

**A SURVEY ON THE FACTORS THAT MOTIVATE LOCAL
INDIVIDUAL INVESTORS TO INVEST IN SHARES OF
COMPANIES QUOTED AT THE NAIROBI STOCK EXCHANGE**

BY

PUDHA ERICK OPONDO

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DECLARATION

This is my original work and has not been presented to any university for any academic credit. I remain responsible for any omissions and errors therein.

Name

Signature

Date

Pudha, Erick Opondo

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.....

This project has been submitted by my approval as the university supervisor

Name

Signature

Date

Herick Ondigo

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**Lecturer, School of Business,
University of Nairobi**

DEDICATION

I dedicate this project to my family member's especially my late parents (George Samuel Pudha and Jane Grace Hayoyo) who instilled in me the virtues of hard work, honesty, humility, determination and resilience and my siblings for laying the foundation that enabled me to reach this far in my studies.

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ABSTRACT

This study was undertaken to investigate the factors that motivate local individual investors to invest in shares of Companies quoted at the Nairobi Stock Exchange (NSE). The NSE has made a remarkable growth from a share index of 100 in 1966 to 4678.78 by the end of December 2009. Number of shares traded moved from 214.90 billion in January 2009 to 490.81 billion in December 2009 while market capitalization moved from Kshs 831.83 Billion to Kshs 1081.86 Billion over the same period.

In this research, a general overview was presented to indicate the broad concern of the study including statement of the problem under investigation, the objective of the study, how the research was conducted and highlights significance visa vis the limitations of the study.

The study sample was randomly selected from various individual shareholders who included; MBA students from the University of Nairobi, using closed and open ended questions in questionnaire. The descriptive research design was adopted and the data collected was analyzed using SPSS version 17, and content & factor analysis and the results presented using descriptive statistics-graphs, charts, tables and percentages.

The respondents were subjected to a 10 question Likert scaled questionnaire with the responses measuring the extent of their motivation on each of the listed factor. The scaled responses were spread from a one representing "Not at all" to a five for "To a very great extent". The listed factors were ; earning dividends, earning capital gains, Profitability of the company, Liquidity position of the company , the asset structure of the firm , Monetary and fiscal policies of the government , earning bonus , the competitiveness of the company in the industry , the caliber of top

management of the company , the responsiveness of the firm to new technology . The most quoted response for all the factors was “moderate” an average of 30.13% followed by “To a great extent” at 27.73%. None of the factors except “*Moderately considers Asset Structure of the Company before investing*” was quoted overwhelmingly (by over half (50%) the respondents) on one response and the distribution of the percentages per response over any factor were relatively equal.

Further from the listed factors, respondents were asked to list any other factors that motivated them to invest in shares in the Nairobi Stock exchange. Diversifying investments was listed by most of the interviewees (21.9%) as the motivating factor behind their investing in the NSE followed by long term investments and savings respectively listed by 18.8% apiece. Improving on own financial performance was a close third at 15.6%. Other factors listed included; the high return on investments, professional management of financial portfolio, thrill of the stock exchange trading and the need to become a shareholder in the trading companies at the NSE.

The research findings also revealed that 29% of the respondents felt the future of NSE was promising with another 21% also saying it was bright if it continued to be run as independently as it is run now. Thirteen percent felt it was volatile and another 11% thought it unpredictable. Others (16%) felt it was still growing and that it largely depended on the performance of the economy (3%). The remaining 8% felt NSE was a good place for long term investments.

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ABBREVIATIONS

CBK-----	Central Bank of Kenya
CBS-----	Central Bureau of Statistics
CDSC-----	Central Depository and Settlement Corporation
CMA-----	Capital Markets Authority
CP-----	Commercial Paper
FOREX-----	Foreign Exchange
GDP-----	Gross Domestic Product
IPO-----	Initial Public Offer
KRA-----	Kenya Revenue Authority
NSE-----	Nairobi Stock Exchange
NYSE-----	New York stock Exchange
SEO-----	Stock Exchange Office
SES-----	Socioeconomic Status
T-Bills-----	Treasury Bills
T-Bonds-----	Treasury Bonds

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

According to Samuelson (1992) an investment is an economic activity which foregoes consumption today with an aim to increasing output in the future it includes tangible capital (structures, equipment and investment) and intangible investments (education / human capital, research and development and health). In finance investment is the purchase of securities such as stocks and bonds and can be taken by either individuals' corporate bodies or the state. It takes the form of expansion of existing business, or replacement and modernization (Reilly& Brown 1996)

Equity investment generally refers to the buying and holding of shares of [stock](#) on a [stock market](#) by individuals and funds in anticipation of income from [dividends](#) and [capital gain](#) as the value of the stock rises. Ben Stein (2003)

The NSE has enabled companies to engage local participation in their equity there by giving Kenyans a chance to own shares. In Kenya many companies have retained overwhelming majority ownership and control by their original owners both local and foreign despite listing at the NSE. From BAT and EABL Ltd in the 1960's followed by Brook Bond (now Uniliver), Jubilee insurance Ltd in 1970's, Barclays Bank and Standard Chartered Bank in the 1980's, Kenya Airways, Nation Media Group and National Bank of Kenya in the 1990's and now KenGen and Safaricom in the 21st century to name a few cases.

The path of the Initial Public Offers, (IPOs) have been the same, therefore very little in terms of corporate ownership and management control have changed hands in the so called publicly owned companies. Most shockingly, the gap

between the poor and the rich has escalated such that Kenya tops in the world in terms of extreme income inequalities (CMA report 2006).

Researchers in behavioral finance have been increasingly interested in the roles that psychological effect plays in people's investment decisions. For instance, Statman, Fisher, and Anginer (2008) recently reported that their study subjects considered that stocks associated with strong positive effect had paradoxically enough both high expected returns and low risk.

On the other hand, in another stream of research one located in the interface between finance and marketing, there has been a growing interest in how individuals' affective evaluations of companies' brands and corporate images, in particular, influence their willingness to invest in those companies' stocks (Aspara & Tikkanen 2008; Frieder & Subrahmanyam 2005; Schoenbachler, Gordon, & Aurand 2004). Aspara and Tikkanen (2008), especially, suggest that a consumer's positive attitude to a company's product or brand has positive influence on his attitude to the company itself, which in turn will positively influence his tendency to invest in the company's stock. In many cases the factors that individuals consider include returns in form of dividends, profitability of the firm, liquidity, risk facing the firm and expected returns from the investment. (Hurt and Block, 1993; Fisher and Jordan, 1996; Bhalla, 1997).

Mugo (1999) identified factors considered by institutional investors in selecting investment in shares of companies quoted at the NSE as economic factors, industry factors, company factors and risk and return factors. Ayieye (2004) carried a study on factors considered by foreign investors in investing in shares of companies quoted at the NSE and identified the factors as managerial forecasts, safety of the amount invested, relevant items in the investment

decisions, specific considerations, monetary and fiscal policies, industrial factors and accounting policies.

The researcher seeks to concentrate on investment in securities purely by local individuals investing in securities (ordinary shares) of companies quoted at the NSE. Over the years the NSE has encouraged both local and foreign investors to invest in securities of companies quoted at the NSE by providing them with necessary information regarding the stock trading and also creating conducive and legal environment where trading in securities can take place.

1.1.1 Classes of investors

Capital market researchers frequently distinguish between two classes of investors namely; informed investors and the uninformed investors (Rosa et. al 2005). Informed traders are those who possess some fundamental information about the value the assets that are not readily available to other traders. Presuming that this information is obtained from costly information search, there is a general assumption that these traders realize superior returns. Uninformed (noise traders) do not possess this information and they trade for their liquidity needs on the basis of information that they correctly believe to be fundamental to the asset value, in most cases they are guided by their intuition, feelings and attitude.

Financial economists tend to view individuals and institutions differently. In particular, while institutions are viewed as informed, individuals are said to have psychological biases and are often thought as the proverbial noise makers in the sense of Kyle(1985). Individual investors can further be categorized as local and foreign. In this paper the researcher proposes to focus on the factors that motivate local individual investors to invest in shares of companies quoted at the NSE.

1.1.2 Factors considered by investors when investing in securities

According to (Samuelson, 1992; Reilly and Brown, 1996; Fisher and Jordan 1996) investors consider the following factors when choosing an investment.

Profitability of the firm

This is the ability of the firm to maximize shareholders wealth. A profitable firm will certainly attract investors while a loss making firm will not attract an investor to purchase its shares

Liquidity position

This is the ease and ability of the firm to convert its assets into cash enabling it to meet its cash obligations such as paying its dividends. Investors prefer a more liquid firm to a less liquid firm.

The asset structure of the firm

A firm with a high asset base is seen in the eyes of investors as stable and will attract more investors than one with low asset base.

