A SURVEY OF THE POTENTIAL BENEFITS OF DEMUTUALIZATION OF NAIROBI STOCK EXCHANGE

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DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the University of Nairobi for academic credit.

Signed: ______________________________ Date: ____________________________

Fredrick Kiragu Gatuma **D61/P/7031/04**

This project has been presented for examination with my approval as appointed supervisor

Signed: ______________________________ Date: ____________________________

James N. Ng'ang'a

DEDICATION

I dedicate this study to my two lovely boys Kyle and Seve'.

ACKNOWLEDGEMENT

First is to give honour and praise to the Almighty God for giving me grace, strength, good health and providence during the time of my study.

I wish to acknowledge the support of my supervisor, Mr. Nganga, for his guidance through every stage of this project which was critical to its success.

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DEFINITION OF TERMS

Demutualization: This is the process of changing an organization from its mutual ownership to a share ownership structure. Ownership and trading are effectively separated. Stockbrokers are no longer the owners but customers to the exchange. Directors are elected by shareholders and are only answerable to them.

Stock Exchange: This is a capital market institution that deals in the exchange of securities issued by publicly quoted companies and the Government.

ABBREVIATIONS AND ACRONYMS

AFDB	African Development Bank
ASIC	Australian Investment Commission
ASX	Australian Stock Exchange
ATS	Automated Trading System
CDSC	Central Depository & Settlement Corporation
CIC	Capital Issue Committee
CMA	Capital Markets Authority
ECNs	Electronic Communication Networks
HKEx	Hong Kong Exchange
HKFE	Hong Kong Future Exchange
JSE	Johannesburg Stock Exchange
LSE	London Stock Exchange
MAS	Monetary Authority Singapore
NSE	Nairobi Stock Exchange
OECD	Organization for Economic Cooperation and Development
RMR	Risk Management and Regulation
SEHK	Stock Exchange Hong Kong
SFC	Securities and Futures Commission
SGX	Singapore Stock Exchange
SRO	Self-Regulatory Organization

ABSTRACT

The purpose of this study was to identify the principal benefits that will be accrued from the demutualization of the Nairobi Stock Exchange (NSE). The basis of the problem regarding demutualization that the research aimed to explore was discussed based on this research objective. This were to identify how demutualization would improve stock exchange and the key issues towards embracing effective demutualization process at NSE. This involved finding out how demutualization at the NSE can improve the overall operations and key considerations that are vital in enhancing effective demutualization of stock exchange market.

The study was done using the descriptive survey method. The target population were the middle level managers of the 19 licensed members (stockbrokers) of the NSE in Nairobi. The sample size was 38 respondents, two employees from each stockbroker. In this study the researcher used simple random sampling. To complement each other, structured questionnaires with open ended and closed questions were used. The raw data from the field was analyzed using descriptive and inferential statistics. Here percentages and cross tabulation were used.

The study found that demutualization could improve the general operations at stock exchange in NSE. This is in the line of; changing the structure of NSE, realization of value for members, prompt and flexible decision making, opening up access to markets, diversifying new markets, spreading of ownership risks for firms operating at NSE, ease access of capital. Furthermore demutualization would enhance restructuring of corporate governance where operations are run by experienced management team which is driven to improve the exchanges bottom line.

In addition the study findings concluded that demutualization enhances NSE capacity to raise capital and expansion of trading platforms by going public to raise capital, new shareholders and through share offerings to non members, elimination of conflict of interest, independent people will own it and all interest will therefore be catered for.

Attracting highly qualified personnel, fair and competitive recruitment & human capital retention policies, enhanced disclosure of information will make more accessible to the public and catch the attention of those interested to pursue a career in the industry. Demutualization aid in unlocking members equity value in realizing market value of their equity and upgrading business.

Demutualization would assist in removing barrier of entry for new brokers as: all the decision will be in the hands of the shareholder which who will determiner if and when to add on more brokers depending on the existing broker performance. Brokers will enter on merit since demutualization will dismantle the current cartel-like structure of ownership. Demutualization may relax entry rules.

CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

Stock exchanges usually provide a platform for investors (shareholders and other financial sources) and capital raisers (joint stock Company) to raise capital so as to provide services to its customers, with profits or assets distributed to equity or debt investors. Stock exchanges assist in trading of stocks and bonds (Aggarwal, 2002). The stock exchanges have a set of rules that govern the execution and clearing of trade. Some of the responsibilities of a stock exchange are enforcing standard rules to reduce transaction costs and monitoring of the trading to prevent manipulations like insider trading. Financial institutions that demutualize receive large influxes of capital from the new owners and easier access to future capital through the financial markets that can be used to invest in growth for effective competition (Ramos, 2006). Life insurers were amongst the earliest pioneers of demutualization, but in 1980s and 1990s building societies and producer co-operatives and trading exchanges adopted demutualization (Delany, 2005).

Mutual companies opt to demutualize because as publicly-traded stockholder-owned companies it is easier to raise capital, effect mergers and acquisitions, and attract and retain employees through the use of stock options. The significance of demutualization becomes real due to the current discrepancies in the prevailing working of the stock exchange (Hughes and Zargar, 2006). Exchanges are not considered to be very efficient in maintaining transparency and have not been able to prevent insider trading. Further, demutualization process eliminates conflicts of interest in decision making because the owners are not the managers themselves. In addition, there is a more flexible governance structure fostering decisive action in response to changes in the business environment, greater investor participation in the governance of the exchange, improved competitive prospects as against alternative trading systems, greater flexibility and access to global markets, faster and more complete consolidation of stock exchanges to enhance available synergies; and increased resources for capital investment raised by way of equity offerings or private investment (Aggarwal, 2006).

Demutualization in emerging markets differs in certain significant respects from the process in developed markets and is often centrally planned by government, as opposed to being driven by the stock exchanges. While there are many advantages to the demutualization of stock exchanges in emerging markets, demutualization in these markets may be occurring prematurely. However, emerging market regulators have made substantial progress in strengthening practices and infrastructure in their capital markets (Emerging Markets Committee, 2005).

Growing competitive pressure has triggered wave of restructuring, merger and alliance among securities market in order to maximize the economies of scale (Serifsoy, 2006). An example is the on-going efforts to form alliances among the exchanges in East Africa (Nairobi, Dar- es-Salaam and Uganda Stock Exchange) under the East Africa Stock Exchanges Association (EASEA). According to Mwanza (2006) all the three stock exchanges need to be demutualized first for easier integration. This means doing away with domestic or regional monopolistic and oligopolistic practices which create barriers to entry and higher unwarranted costs. Demutualization has a potential of making NSE a more efficient exchange by providing better quality services tailored to meet the needs of issuers, investors and brokers, which in turn would increase the revenues of the NSE (Ngugi and. Njiru, 2005).

1.1.1 Nairobi Stock Exchange

The Nairobi Stock Exchange is operated as a “club of brokers” and is currently a monopoly in the country. The members of the club enjoy rights of ownership, decision making (one member, one vote), and trading. Essentially it has been operated as a non-profit making organization. There has been a close identity between ownership of the NSE and the direct use of its trading services. Under the current setup once a member sells their seat at the exchange they automatically loose their trading privileges. The owners of the NSE enterprise are also its customers (NSE, 2007). Securities trading in Kenya can be traced back in the 1920's when European colonists traded shares informally pursuant to contractual commitments and physical settlement of trades. In 1953-54, local brokers in Nairobi obtained the London Stock Exchange's ("LSE") recognition of the NSE as an overseas stock exchange and registered the NSE under the Societies Act as a "voluntary association of stockbrokers." At that time and continuing to this day, the NSE operated as a self-regulatory organization ("SRO") (Ngugi, 2003).

Despite a substantial increase in regulation of business licensing and the "Kenyanisation" policies that arose after independence in 1963, the NSE enjoyed relatively independent self regulation until 1971 with the establishment of the Capital Issue Committee ("CIC"). The CIC essentially vetted public offerings for the purpose of ensuring that capital raised on the NSE would not subsequently be sent outside of Kenya. This sounded the death knell for the regionalization of the NSE, as restrictions on repatriation, which generally were directed at foreigners who were divesting the Kenyan assets to protect themselves from "Kenyanisation" policies, applied just as easily to Ugandan or Tanzanian companies that otherwise would have raised capital on the NSE and brought that capital back to their home country to apply to operations there (Ngugi, 2003).

The repatriation restrictions that accompanied the CIC's vetting of prospectuses, however, were primary market restrictions and as such impacted only on the standards for admission to listing and not the rules for trading on the NSE. Throughout this period the NSE continued to operate as an SRO and, indeed, trading was not even organized around a floor on the basis of the open-outcry system until 1991. It was not until 1990, with the passage of the Capital Markets Authority Act ("CMA Act") and the establishment of the Capital Markets Authority ("Kenya CMA") that Kenya's securities markets gained a multi-tiered financial services regulatory model (Capital Markets Authority Act, 1990).

The following are the roles played by a stock exchange.

First, NSE enables the mobilization of savings for investment in productive enterprises as an alternative to putting savings in bank deposits, purchase of real estate and outright consumption (NSE, 2007). Secondly it enhances the growth of related financial services sector e.g. insurance, pension and provident fund schemes which nurture the spirit of savings. Thirdly, it enables the check against flight of capital which takes place because of local inflation and currency depreciation. It encourages the divorcement of the owners of capital from the managers of capital; a very important process because owners may not necessarily have the expertise to manage capital investment efficiently. It also encourages higher standards of accounting, resource management and public disclosure which in turn afford greater efficiency in the process of capital growth (NSE, 2007). It facilitates of equity financing as opposed to debt financing. Debt financing has been the undoing of many enterprises in both developed and developing countries especially in recessionary periods. It also improves access to finance for new and smaller companies. This is now possible on the Alternative Investments Market Segment (AIMS). This can also be realized through Venture Capital institutions which are fast becoming key players in financing small businesses (Ngugi, 2003). Lastly, NSE encourages public floatation of private companies which in turn allows greater growth and increase of the supply of assets available for long-term investment (NSE, 2007).

NSE is fully owned by the nineteen licensed stockbrokers (Appendix II). The NSE is currently increasingly experiencing volatile as NSE 20-Share Index fell below the 3,000 psychological mark, lowering the total value of shareholders' wealth (market capitalization) to Sh740.877 billion, from Sh1.3 trillion in June 2008. The market capitalization grew to KSh 1.3 trillion by the end of June after the listing of the Safaricom shares (NSE, 2007). NSE's has four core stakeholder; the investors, the listed companies, and the members/brokers. The most important stakeholders in any exchange are the investors (Ngugi, 2003). In case of Kenya, the number of investors remains very small, though in the recent years substantial number of investors has been attracted to the market. The gross number of investors in all listed companies is approximately 1.5 million based on CDS accounts that have been opened as at April, 2008 (CDS Preliminary Report, 2008). NSE has 55 listed companies on Equities board and 2 securities on preference shares board. It also has 9 listed Corporate Bonds and 65 listed Treasury bonds on the fixed income securities board (NSE Weekly Market Statistics, 2008). The NSE has 19 active trading members (brokers) and one dormant member. There are 11 directors on the board of the NSE. 5 of board members are elected from the brokers, 2 are elected to represent listed companies, 2 to represent institutional interests, 1 to represent the public interest, managing director of the NSE and the legal officer/ company secretary (Ngugi and Njiru, 2005).

In the recent past NSE has undergone some major development on the trading and the settlement front. These developments entail establishment of a modern fully automated custody and settlement services which are being provided by the Central Depository System Corporation (CDSC). CDSC became operational in 2004 after decades of manual clearing and settlement system. The shareholders of the CDSC are brokers and some financial institutions. There was a successful implementation of the automated trading system (ATS) in September 2006 on a local area network (LAN) at the trading floor. The system has facilitated efficient trading by reducing the time it takes to execute a trade. The integration of the ATS, CDS and brokers' back office systems improved service delivery to investors. To begin with ATS operated on a Local Area Network (LAN) but after a success testing and implementation phase the ATS now runs on a Wide Area Network (WAN) for members to trade from their offices. On the 17th December 2007, number of the trading hours increased to 6 hours (9.00 hrs-15.00hrs) (NSE Trading Rules, 2008).

