acquired?

1 month to 3 months 1 ☐

3 months to 1 year 2 ☐

1 year to 3 years 3 ☐

3 years to 5 years 4 ☐

Above 5 years 5 ☐

9. At what rate of interest is your current debt accruing? (Please tick one)

1% to 5% 1 ☐

10% to 15% 2 ☐

15% to 20% 3 ☐

10% to 25% 4 ☐

25% to 30% 5 ☐

Above 30% 6 ☐

10. Who makes decision on the sourcing of finances in your firm?

The Board of Directors ☐

The Managing Director ☐

The overseas head office ☐

The head of finance ☐

Others (Specify) ________________________________

11. For what specific purpose do you seek finance for?

1
2
3
4
5
6

12. Have you ever heard of other forms of financing other than the one you are currently on?

Yes ☐

No ☐

13. If yes, which ones have you heard about?

Sale of stocks ☐

Off-shore borrowing ☐

Commercial paper ☐

Corporate bond ☐

Others (specify) ____________________

14. What was the source of the information?

My stockbroker ☐

Investment advisors ☐

Internet, media ☐

My bank ☐

Others (specify) ____________________

____

15. Have you ever considered issuing commercial paper as a way of financing your working capital expenditures?

Yes ☐

No ☐

[If NO, please go to question 21]

16. If yes, did you eventually issue the commercial paper?

Yes ☐

No ☐

[If NO, please go to question 20]

17. If Yes, please rank the following hindrances you encountered in issuing commercial papers indicating the extent to which you agree or disagree

1 - Strongly agree 2 – Agree 3 – Neutral 4 - Disagree 5 - Strongly disagree

Listing requirement by the CMA [ ]

Buyer to take up the commercial papers [ ]

Cost of arrangement and listing [ ]

Resistance from senior management [ ]

Time taken in the process too long [ ]

Lack of awareness on commercial paper in the market [ ]

18. What problems did you encounter when seeking authority from CMA to issue commercial paper?

1
2
3
4
5
6

19. What problems have you encountered after issuing commercial paper, that is when buying them back or rolling over?

1
2
3
4
5
6.

20. If no, please rank the following reasons for not issuing the commercial paper indicating the extent to which you agree or disagree.

1 - Strongly agree 2 – Agree 3 – Neutral 4 - Disagree 5 - Strongly disagree

Our bank matched or bettered the rate at the commercial paper was going to cost 1 [ ]

We could not get information on how to go about it 2 [ ]

The management was not enthusiastic about it 3 [ ]

It was going to be too costly 4 [ ]

The whole concept was too technical for us 5 [ ]

We needed money urgently and could not wait 6 [ ]

The process was too long and time-consuming 7 [ ]

Lack of awareness on commercial papers from the market 8 [ ]

21. Would you consider seeking additional funding through commercial papers?

Yes [ ]

No [ ]

22.If no, please give reasons why.

1.
2.
3.
4.
5.
6.

23. How likely are you to issue commercial paper 5 years from now? (Please tick one)

Very likely	1 ☐
Fairly likely	2 ☐
Neither likely nor unlikely	3 ☐
Not very likely	4 ☐
Not at all	5 ☐
Don't know	6 ☐

24. How likely are you to recommend a company to issue commercial paper?

(Please tick one)

Very likely	1 ☐
Fairly likely	2 ☐
Neither likely nor unlikely	3 ☐
Not very likely	4 ☐
Not at all	5 ☐
Don't know	6 ☐

25. In order of importance , what would you recommend to be improved in the process of commercial paper insurance? Rank the following in the order of importance.

1- Very important 2- Important 3- Neutral 4- Somewhat important 5- Not important

More aggressive marketing effect by the market player	☐
Reducing the cost of arranging and listing	☐
Increasing publicity by the NSE and CMA	☐
Reducing CMA regulations	☐
Creating a secondary market for commercial paper	☐
Reducing time period for the issuing process	☐

26. Please make any other comment you feel relevant about commercial paper financing.

Thank you for your cooperation.

APPENDIX - AP IV Specimen of Introductory letter

TO WHOM IT MAY CONCERN

REQUEST FOR RESEARCH DATA

The above named person is a postgraduate student at the University of Nairobi, Faculty of commerce. She is conducting a research project on "The factor hindering the development of the Commercial Paper market in Kenya". This is in partial fulfillment of the requirement of the Master in Business Administration.

Your reputable organization has been selected to form part of the population of the study. The purpose of this letter is to request you to kindly fill out the attached questionnaire. The information you provide will be treated with strict confidence and will be used solely for academic purposes. Neither your name nor that of your organization will appear anywhere in the final report. A copy of final report will be made available to you upon request.

Any assistance accorded to her shall be highly appreciated