Returns expected on the investment

Individuals will go for securities with high rates of return as compared with those with lower rates of returns.

Financing policy and capital structure of the firm

A firm that spends its earnings in servicing debt financing will not attract many investors as compared to a firm that issue new shares to raise funds.

Industrial factors

The more competitive a firm is in an industry, the more investors will prefer its stock since this is an indication of good performance.

Monetary and fiscal policies of the government

If taxes are high, investors are discouraged from investing and vice versa. Prevailing interest rates for example, low interest rates will favor investment hence more investors.

Dividends

Since companies are under no obligation to pay dividends, it's only those companies that pay dividends that will attract investors.

1.1.3 Brief History of the Nairobi Stock Exchange

A stock exchange is an entity which provides "trading" facilities for stock brokers and traders to trade stocks and other securities. Stock exchanges also provide facilities for the issue and redemption of securities as well as other financial instruments and capital events including the payment of income and dividends. The securities traded on a stock exchange include shares issued by companies, unit trusts, derivatives, pooled investment products and bonds.

The NSE was established in 1920 when Kenya was still a British colony. In 1951 Francis Drummond, an Estate Agent established the first professional stock broking firm and approached the then Finance Minister Sir Ernest Vasey, and impressed upon him the idea of setting up a stock exchange in East Africa. The two approached London Exchange officials in 1953 who then accepted to recognize the setting up of NSE as an overseas stock exchange constituted as a voluntary association of stock brokers registered under the Societies Act, the business commenced in 1954 as a voluntary organization of stock brokers. Dealing in shares during this period was predominantly white up to 1963 when Kenya became independent. Muga (1974).

In 1963 the stock activity slumped due to uncertainty of future independence of Kenya. However the first three years of independence was marked by steady

economic growth. Confidence in the market was rekindled and the exchange handled a number of highly oversubscribed public issues. This steady growth was halted when an oil crisis introduced inflationary pressures in the economy which depressed share prices. A 35% capital gain tax was introduced in 1975 (suspended since 1985) inflicting further losses to the exchange which at the same time lost its regional charter following nationalization and inter-territorial restrictions introduced by Uganda and Tanzania. For instance in 1976 Uganda took a number of companies that were quoted or subsidiaries of companies quoted at the NSE. (Statistical Abstract 2003).

The IFC/CBK study (1984), "Development of Money Markets" became a blue print for structural reforms in the financial markets which culminated in the formation of a regulatory body - Capital Markets Authority (CMA) in 1989. This was to assist in the creation of a conducive environment for growth and development of country's capital markets. NSE was registered under the companies Act Cap 486 of the laws of Kenya in 1991 and phased out call over trading system in favor of floor based open outcry system which has since been replaced by automated system.

As the NSE continued to expand it was reorganized and re-categorized into three distinct (co-equal) market segments; the main market segment, the alternative market segment and the fixed income market segment.(CBK 1995).

The Nairobi Stock Exchange (NSE) has made a remarkable growth from a share Index of 100.00 in 1966 to 4648.78 by end of December 2009. Number of shares traded moved from 214.90 billion in January 2009 to 490.81 billion in December 2009 while market capitalization moved from Kshs 831.83 Billion to Kshs 1081.86 Billion over the same period. (CBK 2010).

As a capital market institution, the stock exchange plays important role in the process of economic development which in turn impacts on the living standards of the people in general. The major role that the stock market plays and will continue to play in many economies is that of promoting culture of thrift/savings. Other roles played by the NSE include; transfer of savings to investment in productive enterprises, rational and efficient allocation of capital which is a scarce resource, promoting high standards of accounting, resource management and transparency in management of business. It also improves the access to finance by different types of users. Last and very importantly is that stock exchange provides investors with an efficient mechanism to liquidate their investments in securities. Muga (1974).

Although the NSE was rated as best performing stock market in the world with a return of 179%, the reality is that four decades after Kenya's independence, very few companies that are quoted at the NSE can be claimed to be publicly owned industrial and commercial establishments by Kenyans from whom they derive their existence in terms of turnover and profits. Over 70% of the GDP is in the hands of a minority of foreigners, indigenous citizens, the African elites, their families and associates who own the quoted companies. The remaining 30% is what is shared amongst the Kenyan majority citizens. (IFC 1994).

Compared to South Africa's Johannesburg Stock Exchange, the largest and the most prosperous stock exchange in Africa which also boast a significant increase in the numbers of listed companies that have black majority shareholders, ownership by individuals in the poor has increased from 5% in 1994 to current 30% and is expected to continue increasing. Many of South Africa's enlisted companies are much bigger in share market value and equity turnover than the entire Kenyan currency. For example Anglo American P.L.C, the continent's

largest corporation at U.S\$.48 billion is over 8 times longer than the entire U.S\$6 billion capitalization of NSE and three times bigger than Kenya's GNP of US \$16 billion.(Economic Survey 2005)

The NSE is at present made up of eighteen broking firms the oldest being Francis Drummond and Company Ltd all based in Nairobi.

There have so far been no studies that would examine the factors that elicit local individual investor's motivation to invest in a company's stock over and beyond the expected financial returns and risk of the stock among other factors mentioned above. It is therefore on this background that this study seeks to investigate the factors that motivate local individuals to invest in stocks of companies quoted at the NSE.

1.2 Statement of the Problem

Many Kenyans do face the problem of where to invest their money for better returns because of the low return associated with many investments in the economy. This has been due to poor governance, corruption, lack of incentives to invest and unfavorable political conditions which has existed in both the current and past regimes. Informed investors in most cases carry an analysis of the state of the economy and its potential effects on the security of returns. They also conduct an industry analysis since stock prices are also affected by industry conditions as companies promising good performance will be favored by investors. In most cases investors purchase those stocks that preserve the capital invested. Shares at the NSE have been associated with both under and over pricing thus deny the meaningful returns on their investment.

However for a long time Kenyans had not shown a burning desire to invest in shares traded at the NSE. This was until the famous KenGen IPO of 2006 and Safaricom in 2008 after which the trend experienced a paradigm shift. These IPOs have exposed Kenyans to another world of investment that was previously a reserve for a few enlightened Kenya's. (CMA 2008)

Following the work of Slovic and others (e.g., Slovic, Finucane, Peters, & MacGregor 2002, 2002, 2007; Finucane, Alhakami, Slovic, & Johnson 2000; MacGregor, Slovic, Dreman, & Berry 2000), researchers in behavioral finance have been increasingly interested in the roles that psychological effect plays in people's investment decisions. For instance, Statman, Fisher, and Anginer (2008) recently reported that their study subjects considered that stocks associated with strong positive effect had high expected returns and low risk. On the other hand, Aspara and Tikkanen (2008), especially, suggest that a consumer's positive attitude to a company's product or brand has positive influence on his₁ attitude

to the company itself, which in turn will positively influence his tendency to invest in the company's stock.

The factors investors consider have been identified as dividends, profitability of the firm, liquidity position of the firm, risk and return. (Hurt and Block, 1993; Fisher and Jordan, 1996; Bhalla, 1997 and Mugo, 1999). These factors may differ across individuals depending on their motives, size and volume of investment and goals behind the investments.

Mugo (1999) carried out a study on the factors considered by institutional investors in evaluating shares of quoted companies at the NSE and identified the factors as economic, industry, company risk and return. Ayieye (2004) carried out a study on factors considered by foreign investors in investing in shares of companies quoted at the NSE and identified factors as managerial forecasts, safety of the amount invested, relevant items in investment decision specific considerations, monetary and fiscal policies, industrial factors and accounting policies.

There have so far been no studies that would examine the specific question on the factors elicit one's motivation to invest in the company's stock traded at the NSE. Consequently, the purpose of this study is to conduct a survey on the factors that motivate local individual investors to invest in shares of companies quoted at the NSE.

1.3 Research Objectives

This study has one objective, which is to investigate the factors that motivate local individuals to invest in shares of companies quoted at the NSE.

1.4 Significance of the Study

The study will benefit many parties among which are here in under listed:

Investors

The study will guide investors when making investment decisions as it will bring out some of the factors that investors should consider when investing in shares of companies quoted at the NSE.

The government

The study will aid the government in formulating both monetary and fiscal policies that will encourage local individual investors to invest in the NSE thereby promoting economic growth.

Stock brokers and Investment advisors

This study will provide both the stock brokers and the investment advisors with the information useful to them in providing investment advice to their clients.

Regulatory Authorities

The capital Market Authority (CMA) and the Central Bank of Kenya (CBK) will find information in this study vital for their decision making regarding the regulatory policies that they intend to initiate.

Scholars

The findings and recommendations of this study will be useful to scholars who intend to carry out further research in the field of stock markets.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of related literature on the subject matter under study presented by various researchers, scholars, analysts and authors. It will analyze history and origin of the stock exchange, the role of the stock exchange in an economy, theories of investing in stocks, empirical studies on what moves the stock prices and how, recent activities in the stock market (NSE) and lastly the instruments traded at the stock market (NSE).