Global financial services industry is being driven by new strong forces. These forces are causing exchanges like NSE to re-examine their business structures in order to remain competitive. Globalization of the markets, advances in technology, competitive pricing pressures and government deregulation are all contributing to the allure of demutualization (Mensah, 2005). In the recent past NSE has gone through some very turbulent times. Three stockbrokers have gone under in a span of three two years due to poor corporate governance. This bad image has led to low investor confidence. This has threatened to negate some huge gains made by automation of both trading and settlement systems. There have been unanimous calls from the technocrats for NSE to demutualize in order to improve corporate governance at the NSE having an autonomous board of directors and management (Mwanza, 2008).

1.2 Statement of the Problem

The demutualization of stock exchanges is a recent new phenomenon in the economic world with a history of approximately 20 years. Thus most of world stock exchanges have been non-profit, mutual organizations with monopoly power, owned by their members (Serifsoy, 2006). Due to the recent years' technology improvements and competitive environment changes, new opportunities alongside with new threats have been created for stock exchanges, causing the stock exchanges to change their ownership organizational form (Aggarwal, 2002). Besides, the increasing conflicts in the stock exchanges member's interests and tough competition led to a reduction in the stock exchanges wealth. As a result, this led to a change in the stock exchanges governance structure; demutualization (Serifsoy, 2006).

A study on the effectiveness and performance of a London Stock Exchange and Hong Kong Stock Exchange on the impact of the change in ownership form from mutual to for-profit showed that demutualized exchanges had a better post listing share and operative performance than mutual exchanges (Aggarwal, 2006, Mendiola and O'Hara, 2003). Demutualization can be a source of significant market capitalization. At the end of 2004, the total stock market capitalization of the world's exchanges was $37.2 trillion. With the addition of the New York Stock Exchange (NYSE) as a publicly traded company in 2006, over 70 percent of the world's total stock market capitalization is comprised of publicly-listed exchanges (Aggarwal, 2006).

Stock exchanges are now increasingly changing their business model and restructuring themselves across the world due to simultaneous convergence of a number of powerful developments. The most notable have been the rapid advancement and innovation in technology that has facilitated Alternative Trading Systems (ATS) including Electronic Communication Networks (ECNs) and growing market competition and integration as well as globalization induced partly by cross-border listing and portfolio flows. Together these developments have eroded the significance of a physical national exchanges and trading floors. ATS /ECNs have allowed efficient and effective matching of buy and sell orders of the customer at lower transaction costs, while offering price transparency, trade anonymity and extended trading hours (Mendiola and O'Hara, 2003).

Due to mutualization there are allegations of price manipulations, inside trading, front running, and other forms of market abuse abound, in spite of the fact that the CMA has a number of rules and regulations pertaining NSE operation and trading. In the last one year two stockbrokers Francis Thuo and Partners and Nyaga Stockbrokers have gone under due to mutualization allowing for malpractices (Mwanza, 2008). Demutualization is perceived as a solution of conflict of interest of the different stakeholders by segregating the ownership from the membership and trading rights thus allowing a proper running of the stock exchanges' management (Moore 1996). This proposed study will therefore survey the potential benefits of demutualization of NSE.

1.3 Objectives of the Study

The main objective is to identify the principal benefits that will accrue from the demutualization of the NSE.

1.4 Importance of the Study

This study will be of importance to the:

NSE Board

The board would benefit from the realization of how demutualization provides opportunities to unlock value, improving governance, efficiency and harmony in operations and raising new of capital. The findings on the potential benefits of will enhance transparency, centralization and automation; the three principles that drive NSE trading system.

Capital Market Authority

The market regulator will be able to look at other demutualization models to enhance regulatory framework and advising the on drafting of proper legislature for deregulation and self listing. Further, the potential benefits of demutualization of stock exchanges will enhance the operations of CMA.

East African Stock Exchanges

This study will be a reference point to other East African Exchanges looking forward to demutualize, since the findings will enumerate the potential benefits of demutualization of stock exchanges.

Future Researchers

The study will be of great benefit to future scholars in the field of demutualization. The research findings will be important and will serve as a source of reference to future scholars.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter outlines the literature done by other authors on demutualization, motives and benefits of demutualization, demutualization models, and operations of Nairobi Stock Exchange.

2.2 Demutualization

Traditionally stock exchanges have been mutual structures with the access to the trading floors restricted to some intermediaries-members. In addition, trading business was protected by regulatory barriers creating regional or national monopolies. The mutual structure was therefore a type of organisation that assured the protection of monopoly power and the extraction of monopoly rents (Pirrong, 1999). In the year 2000 alone, eleven exchanges from around the world converted to a for-profit corporate status. These exchanges include the Chicago Mercantile Exchange, the London Stock Exchange, the Hong Kong Stock Exchange and the Sydney Futures Exchange. Demutualization is truly an international phenomenon (Wilmouth, 2000).

Due to the advances in technology, globalization and government deregulation most exchanges to have been forced to re-examine their business structures to remain competitive. The Stockholm Stock Exchange was first to react to this changing environment by restructuring its corporate governance in 1993 by demutualizing (Wilmouth, 2001). Since then over 21 exchanges in developed markets have demutualized- this represent 40% of the membership of the World Federation of Exchanges (World Federation of Exchanges Annual Report and Statistics). Mensah (2005) reckons that in Africa there are few stock exchanges such as Mauritius, Johannesburg Stock Exchanges and the Bourse Regionale des Valeurs Mobilieres (BVRM) are limited by shares and in theory demutualized (Appendix VI).

As defined by Cameron (2002) demutualization strictly means the transition from a mutual company, in which there are no shares, and every member has one vote, to a company limited by shares and one vote per share. But it is also used to describe the process by which a company limited by shares in which every member is required to have the same number of shares, converts to a more usual economic model; or simply one where the link between the membership in the exchange company or ownership of a share in it, is broken. Permitting non-brokers to own shares in the exchange, and brokers not to have ownership interest of any kind.

Demutualization refers to the entire process of changing the legal structure of a stock exchange from a mutual association, with one-vote per member and usually consensus decision making to a company limited by shares, with one-vote per share and with majority decision making (Onyuma, 2006). Demutualization involves the separation of trading rights from ownership, and in most cases the exchange becomes a profit firm and even, self-lists reckons Akhtar (2002).

Delany (2005), states that there are three reasons advanced by exchanges to demutualize. Firstly, the desire to be more commercially nimble in order to respond to dynamic market needs more quickly, unimpeded by the member committees and their diverse interests. Secondly, demutualization improves capital markets access to new capital. Thirdly, being a publicly quoted allow exchanges and their management a clearer idea of what exactly they are worth. In addition to these, demutualization increases competition between exchanges for market share, as investors demand a return on their investment.

There is now a widespread belief that the demutualization of stock exchanges is both desirable and inevitable. It is now impossible to deny that the securities community has reached an implicit consensus that demutualization maximizes efficiency, incentives and is critical to the survival of international exchanges. The mutuals, as a way of operating financial markets, were never going to survive corporate membership of exchanges, far less computerization in the financial sector, the information age, the internet revolution, or globalization. They reflected the coffee shop origins of the markets, they shouted order across the crowded, noisy and frequently smoke filled room, where every trader knew every other trader and what they were good for. The wonder is not that they are coming to an end, but that they lasted so long. Notwithstanding this almost universal agreement that the merits of demutualizing securities exchanges are self-evident, denotes (Lee, 2003).

The pressure to reduce trading execution costs, the demands for technological innovation and demutualization are raising many market structure issues. These pertinent issues include regulation of ECNs, market fragmentation, market linkages, market information fees and other exchange revenues, the fair treatment of customer orders and the future of self-regulation (Karmel, 2000). According to Cha (1999) it is now impossible to deny that the securities' community has reached an implicit consensus that demutualization maximizes efficiency incentives and is critical to the survival of the international exchanges.

Akpesey (2008) argues that mutually owned exchanges have served their purposes, and markets are increasingly recognising that a trading infrastructure, as well as modern corporate and governance structure, is essential to reducing transaction costs, attracting the funds of investors, and attracting new firms to raise their capital requirements. Accordingly, globally, stock exchanges have been involved in massive demutualization exercises particularly since the beginning of the 21st century.

Ramos (2006), reports that since the beginning of the 90's several stock exchanges have demutualized, i.e. they have become companies and opened ownership to outside investors. In addition, a growing number of exchanges have introduced shares of their companies on the stock market they operate a process called self listing-emphasizing at the same time the profit and public nature of activity. In the mid 90's the number of WFE (World Federation of Exchanges) that were for profit structures was around 10% while in a 2002 survey this number was 63%.

2.3 Motives for Demutualization

Research by (Pirrong 2000; Serifoy 2005 and Gompers et al. 2001) highlights numerous advantages of exchange demutualization. These benefits include a realization of value for members, greater speed and flexibility in decision making, clearer criteria for decision making, clearer and simpler governance, less susceptibility to members' vested interests and conflict between classes of members, greater willingness to open up access to markets, enhanced ability to diversify into new markets, spreading of ownership risk, resolution of growing inequities between members, greater access to capital, flexibility in future negotiations relating to alliances, mergers and similar transactions and ways of rewarding and motivate the management appropriately.

Although a substantial proportion of the property and casualty insurers of the United States are owned by their policyholders, the current industry trend for these mutual insurers is to demutualize. They want to become publicly held stock companies so that they can compete more effectively, diversify, engage in mergers and acquisitions, and get access to their huge reserves of capital (Pearson, 2002). Publicly held company puts much more performance pressure on management, often to the good of the company and the policyholders. But demutualization is a time-consuming and expensive process, and not every mutual insurer wants to experience the rigors of public ownership. There is another solution, one that will give mutuals many of the same benefits, with less risk and cost (Wilmouth, 2001).

2.4 Benefits for Demutualization

Some of the benefits for demutualization are discussed below.

2.4.1 Technology

Aggarwal (2002) denotes that major changes in the structure of operations of stock exchanges have generally coincided with the break-through in communication and data processing technologies. The NSE has recognized the importance of ATS and other platforms as a way of improving efficiency and keeping costs down. However the old member owned association fails to provide the flexibility and the financing needed to compete in today's competitive environment. Demutualization of the NSE will help it adapt to the fast-changing market giving it an impetus to be a one of leading exchanges in Sub-Saharan Africa. According to Hughes and Zargar (2006) there is a threat of competition from alternative trading systems. Case in point is the entry of NASDAQ in the USA as an automated Over the Counter market which offered competition to the NYSE. Time is due for an OTC market to cater mainly for medium and small sized companies which do not meet the listing requirements at the NSE.

2.4.2 Improved governance and managerial structure

Hughes (2002) reckons that mutual association model functions well if an exchange is a provider of trading services with limited competition and the interests of the members are homogeneous. If members' interests diverge from one another and from the exchange, the mutual governance ceases to function well. Consensus decision making becomes slow and cumbersome. Management of the demutualized entities are free to make decisions regarding listing contracts electronically, changing clearing and transaction fees when appropriate, or expanding existing product and service offerings.

Demutualization creates an environment where an exchange can restructure governance on a sustainable basis. The ownership rights and trading rights are de-linked. It increases the role of non-member stakeholders in the affairs of the exchange. This leads to an exchange that is independent and efficient, which undertakes transparent decisions in the interest of all the stakeholders, particularly the investors. Mendiola and O'Hara (2004) investigated the effects of change of governance in stock exchanges on performance and evaluation. They found that exchange performance tends to improve after the change in governance. Hazarika (2005) analyzed two demutualized exchanges, the London Stock Exchange (LSE) and the Borsi Italia, and found out that demutualization helps the stock exchanges to increase order flow. Demutualization may allow an exchange to improve financial decision making by ensuring resources are allocated to business initiatives and ventures that enhance shareholders value.

Demutualization changes the way the exchange is governed to provide for faster decision making ability and to eliminate the control of members who view the exchange primarily as a facility through which they make their profits. Under a demutualized structure, the exchange will be owned by shareholders who will have a stake in the exchange being a profit-generating entity and will be run by an experienced management team which is driven to improve the exchange's bottom- line (Wilmouth, 2001).