2.2 Theories of investing

Modigliani and Miller 1961 came up with MM dividends irrelevance theory. They argued that the value of the firm is determined by basic earning power, firms risk and not distribution of dividends. This has however not been proved in many economies since the assumption that there are no cooperate and personal taxes, no transaction costs and that the market is efficient is not applicable. They argued that capital gains are the main reason as to why investors invest in stocks.

Gordon and Linter (1963) came up with the bird in hand theory and argued that a bird in hand is worth two in the bush. In other words, investors prefer dividends to capital gains. Investors therefore value dividends more than capital gains as companies that pay dividends have higher market value than those that do not.

Irving Fisher, in his treatise, *The Theory of Interest* (1930), predicted a positive relationship between expected inflation and nominal asset returns. Also, common wisdom indicates that stocks are hedges against inflation so that as inflation increases, demand for stocks increases and so would the stock prices. However, the results of empirical analysis by most researchers indicate a negative relationship between common stock returns and various measures of expected and unexpected inflation appearing to contradict the above. These researchers have then tried to explain the negative relation in various ways.

Based on the notion that money demand is procyclical, Fama (1981) theorizes that the inflation-stock return correlation is essentially a proxy for the negative relationship between inflation and real activity. Geske and Roll (1983) offer a “reverse causality” explanation to the inverse relation between inflation and stock returns, arguing that a reduction in real activity leads to an increase in fiscal deficits. Another explanation that is offered is that high rates of inflation increase the cost of living and a shift of resources from investments to consumption. This then leads to a fall in the demand for market instruments which lead to reduction in the volume of stock traded.

The theory of Money supply explains that Money supply in an economy is likely to influence share prices through at least three mechanisms. First, changes in the money supply may be related to unanticipated increases in inflation and future inflation uncertainty and hence negatively related to the share price; second, changes in the money supply may positively influence the share price through its impact on economic activity; and finally, an increase in the money supply leads to a portfolio shift from non-interest bearing money to financial assets including equities. Humpe and Peter (2007) found out that money supply, M1 (a liquid measure of the money supply that contains cash and assets that can quickly be converted to currency), does not contribute significantly to the stock price in the US.

Ross (1977) in the signaling theory argues that investors can use dividends to signal important information in the market which is known to them. thus a firm that pays dividends will signal higher profits and also higher market value.

Litzenberger and Ramaswammy (1979) came up with tax differential theory and noted that dividends are higher than capital gains. Therefore to them a firm that pays dividends has a lower market value resulting from the tax that will reduce the amount of dividends.

2.3 Security Analysis

Before one invests in securities, it is important to gather information about a particular security and then use the information to decide whether or not to invest in the security (Fisher and Jordan 1996). During this analysis, the following approaches are used:

First, economic analysis is done to assess the general state of the economy and its potential effects on the security return. For example, when the economy is facing depression, investors are not likely to buy shares as compared to when the economy is facing a boom (Samuelson, 1992; Gitman and Joehnk, 2001) some of the economic variables include government fiscal and monetary policies.

Second, industry analysis; where industry groupings are studied in terms of competitive position of a particular industry in relation to others and more specifically to promising companies within a particular industry. Since stock prices are influenced by industry conditions, it follows that companies that thrive will be favored by investors as opposed to those that do not.

Third, fundamental analysis; which is an in-depth study of financial conditions and operating results of the firm. Investors will therefore scrutinize the financial statements of the firm i.e. balance sheet, income statement, cash flow statements and ratios to establish the exact price of stock so that mispricing of stocks is minimized.

2.4 Empirical Studies

Standard finance traditionally assumes that investors select investments, including stocks, purely based on their expected financial return-risk profiles (Clark-Murphy & Soutar 2004). In other words, investors are seen to have the sole motivation to select a stock that has the highest expected financial returns at a given risk level.

However, as Fisher and Statman (1997) note, it is in reality no more reasonable to expect that individuals are concerned only about financial risk and return when constructing an investment portfolio than it is to expect that they are concerned only about cost and nutrition when deciding what to eat. Recently, on the emerging literature on the role of psychlogical effect in investments (MacGregor et al. 2000; Slovic et al. 2007; Statman, Fisher, & Anginer 2008) has addressed investment psychology that goes beyond rational financial considerations.

This research has suggested, *inter alia*, that the images and related affective evaluations which individuals have of companies may be a major basis on which they make investment decisions. While this work has mostly focused on the influence of affective evaluations on investors' expectations of financial performance and risk, it also provides us initial insights to the potential influence that company effect has on investment motivations beyond financial returns.

First of all, it is likely that given a choice between the stocks of two or more companies that have approximately similar risk-return profiles, one chooses the stock of the company towards which one has most positive effect, i.e., which one likes most overall. Namely, images, marked by positive and negative effective feelings, guide judgments and decision making (Damasio 1994; Slovic et al. 2002a, 2002b; Zajonc 1980) particularly when accurately judging the 'pros' and 'cons' of various alternatives is difficult due to their inherent complexity or complexity of information about them (Zajonc 1980).

The investment context is a case in point: companies, their stocks, and the pieces of related information are highly complex, which makes it difficult to accurately estimate the financial returns/risks (Statman, Fisher, & Anginer 2008). Indeed, lacking information about future and being unable to form expectations of the financial returns with great accuracy, an individual is able to make only rough approximations of the return-risk profiles of stocks – and may, consequently, just choose to invest in the stock of a company that he “likes” (rather than in other stocks expected to have approximately similar risk-return profiles).

This behavioral tendency would be a somewhat clear instance of using a mental short-cut called “affect heuristic” (e.g., Finucane et al. 2000; Slovic et al. 2002a, 2002b, 2007). That is, using an overall, readily available affective impression as a mental decision-making shortcut can be far easier and efficient than estimating all the pros and cons of various alternatives, especially when the required judgment or decision is complex and/or one’s mental resources are limited. Particularly in contemporary markets, in which thousands of stocks compete for investors’ attention (Barber & Odean 2008), any individual is likely to encounter tens or hundreds of stocks with seemingly similar financial return-risk profiles – and use the very shortcut to arrive at investment decisions partly based on affect motivation.

Importantly, an individual with an affective self affinity relationship with a company will tend to give preferential and supportive treatment to the company and be prepared to cooperatively give more of his scarce resources to it (Aspara et al. 2008; Bhattacharya & Sen 2003; Scott & Lane 2000). One way through which one can give such preferential and supportive treatment to a company is, in turn, through investing in its stock. Such a tendency, stemming from one's affective self-affinity for a company, can therefore be expected to generate even greater extra motivation to invest in the company's stock (beyond its financial returns) than the affect heuristic stemming from "mere" positive attitude towards the company.

In fact, an individual's affective self-affinity for a company may lead him to invest in the company's stock even by consciously accepting a bit lower financial returns from the company's stock (or higher risk) than from certain others (Aspara et al. 2008). Thus, we anticipate that an individuals' affective self-affinity for a company may act as an additional affect-based motivation – distinct from mere positive attitude – to invest in the shares of that particular Company.

Sawhney, Emmanuel and Feridun (2006) examined the long run relationship between economic growth and stock prices for Canada and the United States. Their results reveal that economic growth and stock prices share long run equilibrium relationship for both Canada and the U.S. Further, for the U.S., causality runs from economic growth to stock prices but not vice versa. However for Canada, the results reveal that there is a bi-directional causality between economic growth and stock prices.

Rigobon and Sack (2006) using data from 1994 to 2006, find no significant effect of advance GDP release surprises on equity prices. However, they do find a slightly positive effect that is statistically significant when they use a more advanced econometric method which controls for censoring effects. Fama (1990) shows that monthly, quarterly and annual stock returns are highly correlated with future production growth rates. He argues that the relation between current stock returns and future production growth reflects information about future cash flows that is impounded in stock prices.

The same results are also found by Schwert (1990) who uses a larger data period for his study. In a study of the Indian stock markets, Agrawalla and Tujeta (2008) examine the causal relationships between the share price index and industrial production. The study reports causality running from economic growth proxied by industrial production to share price index and not the other way round.

Interest rates: The basic functions of interest rates in an economy, in which individual economic agents take decisions as to whether they should borrow, invest, save and/or consume, can be said to have three aspects, viz. interest rates as return on financial assets serve as incentive to savers, making them defer present consumption to a future date; interest rates being a component of cost of capital affect the demand for and allocation of loanable funds; and the domestic interest rate in conjunction with the rate of return on foreign financial assets and goods are hedged against inflation.

These broad roles of interest rates emphasize their significance in the structure of asset prices, stock prices being one such asset. According to the Dividend Discount Model (a model used to determine the price at which a security should sell based on the discounted value of estimated future dividend payments), required rate of return and the share price are inversely related. Thus, returns on stocks would decrease with the increase in the interest rate.