2.4.3 Access to economic capital

Demutualization enhances exchange ability to raise new capital e.g. to invest in modernization initiatives rather than rely on donor funding or mutual members. According to Ramos (2001) Demutualized exchanges go public to raise capital and because they face more competition from peers. Weisbach and Kim (2005) reckon that demutualized exchanges go public to raise new finance similar to the evidence for firms. A demutualized exchange stock should be able raise capital from many sources as a normal profit public limited company. An important source of economic capital would be the new shareholders, institutions and individuals. This access to capital would allow large investments required in the technological infrastructure to broaden access to the market. A demutualized exchange should also be able to borrow from conventional lenders, such as banks (Expert Committee on Demutualization and Integration/ Transformation). By demutualizing, exchanges will have a way to raise large pools of capital to finance modernization plans and new technology to compete in today's global marketplace. This can be done eventually through share offerings to non-members (Wilmouth 2001).

2.4.4 Investor Participation

Hughes and Zargar (2006) point out that in today's competitive environment, a stock exchange must be responsive to the needs of its many stakeholders, including participating organizations, listed companies, and institutional and retail investors. In order to respond effectively to the emerging trends, exchanges need to shift power from one group of stakeholder to another. Separating exchange membership from ownership may be a politically and economically feasible way to effect such a shift and resolve conflicts both between exchange's members and between the exchange and its members. For instance, unlike the NSE structure, where often the only broker-dealers may be member, a demutualized exchange affords both institutional investors and retail investors' opportunity to become shareholders.

2.4.5 Creating a catalyst for pursuing new business strategies

Stock exchange industry has been subject to unprecedented dynamics in the recent past particularly in the US and Europe as described by Serifsoy & Tyrell (2006). Continuing financial innovation and demand for new risk management and derivative products are fueling global growth in exchange-traded and over-the-counter products. To capitalize on this potential, demutualized NSE will be able to attract outside investment, further expanding their technology platforms, and broaden their product and service offerings. Demutualization may permit an exchange to reward key market participants giving them financial incentives to bring business to the exchange. Many private owned ATSs and indeed demutualized exchanges have sought to attract trading by giving equity ownership to the largest users of their trading platforms, namely the biggest traders in the market. Technology firms, as well as firms interested in acquiring an equity stake in stock exchanges, are likely to prefer to work with a demutualized corporations, rather than a member-owned mutual organizations. Demutualization and conversion of memberships into shares will create a valuable currency for strategic alliances. A demutualized stock exchange should be able to enter into alliances with other stock exchanges through equity swaps Expert Committee on Demutualization and Integration/ Transformation). This is likely to provide opportunities for investments and cross-listings from other countries especially those in the Sub-Saharan Africa (Karmel, 2000).

2.4.6 Unlocking Members' Equity Values

Demutualization gives the exchange members the chance to realize the market value of their equity in the exchange while retaining their trading rights denotes Wilmouth (2001). Over the years, many retired exchanges owners experienced substantial declines in their seat values and turned to income from leasing. These owners become generally less interested in member opportunity on the floor and more interested in maintaining their asset values and deriving income from their assets. Currently, a member of the NSE cannot sell his membership without foregoing trading rights. Demutualization would unlock the value of equity for all members without loss of trading rights. They may invest the proceeds to upgrade their business.

2.4.7 Global Competition

Aggarwal (2002) points out that competition among exchanges and with electronic communications networks (ECNs) has increased, not just at the national levels, but at the regional and global levels as well. In the new environment, exchanges are no longer monopolies but must be run as efficient business enterprises. In many emerging markets there is increasing competition for global order flow. As a result of globalization and technology, local and regional markets are forced into more direct competition regionally and more particularly internationally (Exchange Demutualization in Emerging Markets, 2005). Demutualization should also lead to domestic and international recognition. A demutualized exchange would be open as and transparent company. This would help improve the perception of exchanges and enhance confidence of domestic and international investors (Expert Committee on Demutualization and Integration/ Transformation).

2.4.8 Emerging Markets Consideration

There some additional principal benefits for demutualization that seem to be peculiar to the emerging markets. Some market regulators view demutualization as a means of collaborating with strategic shareholders with specialized know-how with the object of importing international skills, knowledge and technical efficiencies into the domestic markets reckons (Mensah, 2005).

2.5 Demutualization Models

Stockholm stock exchange pioneered demutualization in 1993. Lastra (2007) reckons that demutualization has become a common phenomenon since 2000. The majority of the European securities markets are currently demutualized. The process of demutualization has been more accelerated in the U.S.A. In Africa major stock exchanges like Johannesburg stock exchange and Besa have also demutualized. In most cases demutualization has been followed by the listing of the shares either immediately or after a short period, very often in the exchange's own market. The following are some of the demutualization models.

2.5.1 Australian Stock Exchange (ASX)

ASX was formed in 1987 for the purpose of dealing in equities, options and fixed income securities. The ASX was created as a result of the merger of six provincial exchanges in Australia namely Melbourne, Sydney Perth, Brisbane, Adelaide and Hobert. The exchange demutualized in 1996 and listed on its own exchange in 1998. Before demutualization the company was wholly owned by its brokers with one member having one vote (Hughes, 2002).

The process of demutualization was of ASX was self initiated. In order to provide a mechanism by which to convert membership to shares, the Australian legislature enacted the *Corporations Law Amendment (ASX) act* in 1998. The new legislation expanded the regulatory and public interest responsibilities of the securities exchanges as self regulatory organizations as well as the exchange's accountability to the Australian Securities Investment commission (ASIC). It also separated stockbrokers' rights to trade from the shareholders' rights, imposed a 5% limit on shareholding of ASX, allowed the securities exchange to self list in it own exchange and provided for the supervision of any self-listing by ASIC (Holthouse, 2002). The ASX demutualized on the 13th October 1998 and on 14th

October 1998 listed on its own board. The Drivers for Demutualization of ASX according to Hughes (2002) the main drivers for demutualization of ASX were deregulation, open competition and technological advances.

2.5.2 Hong Kong Exchange (HKEx)

In 2000 the Stock Exchange of Hong Kong (SEHK), Hong Kong Futures Exchange (HKFE), combined to form the Hong Kong Exchanges and Clearing Limited (HKEx). The exchanges became subsidiaries of the HKEx with new boards and committees being formed (Hughes, 2002). Section 13 of the Exchanges and the Clearing Houses (Merger) Ordinance, set out the framework for HKEx to become a listed company. Requirements of section 13 of the *Merger Ordinance* were satisfied by drafting a new Chapter 38 of the Stock Exchange of Hong Kong Limited's (SEHK) listing rules and a new memorandum of understanding between SFC, HKEx and SEHK (the Pre-listing MOU). Chapter 38 deals with a number of matters, which can be divided broadly into three heads. First, power functions, right and obligations of the SFC, SEHK, HKEx in relation to the listing of the HKEx. Secondly, the Pre-listing MOU contains arrangements designed to ensure integrity of the securities and the futures market and compliance of HKEx with its obligations as a listed company. Finally, pre-listing MOU stipulates administrative and other procedural arrangements to assist SFC to deal with HKEx as listed company.

Shareholding 5% was put down in the law to control ownership by any individual party or parties acting in concert. The company is quoted and listed on its own exchange It is regulated by SFC and to ensure a level playing ground between HKEC and other listed companies which are subject to listing rules administered by HKEx. The main drivers of the demutualization were to compete vigorously for opportunities in the region and around the world and to become a market driven business, operating business driven markets (Pearson 2002).

2.5.3 Singapore Stock Exchange – SGX

Singapore Exchange Limited (SGX) was the first demutualized, integrated securities and derivatives exchange in Asia Pacific. It was formed on 1 December 1999 by the merger of two well-established and respected financial institutions - the Stock Exchange of Singapore (SES) which traded securities, and the Singapore International Monetary Exchange (Simex) which traded derivatives (Hughes, 2002).

With the support of the Singapore Government, members and other related institutions, the merger and demutualization of SGX proceeded smoothly according to the provisions of the Merger Act. Pursuant to legislation adopted to effect the merger, SGX was created to own the exchanges and their related clearinghouses, and the former owners and shareholders were given shares and seats in the exchanges. In 2000, SGX became a public company, with 1,000,000,000 ordinary shares outstanding (Ngiap, 2002).

To array concerns about possible conflict of interests in SGX running the exchange as a business and acting as a regulator of the exchanges at the same time, high set of standards were implemented which improved the brand identity of the exchange. To achieve these objectives, the SGX’s five business divisions were kept separate from the regulatory Risk Management and Regulation (RMR) division, even though they all report to the office of the CEO. Also, the Merger Act provided two main safeguards. One in the form of the Monetary Authority of Singapore (MAS), the exchange’s regulator, whereby under the Deed of Undertaking between SGX and MAS, it was undertaken that MAS would supervise SGX’s compliance with SGX’s own listing rule as any other listed corporation would be supervised by SGX. The other safeguard is in the form of a Conflicts Committee at the exchange level, set up to consider all possible conflicts of interest and to notify MAS of all identified conflicts. The company is publicly owned and is quoted on its own exchange (Hughes, 2002).

The corporate governance structure is as follows. The company has 11 members of which 4 directors represent the broker interests. There is maximum shareholding limit of 5%. Higher shareholding can only be allowed with the approval the Monetary Authority of Singapore. The main drivers of the demutualization of SGX were globalization and technological proliferations of electronic communications networks (ECNs) which were positioning themselves as virtual; exchanges and providing single electronic access to multiple markets. The demutualization was expected to allow SGX to better serve the needs of its customers and end users. The merger was to minimize operating costs and increase value positioning vis-à-vis other foreign exchanges. Also the exchange needed to serve the broader interests of the financial sector, which were not in line with the interests of the brokers.

In summary from the above models demutualization has huge potential to offer in strengthening governance, offering alternate business models of exchanges and raising capital among others.

2.6 Structure & Regulation of the Nairobi Stock Exchange

2.6.1 The Organizational Structure of the Nairobi Stock Exchange

Under the CMA Act, the NSE was required to reorganize itself from a voluntary association of stockbrokers, as it had been since its establishment in 1954, to a Limited Liability Company under Kenya's Companies Act. The CMA Act contains explicit provisions requiring the boards of directors of approved exchanges to include five directors elected from amongst the exchange's broker/dealer members; two directors elected as representatives of listed companies; and three directors to represent the interests of the investing public.

The Kenya CMA has issued regulations under the CMA Act that prohibit exchanges from distributing profits to exchange members. Regulations also require exchanges to submit their annual budget to the Kenya CMA and expend twenty percent of the exchange's annual listing fee income on investor education and upgrading exchange trading system architecture (Capital Markets Regulations, 2002). These limitations on the corporate activities of exchanges appear to be substantial barriers to the development of the NSE as a for-profit, demutualized institution. In addition, the Kenya CMA has curtailed the SRO role of the NSE, and limited the scope of financial services that exchanges may provide, with a view essentially to employing the NSE in the CMA's capital markets development mandate.

These developments in securities trading markets regulation evidence some mixed trends in the world of Kenyan finance. The rationalization of market regulation in Kenya is certainly a positive development, although many market participants complain of "over-regulation" by the CMA; particularly the agency's tendency to impose reporting and compliance requirements that are too costly and complex to administer for a market as thin as the NSE (Raustiala, 2002). More problematic from the standpoint of the goal of enhancing liquidity on the NSE, however, is the CMA's prohibition on the distribution of profits to members of an exchange. If stakeholders in the NSE are prohibited by regulation from realizing profit out of the revenue that the exchange generates, the stakeholders in the NSE will have a significantly diminished incentive to increase trading volume on the exchange. Increased trading volume is necessary to enhance the liquidity of the market, and enhanced liquidity is necessary to make the NSE an attractive primary market on which to issue and list new securities. In turn, it is indisputable that the NSE needs more listings before the exchange will have enough investment alternatives such that it is an attractive venue for prospective investors to bring their capital. There is thus a "virtuous cycle" of liquidity production that the NSE has yet to spur (Ngugi & Njiru, 2005).