One argument substantiating this is that an increase in interest rate will increase the opportunity cost of holding money and investors substitute holdings of fixed income interest bearing securities for shares, hence leading to falling stock prices. In particular, an increase in interest rates leads to a decrease in expected future cash flows and hence a decline in demand for stocks and a fall in stock prices.

Individuals consider returns in form of dividends, profitability of the firm, liquidity, risk facing the firm and expected returns from the investment. (Hurt and Block, 1993; Fisher and Jordan, 1996; Bhalla, 1997).

Mugo (1999) carried out a study on the factors considered by institutional investors in evaluating shares of quoted companies at the NSE, he identified factors considered by institutional investors in selecting investment in shares of companies quoted at the NSE as economic factors, industry factors, company factors and risk and return factors.

Ayieye (2004) carried a study on factors considered by individual investors in investing in shares of companies quoted at the NSE and identified the factors as managerial forecasts, safety of the amount invested, relevant items in the investment decisions, specific considerations, monetary and fiscal policies, industrial factors and accounting policies.

2.5 Stock Market Anomalies

Despite strong evidence that the stock market is highly efficient, there have been scores of studies that documented long-term historical analysis in the stock market that seem to contradict the efficient market hypothesis. While the existence of these anomalies is well accepted, the question of whether investors can exploit them to earn superior returns in the future is subject to debate.

Investors evaluating the anomalies should keep in mind that although they have existed historically, there is no guarantee they will persist in the future. If they do persist, transactions and hidden costs may prevent outperformance in the future.

The weak form Efficient Market Hypothesis (EMH) states that if the market is efficient, then the current stock prices reflect all the information contained in its past prices and thus, follows the random walk. The presence of seasonality or calendar anomalies in stock returns violates the weak form of market efficiency because equity prices are no longer random and can be predicted based on past pattern. Seasonality in stock returns is said to exist if the average returns were not same in all periods. The month-of-the-year effect would be present when returns in some months are higher than other months. In the USA and some other countries, the year-end month (December) is the tax month. Based on this fact, a number of studies have found the 'year-end' effect and the 'January effect' in stock returns consistent with the 'tax-loss selling' hypothesis.

It is argued that investors, towards the end of the year, sell shares whose values have declined to book losses in order to reduce their taxes. This lowers stock returns by putting a downward pressure on the stock prices. As soon as the tax year ends, investors start buying shares and stock prices bounce back. This causes higher returns in the beginning of the year, that is, in the month of January. While some researchers on the Indian markets have found evidence of December effect, others upheld the tax loss-selling hypothesis in the Indian market explaining the presence of abnormal returns in April (India's tax year ends in March).

Pandey (2002) reported the existence of seasonal effect in monthly stock returns of BSE Sensex in India and confirmed the January effect. Kumari and Mahendra (2006) studied the day of the week effect using data from 1979 to 1998 on BSE and NSE. They reported negative returns on Tuesday in the Indian stock market.

Moreover, they found returns on Monday were higher compared to the returns of other days in BSE and NSE. A latest study by Chakrabathi and Sen (2007) found the November effect at the market level. They explain this effect as happening in the month of November perhaps because during the festive season or when the festive seasons are just over, people generally have access to more cash and/or better access to liquid cash.

2.6 Investor Sentiments

Which stock do investors choose to buy and what motivates the purchase of one stock over the other? Kaniel (2006) documents that since individuals tend to buy after prices decrease and sell after prices increase, their profit may also relate to the shorter horizon returns reversals first observed by Jegadeesh (1990) and Lehman (1990). In principle these reversals can be due to either illiquidity or investor overreaction. One best explanation to these findings is that the contrarian tendency of individuals leads them to act as liquidity providers to institutions that require immediacy.

Specifically investor sentiments are defined as situations where individual investors act on belief unwarranted by fundamental values and hereby their buy and sell transactions have a common directional component, De Long et.al. 1990) investor sentiments are thus expectations about the future absolute returns rather than relative returns. It is the propensity to speculate, sentiments in this regard is thus seen to drive the relative demand for speculative investments and therefore causes cross-sectional effects even if arbitrage forces are the same across stocks. What makes stocks to be more vulnerable to broad shifts in the propensity to speculate can be suggested as the subjectivity of their valuations (Backer and Wurgler)

2.7 Importance of investments

According to Fisher and Jordan (1996) there are a number of reasons as to why individuals undertake investment activities. They include: liquidity purposes where investors earn dividends and interest; saving for a large future expenditure like buying a house or land, retirement planning funds, speculative purposes whereby an investor buys a security in expectation of a booming economy to reap huge profits and lastly returns in form of dividends and capital gains.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter centers on the methodology the researcher used to carry out the research. It encompasses the description of the population, the description of the instruments used to carry out the research, data collection procedures and data analysis approaches

3.2 Research Design

Descriptive design was adopted in this study this study, according to Emory and Cooper (1991) it determines the; who, what, where, when, and how of a research. This method is effective in collecting data since it involved asking people information concerning them and allows collection of a large amount of data from the current population.

3.3 Population of the study

The target population comprised all local individual investors in ordinary shares of Companies quoted at the NSE.

3.4 Sample Selection

A sample size of 50 respondents was sampled for the study based on Snedecor (1989) concept of sampling. According to Snedecor, it is often hard to establish sample size in relation to accuracy since factors such as mean and standard deviation of the population is not known before research commences. 50 respondents are more than the minimum required to make a meaningful conclusion. The sample size was drawn from local individual investors who are Master of Business Administration (MBA) students at the University of Nairobi.

This sampling method was adopted due to resource and time limitations and the fact that the targeted respondents are educated/informed in matters investment and will give the appropriate information required for this study.

3.5 Data Collection

This data was collected using self administered questionnaire as it is one way to elicit self reports on people's opinions, attitudes, beliefs and values. It also encourages honest response to sensitive questions since it guarantees confidentiality and anonymity. The questionnaire had both open ended and close ended questions. Open ended questions give respondents room to give more information and clearly express themselves while closed ended questions provide questions whose answers help the researcher form opinion and conclusions.

3.6 Data Analysis and Techniques

The data obtained was quantified to indicate the frequencies and the proportions of investors who responded in different ways to the questions as contained in the questionnaire. Factor analysis was used to rank factors in order of importance while comparative analysis was used to identify any difference between factors considered by the individual investors. The results were analyzed using the statistical products services and solutions (SPSS version 17) software and Microsoft excel.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.0 Findings and Analysis

4.1 Introduction

This chapter presents the results of the data collected and further discusses these findings. The tables, charts and figures in this chapter are derived from the findings of the study after analysis using SPSS (Statistics for Social Scientists) version 17. This chapter presents the findings of the study in line with the objectives. The researcher presents the findings in two sections; the first will be a presentation of the general and demographic information of the sample, the remaining segment will tackle the research question independently.

The instrument used in the research was pretested to improve their validity and reliability basing on the objectives of the study. Data from the questionnaires was cleaned as soon as they were received to ensure completeness. Of the 50-targeted respondents, 42 successfully completed the questionnaires thereby recording 84% response rate, which is statistically acceptable for generalizations.

4.2 General and Demographic Information

4.2.1 Gender

The table below (Table 1) illustrates the distribution of respondents in regard to gender.

Table 1: Gender of Respondents

		Frequency	Percent	Cumulative Percent
Valid	Male	20	47.6%	47.6%
	Female	22	52.4%	100.0%
	Total	42	100.0%	

As depicted by the table, the sample had 20 male respondents constituting 47.6% of the sample with the rest 22 respondents being women.

4.2.2 Age

Fig 4.1 below is a graphical representation of the age distribution of the respondents.

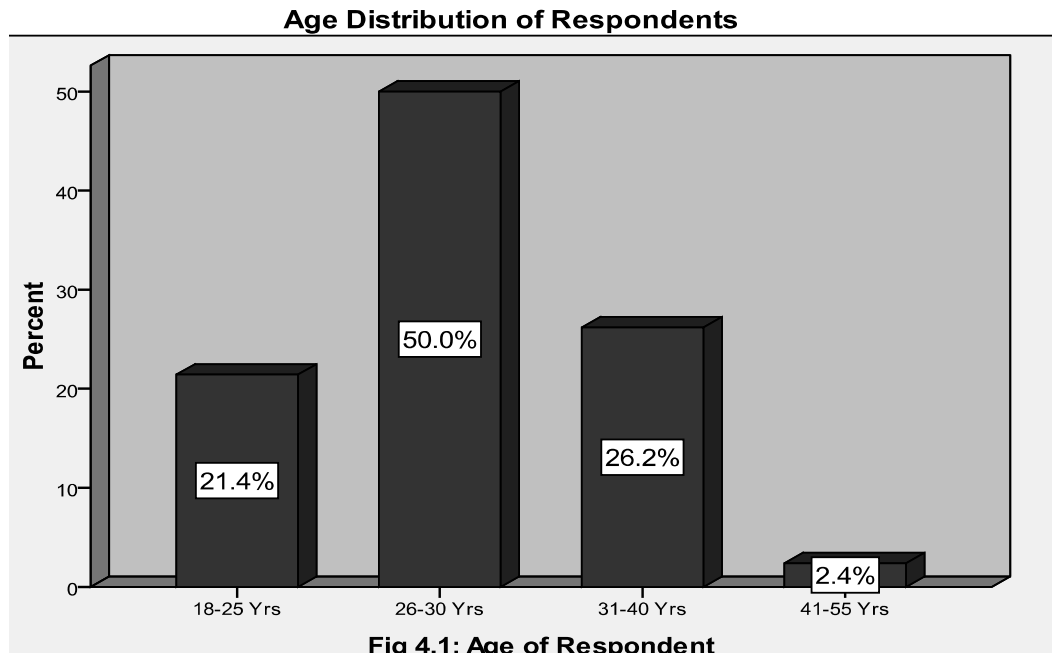


Fig 4.1: Age of Respondent

Fifty percent of the respondents fell in the 26-30 years category while 21.4% were respondents who had between 18-25 years. The 31-40 years age category had 26.2% of the respondents and the remaining 2.4% were between 41-55 years.

4.2.3 Age by Gender

The graph below is an illustration of how the sample was distributed in terms of age by gender. More than half of the female respondents in the sample were in the 26-30 age category while the male respondents in the same age category comprised of 45%. There were no female respondents in the above 40 years age group.

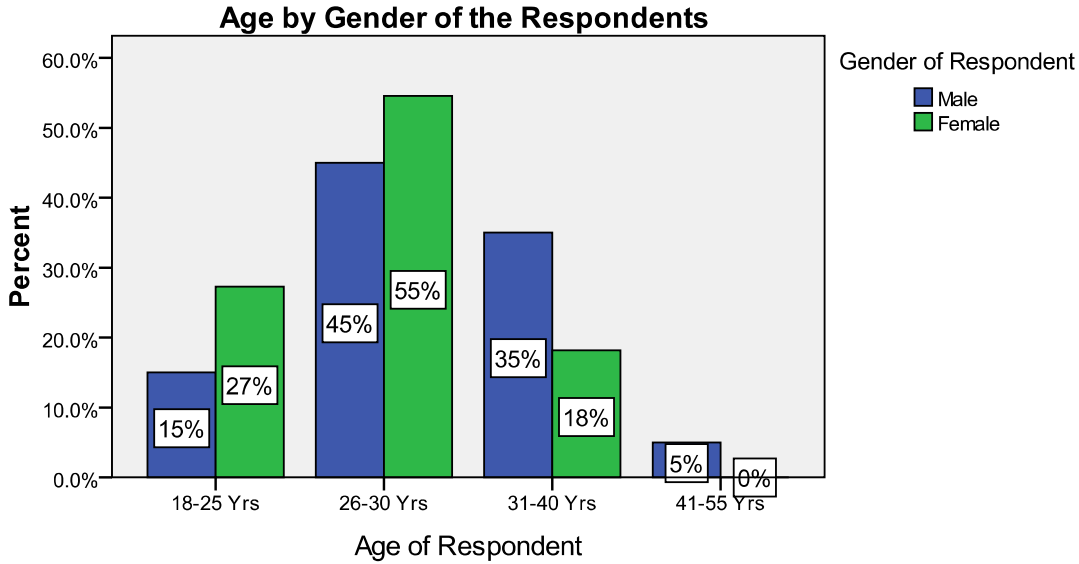


Fig 4.2: Age by Gender of the Respondents

4.2.4 Shares Held by Gender

When respondents were asked to quote the shareholding bracket they fell in, the results grouped by gender were as depicted by the bar graph below (Fig 4.3).

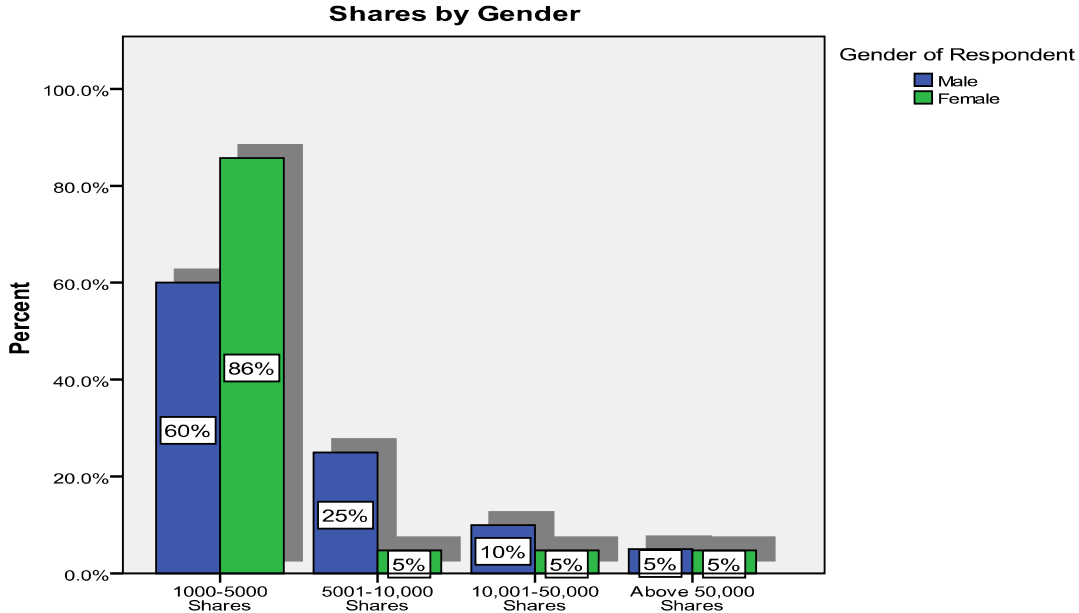


Fig 4.3: Range of Shares held by Gender

More than half; 60% of the male respondents held between 100 and 500 shares while 86% of the women also fell in the same category. Those holding above 50,000 shares across the gender constituted of 5% respectively for both genders.

4.3 Motivating Factors

4.3.1 Factors Motivating Individuals to Own Shares in the NSE

The respondents were subjected to a 10 question Likert scaled questionnaire with the responses measuring the extent of their motivation on each of the listed factor. The scaled responses were spread from a one representing “Not at all” to a five for “To a very great extent”. The table below shows the results that compare the percentages in response to each of the listed factor.

Table 2: Factors Motivating Individuals to Invest in the NSE

Factors Motivating Individuals to Invest in the NSE	Valid Percent					
	Not at All	To a Less Extent	Moderate	To a Great Extent	To a Very Great Extent	Total
Earn Dividends	0.0%	16.7%	26.2%	35.7%	21.4%	100.0%
To Earn Capital Gains	2.4%	14.3%	11.9%	38.1%	33.3%	100.0%
Profitability of the Company	7.1%	4.8%	26.2%	35.7%	26.2%	100.0%
Liquidity Position of the Company	14.6%	7.3%	34.1%	34.1%	9.8%	100.0%
The Asset Structure of the Firm	16.7%	4.8%	54.8%	19.0%	4.8%	100.0%
Monetary and Fiscal Policies of the Government	24.4%	24.4%	26.8%	19.5%	4.9%	100.0%
To Earn Bonuses	0.0%	11.9%	28.6%	28.6%	31.0%	100.0%
The Competitiveness of the Company in the Industry	14.3%	26.2%	31.0%	26.2%	2.4%	100.0%
The Caliber of Top Management of the Company	4.8%	28.6%	33.3%	21.4%	11.9%	100.0%
The Responsiveness of the Firm to New Technology	11.9%	26.2%	28.6%	19.0%	14.3%	100.0%
Average of Column Total	9.62%	16.52%	30.13%	27.73%	16.00%	100.00%

From the above table, the most quoted response for all the factors was “moderate” an average of 30.13% followed by “To a great extent” at 27.73%. None of the factors except “*Moderately considers Asset Structure of the Company before investing*” was quoted overwhelmingly (by over half (50%) the respondents) on one response and the distribution of the percentages per response over any factor were relatively equal.

4.3.2 Other Factors

Further from the listed factors, respondents were asked to list any other factors that motivated them to invest in shares in the Nairobi Stock exchange. Diversifying investments was listed by most of the interviewees (21.9%) as the motivating factor behind their investing in the NSE followed by long term investments and savings respectively listed by 18.8% apiece. Improving on own financial performance was a close third at 15.6%. Other factors listed included; the high return on investments, professional management of financial portfolio, thrill of the stock exchange trading and the need to become a shareholder in the trading companies at the NSE.