2.6.2 The Market Micro-structure of the Nairobi Stock Exchange

The open outcry system that was adopted in 1991 at the behest of the Kenya CMA did not last long. The NSE switched to an automated trading system ("ATS") in 2006. NSE trading rules prescribe a continuous auction in securities from 9:00 a.m. to 3:00 p.m.—expanded from the 10:00 a.m. to 12:00 p.m. trading period that prevailed under the open outcry system. Regulations also delineate how orders are to be matched in the ATS order book and how securities are to be priced. A trader must be a member of the NSE to gain access to the ATS, and all NSE members must be licensed by the Kenya CMA (NSE Trading Rules, 2008).

Trading rules provide for remote trading by NSE members. This provision is crucial to the success of the NSE as a regional exchange for the East African Community ("EAC"). The trading rules also prohibit off-exchange trading, which theoretically should improve price formation in listed securities, but there are criticisms of this rule in the case of the NSE. In particular, off-exchange trading prohibitions could deter firms from issuing securities and listing on the exchange, thus reducing NSE liquidity. The deterrence to issuance could arise because smaller retail investors may not be able to afford brokerage commissions on the NSE (World Bank, 2002). Thus, a firm listed on the NSE would have its potential investor base limited to those investors wealthy enough to afford brokerage costs on the NSE. This could have the effect of reducing the value of a listed firm. The CMA should consider permitting off-exchange trades, or exempting certain classes of off-exchange trades, with a view to increasing competition among brokers. In any event, reducing the dominance of established brokers over issuance and trading has been a goal of the Kenya CMA since its inception.

The switch to an automated system was part of a broader program instituted by the CMA to enhance efficiency in trading, the CMA desired to reduce settlement from T+14, which prevailed under the paper-intensive settlement system utilized under the open outcry and call auction systems, to the current T+5 settlement achieved with the use of the new central depository system. Although earlier practice had permitted purchasers to trade in purchased securities prior to the T+14 settlement date via a special type of note that evidenced security ownership, the long settlement period was clearly a significant impediment to increased trading volume and deterred many investors from choosing the NSE as a venue for investment. The NSE is currently striving to reduce settlement to the Group of 30's T+3 standards (Ngugi, 2003).

2.6.3 Securities Issuance, Listing and the Relationship between Kenya's Primary & Secondary Securities Markets

The NSE has divided the market into three segments: Main Investment Market, Alternative Investment Market and Fixed Income Securities Market. The NSE does not operate an over-the-counter ("OTC") market, although there are plans to establish one. With so few listed securities, however, it seems unnecessary to compartmentalize trading in such a manner (Irving, 2005). Arguably, the small capitalization of listed firms and the small number of listings calls for an OTC market alone. But the Kenyan government's desire to privatize state-owned enterprises appears to be interposing itself on the NSE. Kenya's privatization program dates to approximately the same time as the revitalization of the NSE, and NSE membership rules specifically direct NSE board of directors members to lobby the Kenyan government for privatization of state-owned enterprises ("SOEs") via securities issuances on the NSE (WTO Secretariat, 2006).

Tailoring NSE listing rules to large, privatized former SOEs is inappropriate. Although there appears to be a relatively large number of privatizations remaining, the narrow focus on drawing privatized enterprises into the public securities market is not sustainable. The primary market for securities in Kenya, which is impacted significantly by listing rules and issuance costs, should rather be geared towards attracting the type of enterprises that comprise the bulk of the EAC economy; small and medium scale enterprises ("SMEs"). Evidence on the cost of issuance and listing suggests that this is a major impediment to SMEs entering the NSE primary market. Initial costs of listing have been reported at 10-15% of the actual capital raised in an issuance. The rules of brokers, counsel, and underwriters in the issuance process are legally ambiguous, adding uncertainty to the process. Ongoing disclosure and reporting obligations for listed companies also entails significant costs (World Bank, 2002).

The focus on luring privatized SOEs into the NSE primary market appears to be a boon to brokers and the financial services industry, given the substantial fees they earn in the process. There is, however, insufficient trading volume in former SOE securities to have any significant impact on NSE liquidity. The statistics bear this out: only 35% of NSE market capitalization is available for trading and, in 2001, the turnover ratio was as low as 3% (World Bank, 2002). The NSE ranks near the bottom of emerging market securities exchanges in terms of its annual turnover ratio. Although SOE privatizations contribute substantial capitalization to the exchange, that capitalization does not significantly contribute to liquidity if investors do not trade regularly in those securities. Experience with the major institutional investors that tend to purchase the shares of privatized former SOEs shows that they are buy and hold investors.

2.6.4 Conflicting Rules Regarding Portfolio Investment and Direct Investment

The CMA's stance regarding portfolio investment by foreign entities also has a significantly negative impact on market liquidity and the price a firm can realize for an issuance on the NSE. Recent CMA rulemaking has limited permissible foreign participation in a security issuance to 60% of issued shares—down from the 75% that had prevailed since 2002. Foreign investors had only been permitted to participate in the NSE since 1995, and since that time the CMA has in fits and starts begun to liberalize the regime for foreign participation in the securities market (Capital Markets Regulations, 2007).

The anti-foreigner stance is understandable in light of Kenya's colonial past and Kenyanization, but the rules limiting foreign participation are problematic for a number of reasons. First, the NSE has historically had a significant volume of foreign participation, which has unquestionably increased liquidity on the exchange. Second, regulation of foreign owned capital in Kenya is better done through Kenya's more highly evolved Kenya Investment Authority ("KIA"). For example, Kenya's rules on foreign direct investment generally permit 100% foreign ownership. But once that same foreign owned entity seeks to issue shares on the NSE, 40% of issued shares must be reserved for purchase by local investors pursuant to CMA regulations. This clearly reduces the exchange-listed value of firms with significant global ties and creates huge barriers for transnational companies that would like to set up subsidiaries in Kenya. Third, and more generally, the goal of capital markets development and, specific to the NSE, the goal of enhancing exchange liquidity is flatly incompatible with outright restrictions on the supply of capital to the market (World Bank, 2002).

The unease developing nations such as Kenya feel towards foreign portfolio investment generally arise from concerns on volatility. This is an understandable concern given the financial crises of the 90's, during which many developing nations experienced frightful capital outflows. Volatility, however, is a component of liquidity: volatility induces trading, trading attracts issuance, and issuance attracts investor capital. Modern trading systems have tools to control volatility; indeed, the NSE has specific rules for calling general market halts and trading halts in particular securities. Moreover, volatility itself can be an investment vehicle in the derivatives markets and the NSE is currently developing plans for an options and futures market segment. The point is that volatility is a necessary element of a liquid market; it need only be priced correctly. The lack of derivatives instruments in many developing securities markets leaves the potential for outflow of foreign portfolio investment un priced, thus increasing overall market risk. The CMA need not use the blunt instrument of exclusion to address volatility concerns. Restrictions on foreign participation in the market should be eliminated and the NSE should redouble its efforts to open a futures and options market segment.

2.7 Empirical Review

The increasing process of globalization and internationalization of financial markets has washed off the boundaries to access and put stock exchanges in direct competition with each other. The mutual organizational structure of ownership could be considered as an obstacle to the stock exchange's efforts to remain competitive and profitable and even because of its rigid nature the mutual organizational structure could create serious threats to the financial stability and health of stock exchanges in the changing environment. For instance, members may oppose "innovations" that reduce demand for their intermediation services even if such innovations would enhance the value of the exchange (Domowitz and Steil 1999).

Hart and Moore (1996) focused on the user welfare of different governance setups for stock exchanges; the relative merits of a mutual structure and outside ownership in dependence of the level of competition and the diversity of member interests. Their conclusions were that outside ownership was more efficient than a mutual structure as the members of the mutual become more diverse in terms of preferences and that outside ownership becomes more efficient than a mutual structure as the exchange faces more competition. Pirrong (2000) takes a different approach to analyze governance issues. In contrast to Hart and Moore (1996), he does not compare different owners of the exchange, but focuses on different types of users that may organize their stock exchange either as a for-profit or as a not for-profit entity. He describes governance mechanisms to mitigate conflicts of interests between the members. In Pirrong (1999) and Pirrong (2002), an analysis of competition between stock exchanges is provided and is based on switching costs and liquidity effects, respectively.

According to the data of the World Federation of Exchanges the weight of mutuals dropped down dramatically from 40% in 1999 to 25% in 2003. In the same period, the number of demutualized stock exchanges rose from 10% in to 25%.The fact that almost all major exchanges have undergone demutualization and became public companies is showing the necessity of having a structure that will allow the exchange to be able to respond to the industry challenges (Otchere, 2007).

2.8 Conclusions

Stock exchanges are continuously looking to conduct their activity as for-profit organizations using business strategies capable to face competition challenges posed by other competitors or new electronic trading platforms. In general, the demutualization of stock exchanges is offering a certain range of advantages; Abolishment of the member's intermediation monopoly; A more effective and better response to the investors (direct and cost effective exchange access); Generation of required level of investments that is offering the appropriate returns to their owners.

Demutualization of NSE has numerous benefits; this study therefore aims at establishing these benefits. The demutualized stock exchanges continuously push to adopt cost efficient strategies and broad up their revenue sources in order to improve their competitiveness. In contrast to this study, the past studies do not deal with the issue of potential benefits of demutualization in the developing countries , given the varied economies, technological advancement, competitiveness of developed and developing countries.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1Introduction

This chapter explains the research design, target population, data collection procedure and data analysis.

3.2 Research Design

Research design is the plan and structure of investigation so conceived as to achieve the objectives of the study. According to Mugenda & Mugenda (1999) descriptive survey research seeks to obtain information that describes an existing phenomenon by asking individuals about their perceptions, attitudes, behavior or values. This study will be carried out using the descriptive survey method.

3.3 Population and Sample

3.3.1 Target Population

A population is an entire group of individuals, events or objects having common characteristics that conform to a given specification (Mugenda & Mugenda, 2003). The target population will be the middle level managers of the 19 licensed members (stockbrokers) in the NSE. This target population is appropriate since these stockbrokers have rich information on demutualization concept. The licensed member firms of the NSE are licensed to buy and sell securities listed on behalf of investors.

3.3.2 Sampling and sample size

Sampling is the process of selecting a number of individuals for a study in such a way that the individual selected represents the large group from which they are selected (Mugenda & Mugenda, 2003). The sample size will be 38 respondents, two employees from each stockbroker. In this study the researcher will use simple random sampling. This technique is ideal because it gives the respondents an equal opportunity to participate in the study without bias.

3.4 Data Collection

Data collection is gathering empirical evidence in order to gain new insights about a situation and answer questions that prompt undertaking of the research (Robson 2002). Primary and secondary data will be used for the purpose of this study. Data will be collected using questionnaires administered to the middle level managers of the stockbrokers. Secondary data will be obtained from NSE and CMA records. To ensure high response rate, calls and visits to the selected respondents will be done for follow up.

3.5 Data Analysis

After the data collection, questionnaires will be checked for completeness and consistency and data coded for easy input. The data will be analyzed with the help of Statistical Package for Social Sciences (SPSS). Data will be interpreted using descriptive statistics. Qualitative data from open questions will be presented in prose.

CHAPTER FOUR

4.0 DATA ANALYSIS, INTERPRETATION AND PRESENTATION

4.1 Introduction

The study was conducted to investigate the extent to which NSE demutualization have been adopted and its influence in improving operations at NSE in aiding proper and efficient brokerage activities. The study focused on NSE offering stock exchange services in Nairobi Province. Retrieved data was checked for completeness, coded, entered and finally analyzed using statistical package for social sciences. A total of 19 questionnaires were distributed to various companies operating at NSE in Nairobi and the results were considered a success since survey managed to target the NSE. Result of the analyses are presented and discussed in the sub sections as follows.

4.2 General information

The general information data were collected concerning the company at NSE, length of time the company has been in operation at NSE, management and ownership, staff employed and the company perception of demutualization. These data were important because they indicated the background information of the company and their basic understanding of demutualization which was important to understand the extent of improvement of stock exchange at NSE.

4.2.1 Functional title of the respondent

Functional title information is important in respondent profiling as it helps the researcher understand the nature and position of respondents she /he is dealing with in the study. In this case respondents were asked to indicate their functional title under provided functional titles. Results were as presented in the Table 4.1.

Table 4.1: Functional title of the respondents

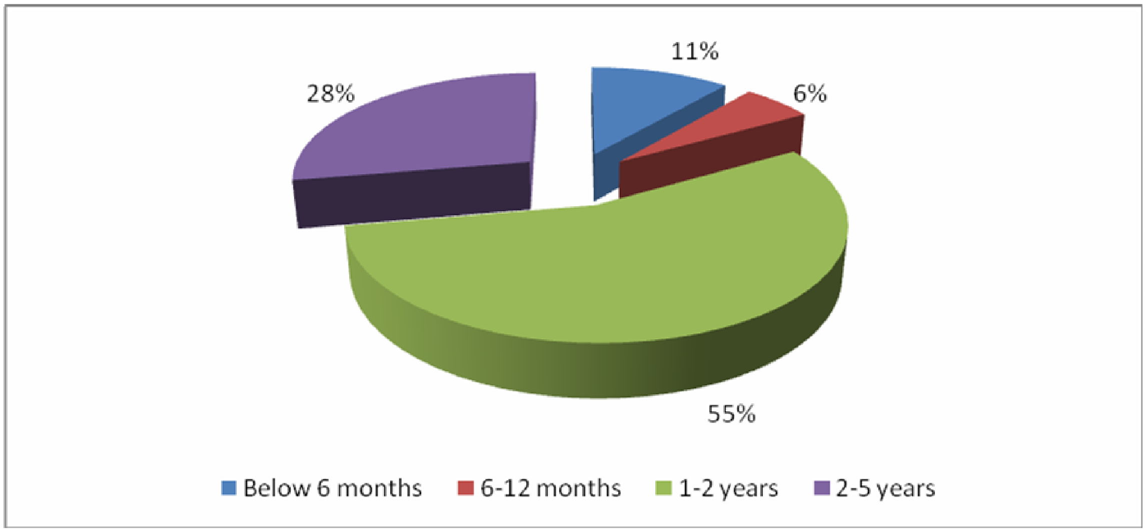
Functional Title	Distribution	
	Frequency	**Percent**
Administration Manager	2	11
Investment and Fund Manager	1	6
Finance Director	1	6
Underwriting Assistant	1	6
No Response	13	72
Total	**18**	**100**

The above tabulation shows that most of the respondents surveyed had occupied various functional titles but were hesitant to disclose their job titles, constituting the majority, 72%. Meanwhile, the administration manager constituted 11%. Six percent, each, were diversified along the distribution of investment fund managers, finance director and underwriting assistant.

4.2.2 Duration in current position

The number of years a respondent has held in an organization is very important. High number of years indicates that the respondents has high experience with the operations of that particular organization and therefore can give concrete information about the organization. This part of the study sought to find out the number of years the respondents had in their current position in the organization results were as presented in the Figure 4.1.

Figure 4.1: Duration in current position

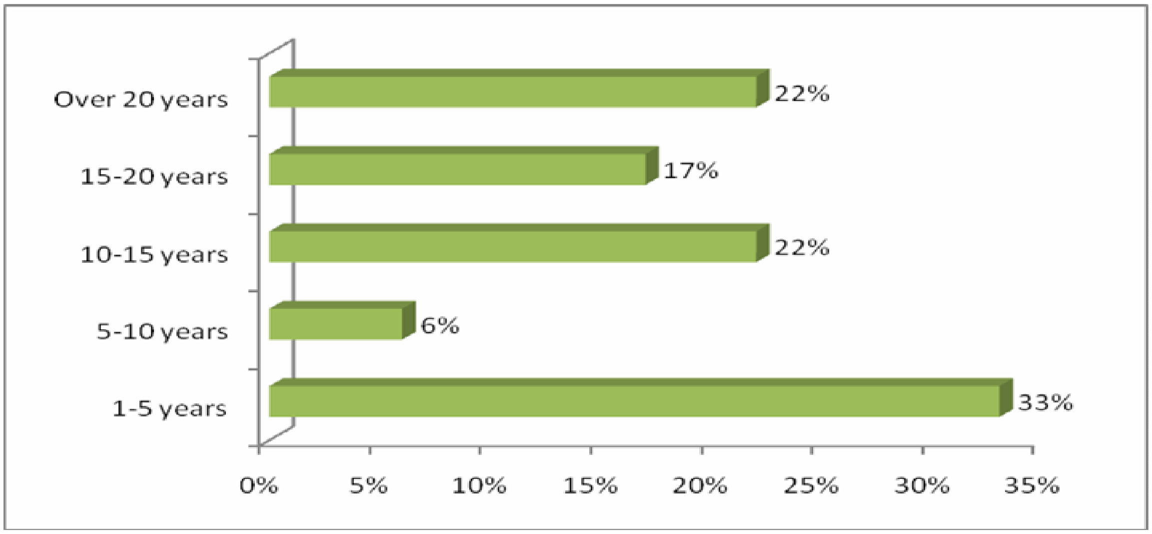


The study revealed that most of the surveyed respondents (55%) had held their current functional positions for a period of between 1-2 years. This was followed by those who stated that they had been in the current positions for a period between 2-5 years (28%). The least (6%) had been in their current positions for less than 12 months.

4.2.3 Duration of the companies at the NSE in years

The number of years an organization has been in the operation is important as it helps determines soundness of that particular firm. Additional information on the years of operation of the organization was sought. Respondents were asked to indicate years their organization has been in operation. Results are shown in the Figure 4.2.

Figure 4.2: Duration of the companies at the NSE in years



The findings presented in Figure 4.2 indicates that most of the companies (33%) had been in operation at NSE for a period between 1-5 years. Meanwhile, 22% of the companies had been in operation at NSE in a period between 10-20 years. The least (6%) indicated that they had been in operation for a period between 5-10 years. This shows that on average most companies at NSE had been in operation for more than 5 years.

4.2.4 Management and ownership of firms operating at NSE

Management and ownership of companies often than not tells more about that company. Of importance the credibility, liability, organization, operation , survival of the company all depends on the management and ownership strategies. In respect to this, this section of study focused on finding out how the various companies operating at NSE are managed and owned. Below are the findings.

Table 4.3: Management and ownership of company

Type of management and Ownership	Distribution	
	Frequency	Percentage
Subsidiary/branch of international Firm	2	11
Subsidiary/branch of Pan-African firm	1	6
Wholly Kenyan incorporated firm with branches /subsidiaries outside Kenya	2	11
Wholly Kenyan incorporated firm with branches/subsidiaries only in Kenya	9	50
Wholly Kenyan incorporated firm without branches/subsidiaries	4	22
Total	18	100

From the above tabulation it can be seen that majority of the firms at NSE (50%) as found from study are wholly Kenyan incorporated with branches /subsidiaries only in Kenya. This category was followed by those companies (22%) that were wholly Kenyan incorporated firms without branches/subsidiaries. The least (6%) in this section of study indicated that they were subsidiary/branch of Pan –African firm.

4.2.5 Number of employees in the organization

Organization size is determined by among other things the size of its labor force. Respondents aimed at establishing the size of the organization under study to achieve that respondents were asked to indicate the number of employees within their firm. Table 4.3 presents the findings.

Table 4.4: Number of Employees in the Organization

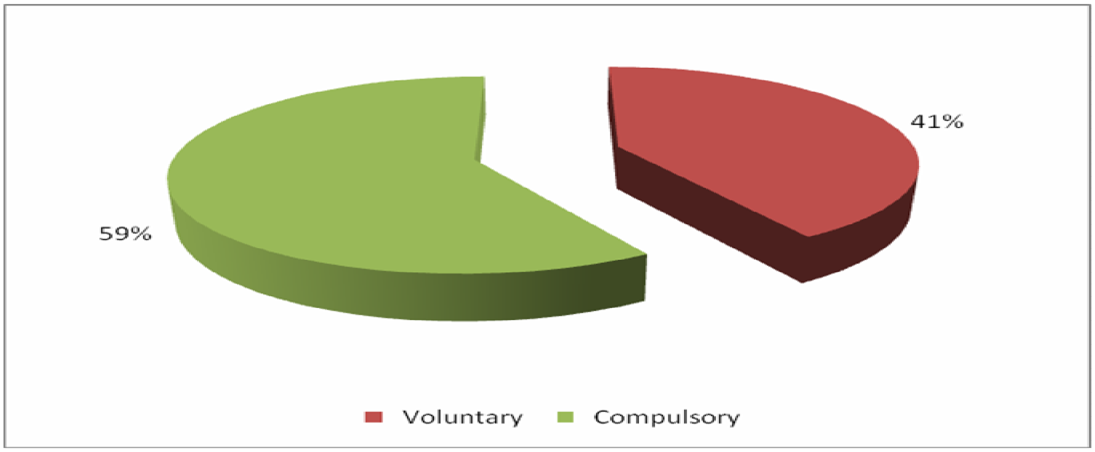
Number of employees	Distribution	
	Frequency	Percentage
Below 50 employees	13	72
51-100 employees	5	28
101-150 employees	0	0
151-200 employees	0	0
Over 200 employees	0	0
Total	18	100

Results findings established that majority (72%) of organization under study reported to have below 50 employees. The minority, 28% of the respondents had between 51-100 employees. As observed from the results no firm had more than 100 employees.

4.2.6 Company perception of Demutualization

Various firms have varying perception of strategies and structures employed either by the government laws, top managing organization or changes in the operational structures. Its in line with this that the study was directed towards finding out what perception the various firms under study had in relation to demutualization at NSE. The statistical data below provides the results gathered.

Figure 4.3: Company's perception on Demutualization



The results in the above figure indicate that most firms (59%) perceive demutualization as compulsory while to (41%) of the surveyed firms indicated their perception of demutualization as Voluntary.

4.3. Demutualization of stock exchange

This section of the study sought to establish the level of demutualization of stock exchange at NSE. To achieve this, respondents were asked to indicate the extents to which they agreed with the provided statements measuring level of demutualization at NSE. Results were as indicated in the Table 4.5.

Table 4.5 Demutualization of stock exchange

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	No response	TOTAL
	%	%	%	%	%	%	N
Demutualization of the NSE would solve the current weakness in the structure of NSE	28	56	6	11	0	0	18
The current corporate structure of the NSE is responsible for the perceived low market confidence and lack of corporate governance	17	39	17	28	0	0	18
The demutualized NSE's structured should be as a public company	44	39	17	0	0	0	18
Corporate governance structure of the demutualized NSE should be in line with CMA guidelines and best practice	61	33	7	0	0	0	18

From the above tabulation it was evidence that majority(61%) strongly agreed, while 33% agreed that corporate governance structure of demutualized NSE should be in line with CMA guidelines and best practice. Fifty six percent of the sampled firms at NSE agreed that demutualization of the NSE was a way solving the current weakness in the structure of NSE, whereas 28% strongly agreed. On the issue of demutualised NSE's structured being a public company, 44% strongly agreed, while 39% just agreed. Meanwhile, 39% agreed that the current structure of NSE was responsible for the perceived low market confidence and lack of corporate governance. Overall majority of the surveyed firms at NSE agreed with the demutualization of stock exchange as a way of improving operations at NSE.

4.3.1 Considerations in demutualization of NSE

In any undertakings in various firms, a number of considerations are taken into focus. Various strategies that are meant to be implemented in the structure and operations of a firm often than not always follows some considerations. Thus this part of study sought to study key considerations that were undertaken in demutualization at NSE in identifying and managing conflict of interest. The resultant findings were as below.