The graph below gives a pictorial representation of the distribution of these factors as listed by the respondents.

Distribution of Other Factors Motivating Individuals to Invest in Shares

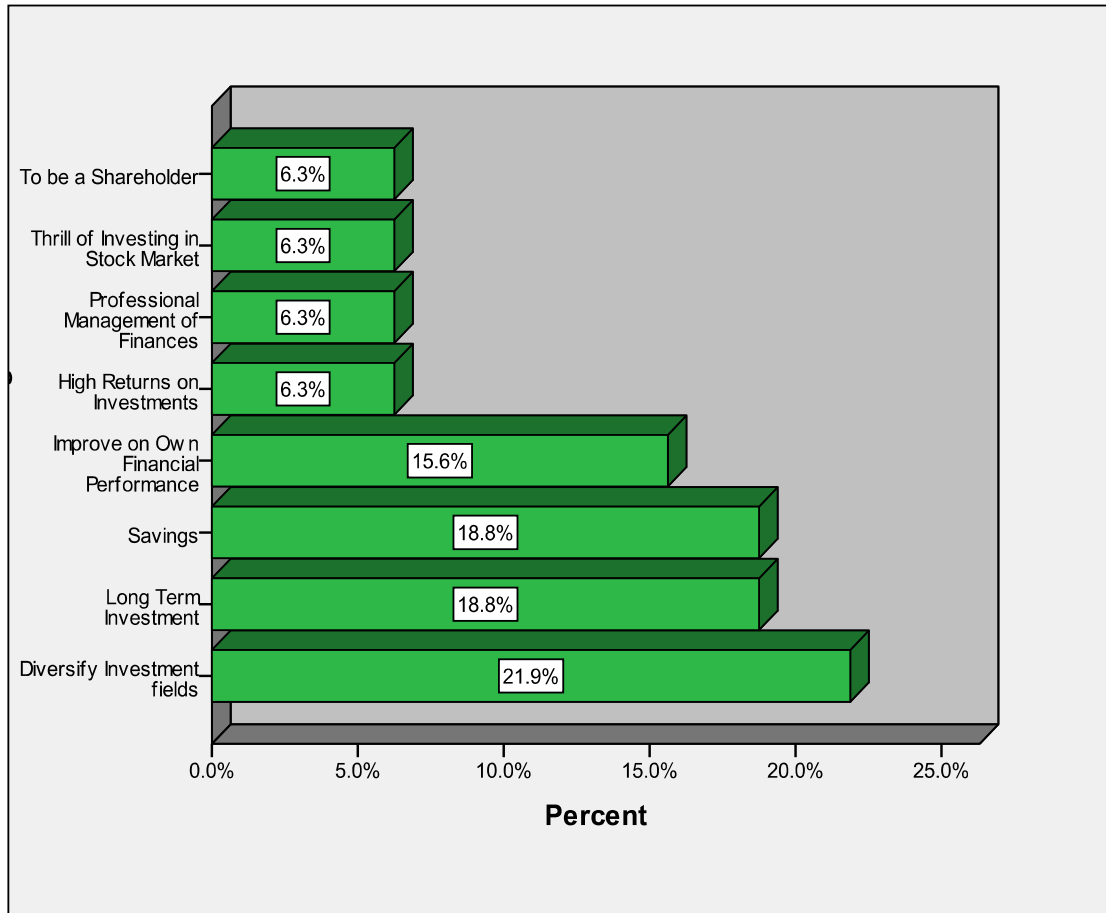


Fig 4.4: Other Factors Motivating Individuals

4.3.3 Initial Public Offers (IPO)

The respondents were asked whether they invested in shares through initial public offers (IPO) or otherwise and responded as shown in the pie chart below, Fig 4.5.

More than two thirds of the respondents indicated they utilized IPO only to secure shares trading at the NSE while 16.67% used other means with the remaining 9.52% using both IPOs and other means to do this. Its also notable that the total number of respondents who used IPOs constituted 83.33% of the sample.

Purchased Shares Through an IPO

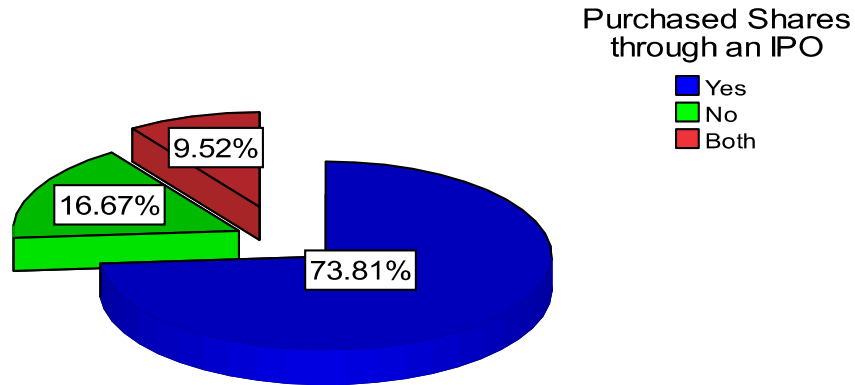


Fig 4.5: Ways Shares Were Purchased

4.4.4 Reason for Purchasing Through IPO

Figure 4.6 illustrates the distribution of reasons for purchasing shares through IPOs as listed by the interviewees.

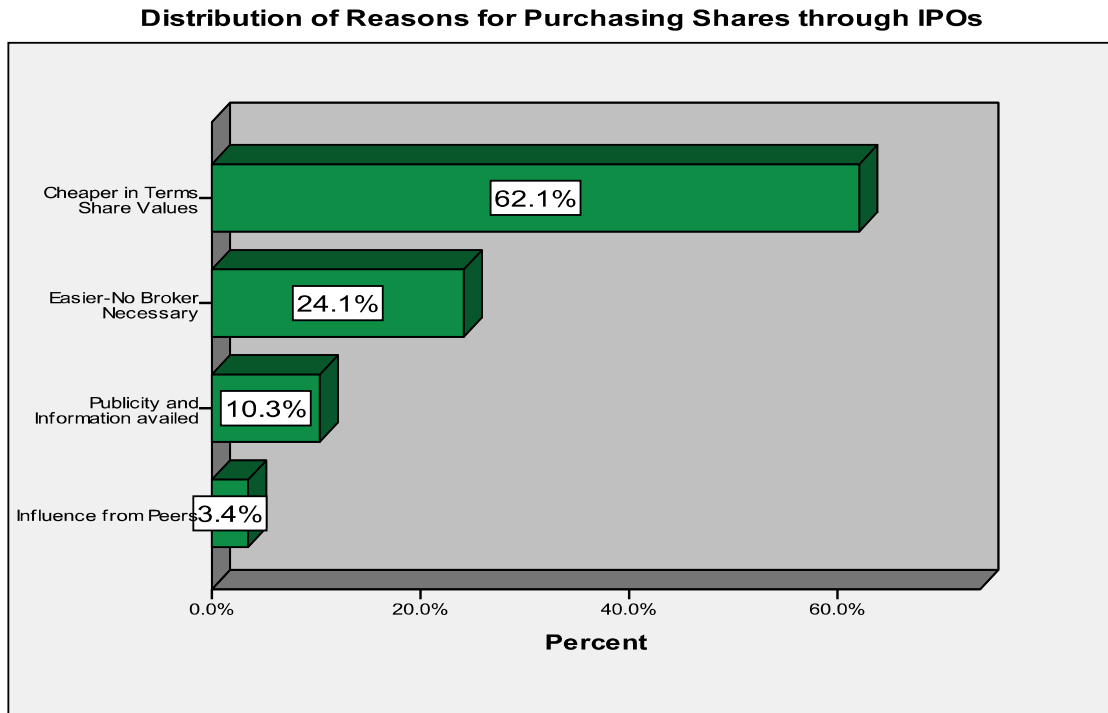


Fig 4.6: Reasons for Purchasing through IPOs

Sixty two percent of the respondents indicated they purchase their shares through an IPO because it was cheaper in terms of the cost of the share value followed by the easiness of purchasing during an IPO since the process was not as complicated since it did not necessitate stockbrokers. Ten percent of the respondents bought shares through an IPO because of the publicity such trading are given together with the information available during an initial public offer. The remaining 3.4% were influenced by their peers to buy through an initial public offer.

4.4.5 Role of NSE in the Economy

When asked what in their own opinion they thought was the role of the NSE especially to the economy, the respondents reacted as illustrated by the table below, Table 3.