Table 4.6: Tabulated responses in regard to key considerations undertaken in demutualization at NSE.

key considerations undertaken in demutualization at NSE	**Very important**		**Important**		**Fairy Important**		**Not Important**		**No comment**		**Total**
	N	**%**	**N**	**%**	**N**	**%**	**N**	**%**	**N**	**%**	**N**
Background to conflict	6	33	7	39	2	11	3	17	0	0	18
Self listing of the NSE company	0	0	9	50	6	33	3	17	0	0	18
Regulations of other listings	2	11	8	44	4	22	4	22	0	0	18
Supervision of intermediaries	5	28	9	50	2	11	2	11	0	0	18
Profit motive versus supervisory function	4	22	6	33	5	28	2	11	1	6	18

In the above findings in relation to background to conflict consideration, majority of the surveyed firms (50%) each, agreed that self listing of the NSE company or supervision of intermediaries was important. However 17% and 11% stated that the two were not important at demutualization of NSE, in that order. Thirty nine percent viewed background to conflict as an important consideration to demutualization at NSE. Forty four percent were of the opinion that regulation of the listing was important as a consideration for demutualization at NSE. Meanwhile, 22% argued that it was not an important consideration of demutualization at NSE. On the issue of profit motive versus supervisory function, 33% of the respondents indicated that it was important, while 22% were of the opinion that it was very important.

4.3.2 Demutualization process

Most often firms may not understand fully what a particular strategy of operation is all about. In order to determine the extent of understanding of demutualization process in various firms at NSE, this portion of study focused on accessing firms understanding of the demutualization process. The responses were as follows;

Demutualization process is: Change of ownership structure, Demutualization is the separation of membership direction and management of the NSE, However the public list of the entity to eliminate the current conflict of interest, it is a process where the NSE will be selling its share to the general public. It will change from a member owned to the public owned, Moving ownership from stockbrokers to members of the public, Process of opening up the NSE to incorporate new players, facilitate faster listing of firms to the market and thus increasing the equity fund, This is privatization of the NSE so as to hiring more stake holders, This is when the stock market owners open up ownership to others parties and Turning the NSE from a member /private company to being public and listed by investing others.

4.3.3. Expected demutualization results at NSE by stakeholders

Most often in times of strategies implementation, there are the goals and objectives that are targeted. Therefore in respect to this, demutualization at NSE is expected to give results. Often various stakeholders involved will expect results from strategies employed to improve performance. It is in this respect that this portion of study sought to find out from the respective firms operating at NSE what their various expected results were. The responses were as a shown in Table 4.7.

Table 4.7: Firms expectations of the demutualization at NSE

Expected demutualization Results	very high extent	High Extent	Moderate Extent	Low Extent	very low extent	Total
	%	%	%	%	%	N
Realization of value for members	17	61	22	0	0	18
Prompt decision making	11	56	22	11	0	18
Flexibility in decision making	6	56	33	6	0	18
Clearer criteria for decision making	0	67	17	11	6	18
Clearer and simpler governance	6	56	28	6	6	18
Less susceptibility to members' vested	22	33	33	6	6	18
Interests and conflict between classes of members	28	39	22	6	0	18
Greater willingness to open up access to markets	28	33	17	17	6	18
Enhanced ability to diversity into new market	22	44	17	17	0	18
Spreading of ownership risks	11	39	44	5.6	0	18
Resolution of growing inequalities between members	6	28	28	22	11	17
Ease of access to capital	0	50	22	28	0	18
Flexibility in future negotiation	11	50	28	11	0	18

From the results illustration above, it was apparent that most stakeholders (61%) agreed that realization of value for members was to high extent expected after demutualization. Prompt decision making was another demutualization highly expected results; this was strongly supported by 56% of the portion surveyed. On the other hand 11% were of the opinion that prompt decision making was to low extent the expected demutualization result. On flexibility in decision making, majority (56%) were of the opinion that it was expected to high extent as a demutualization result. Further majority 66% also agreed that clearer criteria for decision making was a highly expected results of demutualization, in spite of the fact that 11% had a low expectation. Clearer and simpler governance was another highly expected result of demutualization by 67%. On susceptibility to members' vested only a fair percent (33%) agreed that it was an expectation highly expected. Further to this was that (44%) were of the opinion that enhanced ability to diversify into new markets was another outcome that was eagerly expected as a result of demutualization. Meanwhile, 50% were of the opinion that ease of access to capital was a highly expected outcome of demutualization at NSE. This was also the case with the majority (50%) who agreed that flexibility in future negotiations was another highly expected results at NSE after demutualization.

4.3.4 Improvement of liquidity and product quality improvement through demutualization

Demutualization has been a new concept adopted by NSE in diversification of operations of firms operating at NSE and services to their customers. A number of factors therefore hinder proper improvement of effective implementation of structural changes. The researcher therefore sought to identify ways in which demutualization of NSE can help improve liquidity at NSE through product innovation. Here are some of the responses gathered; Demutualization attracted the best managers who were innovative, hence a better (competitive) management. Consequently, there was a higher expectation from investors. Capital became more accessible from the public hence making it easy to expand. In addition, the citizen and corporate investors were more confident because their funds were secure, thus increasing their investment. Entrance of new stakeholders due to demutualization brought constructive competition, efficiency and professionalism, and flexibility in decision making. Demutualization reduced the intense involved in listing of new equities and facilitated faster and efficient trading of equities. In fact, once NSE is demutualized; funds from the public are readily available thus boosting capital (liquidly) which in turn is used for more improvement on provision of services. Nevertheless, a few respondents declined that demutualization had a direct impact on liquidity.

4.3.5 Role of Demutualization in preparing NSE for regional integration and mergers

Most often individuals do not understand how various policies employed in their operation sectors can be beneficial to them and their environment of operation. Demutualization has been aimed at improving stock exchange services and operations at NSE, where many people across different regions merge. It is in this respect that this portion of study focused towards finding from the firms operating at NSE how demutualization could enhance integration of regions. Here are some of the explanations given.

Faster decision rather than self interest was made possible. Foreigners have an opportunity to buy shares and own part of NSE due to increased transparency. Demutualization eliminated limited ownership by brokerage fraternity and allowed for a wider scope for recruiting directors. Consequently, NSE had greater capacity, broader spectrum of operation and enhanced confidence, thus open ownership allowing for more regional integration. Also, public ownership opens the doors beyond members and local investors to regional and material mergers. The market opened up in terms of shareholding thus enabling external parties to participate in a more flexible manner. In addition, when demutualized, NSE becomes a company limited by shares, then the shares can be as currency in organizing for merger and acquisition.

4.3.6 Demutualization and governance of NSE

Demutualization has been a recent development at NSE sector and therefore there is the expected improvement in the governance of the NSE. It is on this understanding that the researcher sought to identify ways in which demutualization would improve governance at

NSE based on certain statements that were asked to the respondents. Below are therefore the tabulated statistical results of the responses given.

Table 4.8: Tabulated results of how demutualization can improve governance of NSE

	very high extent		High Extent		Moderate Extent		Low Extent		very low extent		Total
	N	%	N	%	N	%	N	%	N	%	N
Creates an environment where an exchange can restructure governance on a sustainable basis	0	0	11	61	5	28	2	11	0	0	18
Ensures resources are allocated to business imitative and ventures that enhance shareholders value	0	0	10	56	3	17	5	28	0	0	18
Changes the way the exchange is governed to provide for faster decisions making ability	0	0	8	44	7	39	3	17	0	0	18
Eliminates the control of members who view the exchange primarily as a way through which they make profits	1	6	10	56	1	6	6	33	0	0	18
Run by an experience management team which is driven to improve the exchanges bottom-line	0	0	8	44	6	33	4	22	0	0	18

In regard to how demutualization would improve corporate governance of the NSE, majority (61%) were of the agreement that it will create an environment where an exchange can restructure governance on a sustainable basis. Demutualization was also perceived to ensure resources are allocated to business initiatives and ventures that enhance shareholders value. This was according to 56% who were in support of this statement. On the issue of demutualization and changes in the way the exchange is governed to provide for faster decision making ability, 44% were of the opinion that this would improve corporate governance at NSE. Fifty six percent, agreed to high extent that demutualization changes the way the exchange is governed to provide for faster decision making ability. On the other hand 33% did not see it as a way of improving corporate governance of NSE. Forty four percent also agreed that if the demutualization is undertaken, the NSE will be run by an experienced management team which is driven to improve the exchanges bottom line.

4.3.7. Demutualization and capacity to raise capital in expansion of trading platforms.

Structuring of organizations is vital as it opens up opportunities for expansion. This is particularly the case when clear rules are set for operational sing activities This portion sought to find out how demutualization enhances NSE capacity to raise capital modernization and expansion of its trading platforms. Therefore through research on firms operating at NSE, the following results were gathered. The statistical tabulation of results areas follows in Table 4.9.

Table 4.9: Distribution of responses on demutualization and capital raise

	Most effective		Effective		Moderate		Least effective		Not effective		Total
	N	%	N	%	N	%	N	%	N	%	N
They can go public to raise capital	8	44	5	28	1	6	0	0	4	22	19
New shareholders, institutions and individuals are access to larger capital to broaden access to market.	6	33	7	39	1	6	0	0	4	22	19
They are able to borrow from conventional lenders such as banks	7	39	7	39	1	6	0	0	3	17	19
Through share offerings to non-members	6	33	9	50	0	0	1	6	2	11	19

From the study done on the various firms operating at NSE in identifying how demutualization can enhance capacity to raise capital for modernization, majority (44%) were of the opinion that now NSE could now go public to raise capital. Despite this, a portion of 22% did not deem demutualization as effective in enhancing firms to go public to raise capital. On the issue of new share holders, institutions and individuals accessing large capital in broadening market, 39% were sure that demutualization would enhance this. Only a few, 22% did not see it as effective. Demutualization enhances NSE capacity to raise capital and expansion of its trading platforms, this is effective according to 39% of the respondents interviewed, while to 16% they did not see it as effective. Further to this is that demutualization will enhance NSE capacity through raising capital and expansion of trading platforms through share offerings to the nonmembers. This was according to 50% of the study portion who agreed with this statement. In contrast, 11% did not view demutualization at NSE as been effective in enhancing capital raise through share offerings to non members.

4.3.8 Demutualization and goal realization at NSE.

The survival, effectiveness, efficiency and the productivity of particular structure programs aimed at goal realization of any company is very vital. Most often structural programs aimed at a particular area of organization has its goal in output and impact goal orientation. It is for this reason that this section of study sought to find out how demutualization at NSE helped in realizing the goals and assisting in efficient allocation of capital. Thus from the study the following responses were analyzed:

A more professional outfit under demutualization of NSE is likely to attract a wider array and local or foreign investors, borrowing from convectional leaders e.g. bank and international financial institutions. By listing many new companies, companies have the markets (equity market) secure and viable investment and source of capital allocated in the most important projects. Further, there is elimination of conflict of interest, independent people own it and all interest is therefore being catered for. In addition, information systems allows pricing to be efficient, shareholders can decide on how and the best way to distribute their funds unlike when it is the boards decision, NSE itself will be a listed entity no better way to preach the gospel of corporate listings, resource allocation will be functional based and thus performance oriented, This is a feature that is hindered by government and CMA and NSE is only a player that cannot control.

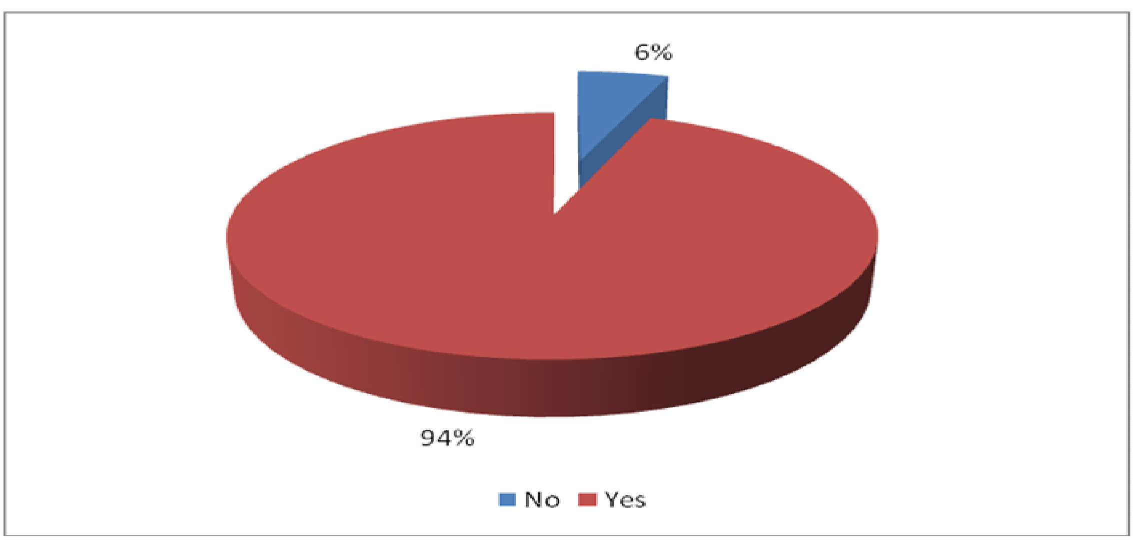
4.3.9 Demutualization and human capital.

Human capital is important in any organization that seeks to maximize its output and have attractive services to its clients. It is through human capital that proper and effective management of resources is made. Therefore proper and efficient human resource depend on the structural measures put in place to acquire and make good human capital. It is in line with this that this part of study sought to know how demutualization would help in accessing human capital. From this perspective, the following were the responses gathered: High caliber professionals are more likely to be attracted to demutualised and professionally managed by NSE. Attracting highly qualified personnel, closed entities are opened to fair and competitive recruitment and human capital retention policies. Meanwhile, enhanced disclosure of information makes ease accessibility to the public and grasp the attention of those interested to pursue a career in the industry. Demutualization resulted in transparency and thus people were willing to participate in a environmental that was fairly structured. The general public was in a position to access the performance of the directors and those who did not deliver were dismissed, and substituted with "fresh" and new talent, through looting of various companies privatization.

4.3.10 The Role of Demutualization in Unlocking members' equity value

Most often new structures normally open up organizations operations at various levels. This includes both the effects on the organization and the specific individuals on the line of equity. To get a deeper insight on how demutualization would unlock the members' equity value, a survey was carried out. The finding s below was gathered as shown in the figure.

Figure 4.4: Distribution results of how demutualization aid in realizing market value

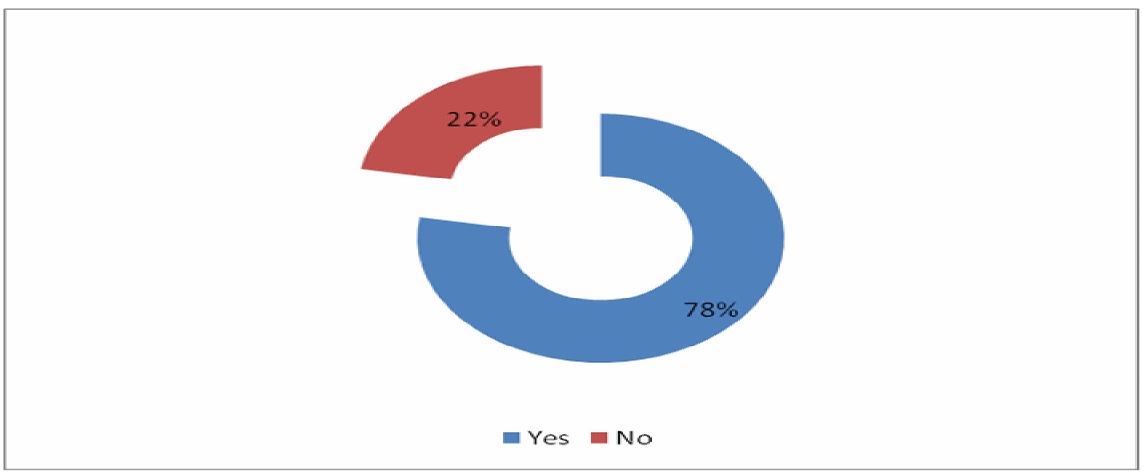


The study revealed that the majority, (94%) agreed that demutualization aided in unlocking members' equity value in realizing market value of their equity. In contrast, 6% were of the opinion that demutualization do not enhance unlocking of members' equity in realizing their market value equity.

4.3.11. Investing proceeds in upgrading business

Further study in this part was aimed at finding out how demutualization would aid in unlocking the members equity value by investing the proceeds in upgrading their business. The figure below indicates the feedback of respondents in terms of agreement with this statement.

Figure 4.5: Demutualization and business upgrade



This observation shows that to the majority, 78%, they were of the agreement that demutualization would aid in unlocking members equity value through investing proceeds to upgrade business but to 22% this was not the case.

4.3.12. The Role of Demutualization in removing Entry Barriers at NSE

Various strategies and structural programs undertaken in any organization are meant to open up their interior operations and consequently losing some barriers that impede effective operations. Demutualization therefore was aimed at opening up and improving operations at NSE stock exchange in service provisions to the various stakeholders. This part was directed towards establishing how demutualization would assist in removing barrier of entry for new brokers.

All the decisions were in the hands of the shareholders who determined if and when to add on move brokers depending on the existing broker performance. As the existing brokers disposed off their ownership, other people gained entry to the business and through that they were able to register on their own. Brokers were able to enter on merit since demutualization had dismantled the current cartel-like structure of ownership, and relaxed entry rules. However there was still need to manage entry/exit to avoid loops in the market. Demutualization reduced the high initial capital required in purchasing the seat. It removed self interest and greedy and brought fair competition. Opening the field from the 18 members to others in the business sector removed conflict of interest. The value of a seat was to be market based so as to allow easier entry to NSE seat and reduced licensing requirement.

4.3.13. Suggestions on topic of study

This section of the study inquired the respondents' comments on the potential benefits of demutualization at NSE. The following comments were thus garnered:

The respondents proposed the need of getting more information from NSE staff and comparing it with what others especially the investors suggested. The results of the study should be availed to the NSE, since it deals with the investment markets and future investment growth. A section of the respondents commended demutualization, but indicated that the platforms need to be raised first before the NSE can stand to be demutualized. These include; training and education to the management and actors at NSE.

CHAPTER FIVE: DISCUSSIONS

5.1 Introduction

The general objective of this study was to investigate how demutualization can improve operations and services at NSE -a case study of companies operating in the Nairobi stock exchange. The study covered a substantial sample case study of prominent firms operating in Nairobi using competent scientific methodological research tactics. The findings and results of the study therefore have been summarized in the section below

5.2 Summary of Findings

5.2.1. General information

Most of the individuals surveyed occupied various functional titles; administration managers, investment fund managers, finance director underwriting assistant, analysts, research advisors, equity dealers and investment banker operation assistants. Most of them had held these functional positions for a period of between 1-5 years. Most of the companies had been in operation at NSE for a period between 1-5 years. Majority of the firms at NSE were found to be wholly Kenyan incorporated with branches /subsidiaries only in Kenya. This category was followed by those companies that were found to be wholly Kenyan incorporated firms without branches/subsidiaries. Only a few respondents indicated that some firms were subsidiary/branch of Pan –African firms. Further findings established that majority of firms at NSE were reported to have employees below 50. The rest of them had between 51-100 employees. The results further indicated that most firms at NSE perceived demutualization as compulsory while the rest of the surveyed firms indicated their perception of demutualization as voluntary.

5.2.2. Demutualization of stock exchange at NSE

It was evidenced that majority of the sampled firms at NSE supported the statement that demutualization of the NSE was a way of solving the current weakness in the structure of NSE. On the issue of current structure of NSE, it was responsible for the perceived low market confidence and lack of corporate governance, a fair portion of surveyed firms at NSE agreed that lack of demutualization causes improper management at NSE. Further, a good number agreed that the demutualised NSE's structure should be a public company. On corporate governance structure of demutualized NSE, CMA guidelines and best practice, majority were in strong agreement with demutualization in improving corporate governance at NSE. Overall majority of the surveyed firms at NSE agreed with the demutualization of stock exchange as a way of improving operations at NSE.

5.2.3. Considerations for demutualization at NSE

The study revealed that majority of the firms agreed that it was relevance for the demutualization at NSE to consider background to conflict as a key consideration for demutualization at NSE. Likewise self listing of the NSE, of firms was vital for demutualization. Further, regulation of the listing was important as a consideration for demutualization at NSE. On the context of supervision of subsidiaries, majority were in agreement that supervision of intermediaries was key consideration towards demutualization at NSE, in addition, the issue of profit motive versus supervisory function was also rated as vital factor to be considered in demutualization at NSE.

5.2.4 Expected demutualization results at NSE by stakeholders

In this section it was apparent that, to most stakeholders, realization of value for members was to high extent expected after demutualization. Prompt decision making as a result of demutualization was highly expected but to others they were of the opinion that prompt decision making was to low extent the expected demutualization result. On flexibility in decision making again majority were of the opinion that it was expected highly as a demutualization result. Further to this majority agreed that clearer criteria for decision making was a highly expected results after demutualization. This was not the case to few who thought it had been a low expected result. Clearer and simpler governance was another highly expected result after demutualization of NSE. In addition, majority were of the opinion that enhanced ability to diversify into new markets was another outcome that was eagerly expected as a result of demutualization. Majority were also of the opinion that ease of access to capital was a highly expected outcome of demutualization at NSE. This was also the case with the majority who felt that flexibility in future negotiations was highly expected results at NSE after demutualization.

5.2.5. Improvement of liquidity and product quality improvement through demutualization

The findings here indicated that demutualization of NSE can help improve liquidity at NSE through product innovation, attracting best managers who are innovative, Better management (competitive Management) Higher expectations from investors, Capital will be more accessible from the public hence making it easy to expand, Citizen and corporate investors will have more confidence because their funds are secure and thus increase their investment. Entrance of new stakeholders will bring competition efficiency and professionalism. Furthermore, demutualization reduced the intensity of listing of new equities and facilitated faster and efficient trading of equities. Once NSE is demutualized; funds from the public were readily available thus boosting its capital (liquidly) which in turn was used for improvement on its services.

5.2.6 Demutualization and preparation of NSE for regional integration and mergers

From the study it became apparent that demutualization at NSE would enhance regional integration through faster decision making which will replace self interest, foreigners will have an opportunity to buy shares and own part of NSE, increase transparency, eliminate limited ownership by brokerage fraternity and allow for a wider scope for recruiting directors. NSE will have greater capacity, broader spectrum of operation and enhance confidence. Open ownership will do a way with the referred interest of few members and allow more rooms for regional Integration. Public ownership will open the doors beyond members and local investors to regional and material mergers.

The market becomes opened up in terms of shareholding thus enabling external parties to participate in a more flexible manner while the public will be in a position to make concrete decision on the best business regions to link up with for business since they will be the main decision makers. When demutualized, the NSE becomes a company limited by shares, thus, the shares can be used as currency in organizing for merger and acquisition at the large regional level.

5.2.7. Demutualization and governance of NSE

In regard to demutualization and improvement in corporate governance of NSE, findings indicated that majority were of the agreement that it would create an environment where exchange can restructure governance on sustainable basis. Demutualization was also perceived to ensure resources are allocated to business initiatives and ventures that enhance shareholders value.

Demutualization changed the way the exchange is governed to provide for faster decision making ability. In addition vast number agreed that if demutualization is undertaken, operations at NSE is done by experienced management team which is driven to improve the efficiency of stock exchanges services.

5.2.8. Demutualization and capacity to raise capital in expansion of trading platforms.

After study was done on various firms operating at NSE in identifying how demutualization can enhance capacity to raise capital for modernization, majority concurred that this would enable NSE go public to raise more capital. However, a portion of the case study did not deem demutualization as effective in enhancing firms to go public to raise capital.

Majority of the firms were sure that demutualization would enhance new share holders, institutions and individuals accessing large capital in broadening market. Further demutualization would enhance NSE capacity through raising capital and expansion of trading platforms through share offerings to the nonmembers.

5.2.9 Role of Demutualization in Goal Realization at NSE.

It was found that demutualization would enhance goal realization through a more professional outfit under a demutualized NSE, which would be likely to attract a wider array of both local and foreign investors as more local Africans enlist. Moreover, demutualization resulted into borrowing of funds from convectional lenders e.g. bank and international financial institutions.