Opinion	Distribution		
	Frequency	Percent	Cumulative Percent
Raise Capital For Companies	12	28.6%	28.6
Improve Country's Development	5	11.9%	40.5
Create Employment	2	4.8%	45.2
Encourage Savings Among Kenyans	6	14.3%	59.5
Regulatory Body and Stabilize Market Prices	9	21.4%	81.0
Help Gauge Performance of Companies through Prices	2	4.8%	85.7
Give Kenyans Ownership of Local Companies	6	14.3%	100.0
Total	42	100.0%	

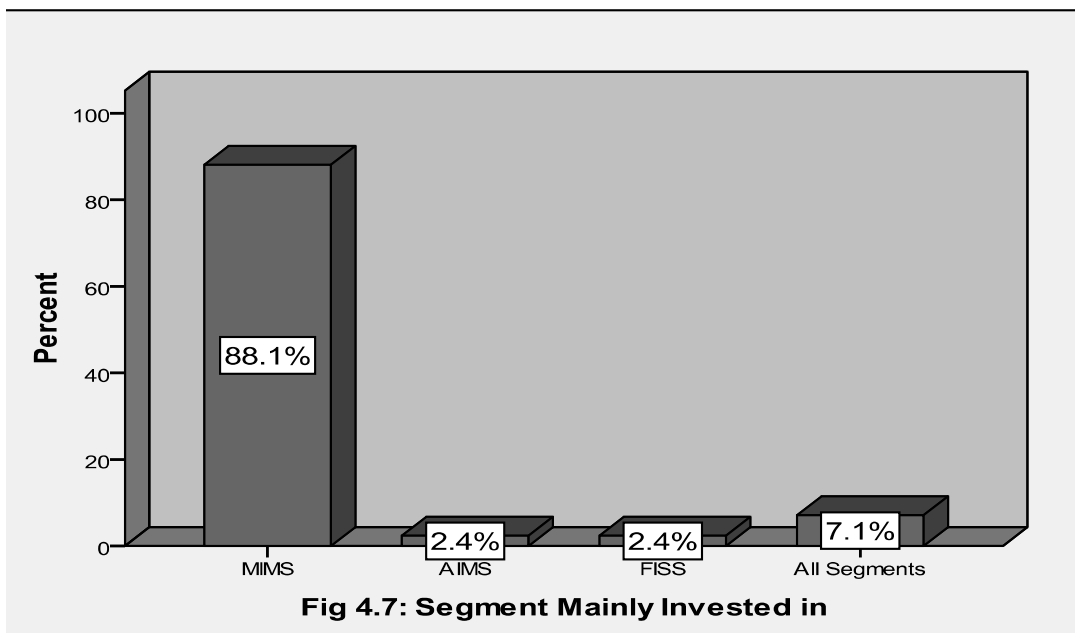
The respondents gave a list of answers when asked what they thought the role of NSE in the economy was; the answers as shown above indicate that a majority of them at 28.6% were of the opinion NSE main role was to raise capital for listed companies in the bourse followed at 21.4% of those who thought NSE acts as a regulatory body for the bourse. Encouraging saving and giving Kenyans ownership in local companies was quoted by 14.3% apiece of the sample while assisting in the country's development was cited by 11.9% of the respondents. Other roles cited included helping to gauge performance of listed companies and creating employment.

4.5 Segmentation

4.5.1 Favoured Segment

The sample was subjected to a segmentation question in terms of being asked to state the investment segment they preferred in the bourse and the results were as illustrated in the figure below.

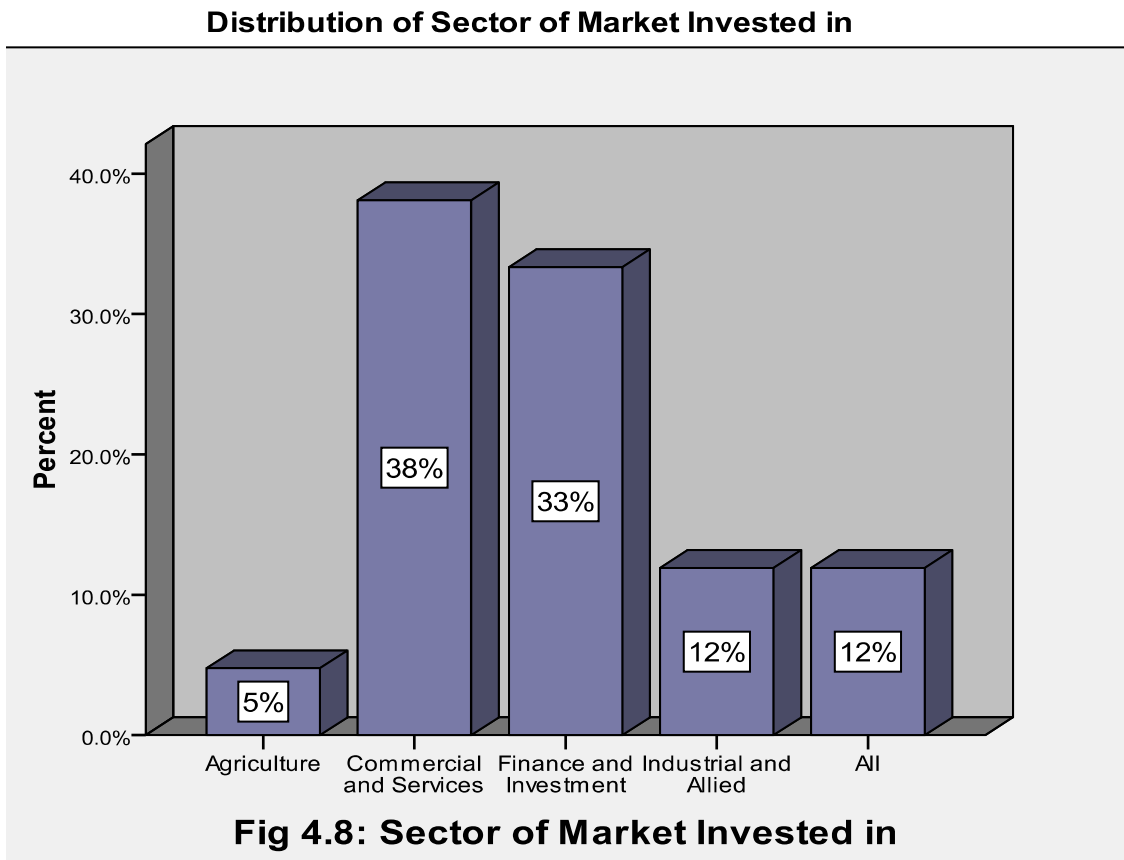
Distribution of Segment Mainly Invested in



The main market segment (MIMS) was quoted by 88.1% of the sample as their preferred investment segment in the NSE followed by those who invested in all segments. Alternative investment markets (AIMS) and fixed income security segment (FISS) were quoted by the least number of people at 2.4% each.

4.5.2 Favoured Sector

The graphical representation below gives a breakdown of the distribution of the sample in terms of the sector they most favoured for investment in their respective investment segments.



Commercial and services was the favoured sector by many at 38% followed by finance and investments at 33%. Twelve percent of the interviewees indicated

they invested in industrial and allied with 5% investing in the agricultural sector and another 12% saying they invested in all the mentioned sectors.