Information systems allowed pricing for efficiency since the shareholder has to decide on how and the best way to distribute their funds unlike when it is the boards decision.NSE itself will be a listed entity and as such be a corporate listings. Resource allocation will be functional based and thus performance oriented. This is a feature that is hindered by government and CMA and NSE is only a player that cannot control.

5.2.10. Role of Demutualization in Accessing Human Capital

Human capital is important in any organization that seeks to maximize its output and have attractive services to its clients. Demutualization was found to help in accessing human capital by attracting highly qualified personnel, closed entities would be opened for fair and competitive recruitment & human capital retention policies, enhanced disclosure of information would make more accessible to the public and catch the attention of those interested to pursue a career in the industry.

Demutualization resulted in transparency and people were willing to participate in an environment that is fairly structured. The general public was in a position to access the performance of the directors and those who don’t deliver will be evicted. They were able to get fresh and new talents, through looting of various companies privatization.

5.2.11. Demutualization and Unlocking members’ equity value.

From the statistics it was found out that according to the majority, demutualization aids in unlocking members equity value in realizing market value of their equity. Further observation showed that, majority also supported demutualization in the sense that it would aid in unlocking members equity value through investing proceeds to upgrade business.

5.2. 12. Demutualization in Entry Barrier removal at NSE

Demutualization therefore was aimed at opening up and improving operations at NSE stock exchange in service provisions to the various stakeholders. It was found that demutualization would assist in removing barrier of entry for new brokers as all the decision will be in the hands of the shareholder who will determine if and when to add on more brokers depending on the existing broker performance. As the existing brokers dispose off their ownership, other people will gain entry to the business and through that they can be able to register their own.

The study revealed that brokers would enter on merit since demutualization would dismantle the current cartel-like structure of ownership by relaxing entry rules. As a result, it was no longer the member brokers to decide who is to join their membership club. Furthermore demutualization will reduce the high initial capital required in entry to NSE. It will also remove self interest and greedy and bring fair competition. There would be no owner restriction of club members as such, opening the field for others in the business sector. The value of a entry will be market based and reduce licensing requirement.

CHAPTER SIX: CONCLUSION AND RECOMMENDATIONS

6.1 Conclusions

The purpose of the study was to investigate the extent to which demutualization improve general operations at NSE in line with restructuring the governance of NSE in the Nairobi stock exchange. Thus the following conclusions were made.

6.1.1 Demutualization and stock exchange improvement at NSE.

From the study it can be seen that demutualization can improve the general operations at stock exchange in NSE. This is in the line of; changing the structure of NSE, realization of value for members, prompt and flexible decision making, opening up access to markets, diversifying new markets, spreading of ownership risks for firms operating at NSE, ease access of capital. Furthermore demutualization will enhance restructuring of corporate governance where operations are run by experienced management team which is driven to improve the exchanges bottom line.

In addition the study findings conclude that demutualization enhances NSE capacity to raise capital and expansion of trading platforms by going public to raise capital, new shareholders and through share offerings to non members. Therefore demutualization would enable NSE to realize its goals of assisting efficient allocation of capital by listing many new companies because the companies have the markets (equity market) which are secure and viable investment and source of capital, elimination of conflict of interest, independent people will own it and all interest will therefore be catered for.

In addition demutualization will aid in attracting highly qualified personnel. Have fair and competitive recruitment of human capital retention policies, enhanced disclosure of information will make more accessible to the public and catch the attention of those interested to pursue a career in the industry. Demutualization aid in unlocking members equity value in realizing market value of their equity and upgrading business.

Demutualization would assist in removing barrier of entry for new brokers as all the decision will be in the hands of the shareholders which who will determiner if and when to add on more brokers depending on the existing broker performance. Brokers will enter on merit since demutualization will dismantle the current cartel-like structure of ownership.

6.2 Recommendation

6.2.1 Recommendation for Improvement

For effective adoption and implementation of demutualization at NSE, there should be clear understanding of demutualization process, key considerations in demutualization, results to be expected, goals and objectives aimed. All the stakeholders operating at NSE need to be targeted by the demutualization process.

6.2.2 Recommendation for further studies

The area of demutualization is a new area in stock exchange thus further study should be focused on all stakeholders that are involved at NSE to get an insight on how well demutualization exercise can be undertaken. These stakeholders include; banks, brokerage firms, investors, and government ministry of trade. Future study should also focus on study done in the same line for effective and clear comparison.

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APPENDICES

Appendix 1: Research Questionnaire

PART A: GENERAL INFORMATION

1. Please indicate below your functional title

Administration Manager [ ] Investment and Fund Manager [ ]

Finance Director; [ ] Underwriting Assistant [ ]

others (please indicate) ____

2. How long have you held your current position?

Below 6 months [ ] 6-12 months [ ] 1-2 years [ ]
2-5 years [ ] 5-10 years [ ] Over 10 years [ ]

3. How long have your company been operating in the Nairobi Stock Exchange?

Below 1 year [ ] 1-5 years [ ] 5-10 years [ ]

10-15 years [ ] 15-20 years [ ] Over 20 years [ ]

4. Management and ownership of the company

Subsidiary/branch of International Firm [ ]

Subsidiary/branch of Pan-African firm [ ]

Wholly Kenyan incorporated firm with branches/subsidiaries outside Kenya [ ] Wholly Kenyan incorporated firm with branches/subsidiaries only in Kenya [ ]

Wholly Kenyan incorporated firm without branches/subsidiaries [ ]

5 Using the categories below, please indicate the number of staff employed in your company within Kenya.

Below 50 [ ] 51-100 [ ] 101-150 [ ]
151-200 [ ] Over 200 [ ] Other (please specify)-------

6 How do you perceive demutualization?

Voluntary [ ] Compulsory [ ]

7 The following statements concerns demutualization of Stock exchange. Rate the statements on the given scale

Statement	Strongly Agree	Agree	Neutral	Disagree
Demutualization of the NSE would solve the current weaknesses in the structure of NSE.				
The current corporate structure of the NSE is responsible for the perceived low market confidence and lack of corporate governance				
The demutualized NSE's structured should be as a public company				
Corporate governance structure of the demutualized NSE should be in line with CMA guidelines and best practice				

8. What are the Key considerations in demutualizing the NSE (in identifying and managing conflict of interest?)

	Very important	Important	Fairly important
Background to conflict	[ ]	[ ]	[ ]
Self listing of the NSE Company	[ ]	[ ]	[ ]
Regulations of other listings	[ ]	[ ]	[ ]
Supervision of intermediaries	[ ]	[ ]	[ ]
Profit motive versus supervisory function	[ ]	[ ]	[ ]

9. Explain briefly the demutualization process at the NSE? ______________________

____

10. What are the expected demutualization results at the NSE by the stakeholders?

Expected Demutualization Results	Low Extent	Moderate Extent	High Extent
Realization of value for members			
Prompt decision making			
Flexibility in decision making			
Clearer criteria for decision making			
Clearer and simpler governance			
Less susceptibility to members' vested			
Interests and conflict between classes of members			
Greater willingness to open up access to markets			
Enhanced ability to diversify into new markets			
Spreading of ownership risk			
Resolution of growing inequities between members			
Ease of access to capital			
Flexibility in future negotiations			

11. How will demutualization of NSE improve liquidity at the NSE through product innovation and services?____

____

12. Explain how the demutualization can prepare NSE for regional integration and mergers

____

____

13. How will demutualization improve corporate governance of the NSE? 1-Low Extent 2-Moderate Extent 3-High Extent

	1	2	3
Creates an environment where an exchange can restructure governance on a sustainable basis.			
Ensures resources are allocated to business initiatives and ventures that enhance shareholders value.			
Changes the way the exchange is governed to provide for faster decision making ability			
Eliminates the control of members who view the exchange primarily as a facility through which they make their profits			
Run by an experienced management team which is driven to improve the exchange's bottom- line			

14. How will the demutualization enhance NSE capacity to raise capital modernization and expansion of its trading platforms? 1-Effective, 2-Most effective, 3-Not effective

	1	2	3
They can go public to raise capital	[ ]	[ ]	[ ]
New shareholders, institutions and individuals are accesses to larger capital to broaden access to the market.	[ ]	[ ]	[ ]
They are able to borrow from conventional lenders, such as banks.	[ ]	[ ]	[ ]
Through share offerings to non-members	[ ]	[ ]	[ ]

15. How will the demutualization enable NSE to realize its goal of assisting efficient allocation of capital? ____

____

16. How will the demutualization help in accessing human capital?________________

____

17. How will the demutualization aid in unlocking the members' equity value? _____

	YES	NO
They will have chance to realize the market value of their equity.	[ ]	[ ]
They may invest the proceeds to upgrade their business	[ ]	[ ]

18. Explain how the demutualization will assist in removing barrier to entry for new brokers?

____

____

19 What are your suggestions on the topic of study? ___________________________

____

Thank you for your time and cooperation

Appendix II: Licensed Brokers/Members of the NSE

1. Drummond Investment Bank Limited.
2. Ngenye Kariuki & Co. Limited.
3. Ashbhu Securities Limited.
4. Dyer & Blair Investment Bank Limited.
5. Suntra Investment Bank Limited.
6. ABC Capital.
7. Renaissance Capital.
8. Reliable Securities Limited
9. Apexafrica Investment bank Limited.
10. CFC Financial Services – Stock broking Division.
11. Faida Investment Bank Ltd.
12. Kestrel Capital (EA) Limited.
13. Discount Securities Limited.- Under restructuring
14. NIC Capital Limited.
15. Sterling Securities Limited.
16. Africa Alliance Kenya Securities.
17. Standard Investment Bank Limited.
18. Genghis Capital
19. Kingdom Securities/Cooperative Bank

Appendix III: Ownership Characteristics of African Stock Exchanges

Source: Mensah 2005

Country	Ownership Characteristics
Botswana	• Established by statute (Botswana Stock Exchange Act, 1994) as body corporate • Statutory body Committee of Botswana Stock Exchange manages exchange • 3 members appointed by Minister of Finance • 2-6 elected from membership of stock exchange
BRVM	• Private corporation • 13.5% owned by the West African Economic and Monetary Union (WAEMU) • Remainder distributed among brokerage firms, chambers of commerce and industry, subregional institutions and other private institutions or WAEMU companies
Egypt	• Mutual; Member-based
Ghana	• Company limited by guarantee • Member owned
Kenya	• Registered under the Companies Act in 1991 as a company limited by guarantee
Mauritius	• Shareholder owned • Trading membership separate from ownership
Namibia	• not for profit • Comprises 43 associate members (banks, listed companies, investment institutions, etc.)

	• Executive Committee of nine members of the business community, representing different business sectors, and the tenth member represents(Namibia Financial Institutions Supervisory Authority, • Regulated by the Stock Exchanges Control Act (1985, amended 1992)
Nigeria	• Limited by guarantee • Mutual, member based
South Africa	• Demutualized
Tanzania	• Incorporated in September 1996 as a private company limited by guarantee and not having a share capital under the Companies Ordinance (Cap. 212).
Zimbabwe	• The ZSE is regulated by the Zimbabwe Stock Exchange Act Chapter 24:18 of 1996. It operates under the supervision of a nine member Committee comprising of 2 members appointed by the Minister of Finance and not less than 4 and not more than 7 members elected from within the stock broking fraternity.

Appendix V: Largest Stock Exchanges of the World

Stock Exchange Name	**Governance Regime**	**Market Capitalization (USD Million Dollars)**
New York Stock Exchange	Member-owned	12,707,578
Tokyo Stock Exchange	Private Limited	3,557,674
NASDAQ Stock Market	Publicly Listed	3,532,912
London Stock Exchange	Publicly Listed	2,865,243
Osaka Securities Exchange	Publicly Listed	2,287,048
Deutsche Borse	Publicly Listed	1,194,517
TSX Venture Exchange	Publicly Listed	1,177,518
Euronext	Publicly Listed	1,147,037
Spanish Exchanges	Private Limited	940,673
Stock Exchange of Hong Kong	Publicly Listed	861,463

Source: (Ramos, 2006)