4.5.3 Reasons for Preferred Segment and Sector

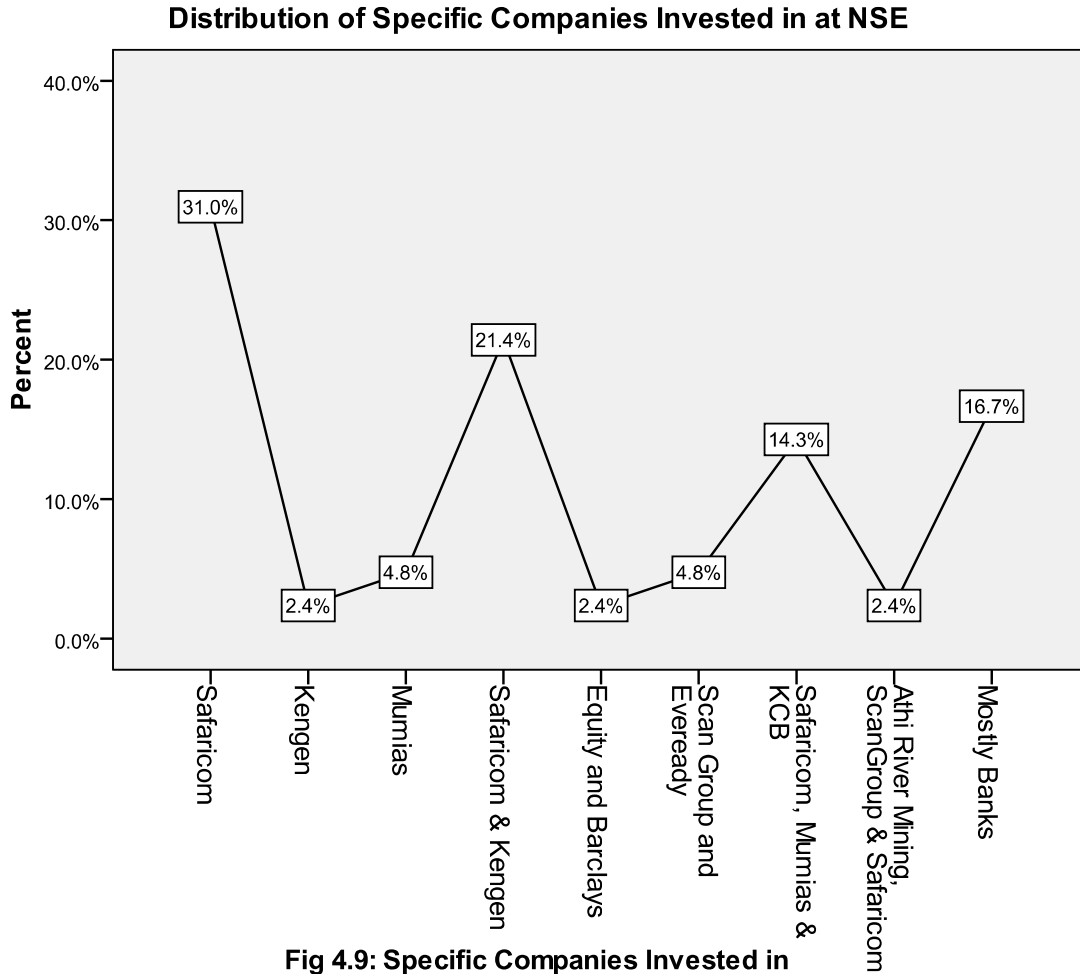
The respondents when asked why they preferred their cited segments and sectors had a number of reasons to give as tabulated distribution wise below in table 4.

Table 4: Reason for Investing in that Sector		
Reason	Distribution	
	Frequency	Percent
High Returns	16	38.1%
Because its Market Driven	10	23.8%
For Diversification Purposes	4	9.5%
Stability of the Sector	8	19.0%
Speculation	4	9.5%
Total	42	100.0%

The reasons quoted are therefore as listed in table above together with their respective distribution.

4.5.4 Companies Invested in

The sample when asked to list the companies listed in the NSE which they had invested in listed a good number of them as shown in the graph below and with varying distribution as illustrated.



Safaricom had the highest number of respondents investing in it individually at 31% followed by Mumias and Kengen. In combination, Safaricom and Kengen were listed by 21.4% followed by mostly banks at 16.7%. The rest consisted of combination of banks and other service industry companies listed in the NSE.

4.5.5 Investors Feelings about NSE Future

The respondents when asked what their feelings were regarding the future of the NSE had various responses varying from promising to unpredictable. The graph below shows the percentage distribution of these feelings as cited by the respondents.

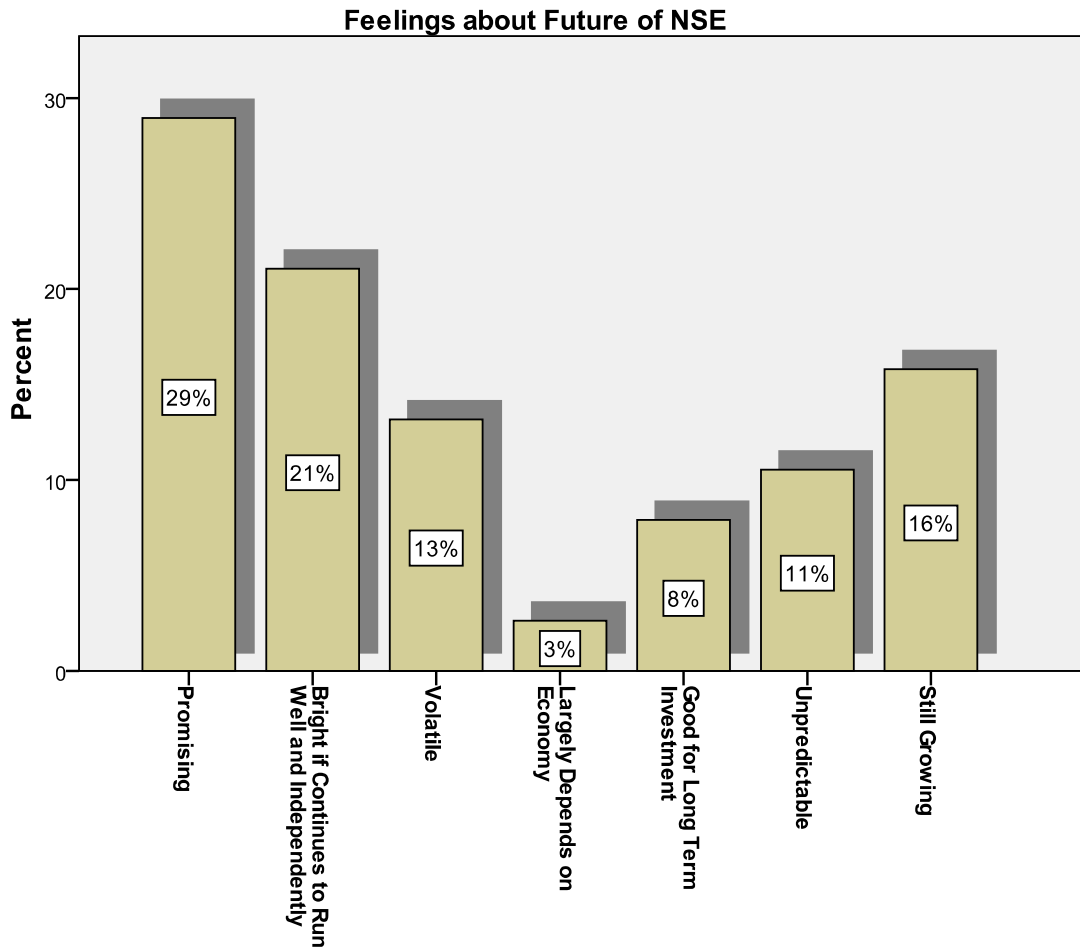


Fig 4.10: Feelings about Future of NSE

From the above graph, 29% of the respondents felt the future of NSE was promising with another 21% also saying it was bright if it continued to be run as independently as it is run now. Thirteen percent felt it was volatile and another 11% thought it unpredictable. Others (16%) felt it was still growing and that it largely depended on the performance of the economy (3%). The remaining 8% felt NSE was a good place for long term investments.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMENDATIONS

5.1.1 Summary

This research has been designed to investigate the factors that motivate local individual investors to invest in shares of companies quoted at the NSE. The target population comprised all local individual investors in ordinary shares of Companies quoted at the NSE. The study sample was randomly selected from various individual shareholders who included; MBA students from the University of Nairobi, using closed and open ended questions in questionnaire. The major contribution of this study has been its findings that answered research objective as formulated earlier in the research.

5.1.2 Conclusion

Although the NSE was ranked eighth among the best performing exchanges in Africa ICEA (2006), this institution needs to restructure and decentralize its operations not only to move to the top position in Africa, but also to enable the local investors to participate in stock trade. For investors to make sound investment decisions they need the necessary information that will enable them assess the viability of the investment owing to uncertainties arising from economic, political, social and technological forces because these uncertainties can expose investors to risks that could amount to loss of large amount of funds.

Investing in securities is one of the smartest forms of investment where investors can realize gains without incurring operation and administration costs associated with running a business. The following are the researcher's recommendations:

- i. Adoption of an online system, with the automation of trading at the NSE, a step further should be taken to adopt a system where investors can open

- CDS accounts, sell & buy their shares, enquire about their records from any part of the world.
- ii. Reviewing regulations governing the NSE, this will involve passing a legislation that will give the CMA the powers to totally oversee the activities of the NSE so as to curb insider trading.
 - iii. Taxation of excess Capital gains, the government through parliament should consider revising tax laws thereby ensuring that the few investors who make supernatural gains at the NSE are taxed as a means of allowing small scale investors to expand their investments and potential investors to come into the market. This can only be realized if the large investors give up some of their shareholding to reduce their tax liability.
 - iv. Promotion of local participation, the study found out that most Companies listed at the NSE are foreign if not controlled by foreigners as majority shareholders. This can be achieved by ensuring that listed Companies are at least 50% owned by indigenous Kenyans.
 - v. Setting up a second Stock Exchange, as in the case of USA where there exist the NYSE and the ASE, such a stock exchange will compete with the NSE making it more sensitive to the needs of its investors.
 - vi. Valuation of stocks should be highly standardized, there have been complaints that the NSE 20 share Index is not up to the international standards, NSE should consider emulating standards set by international rating agencies such as Standard & Poor's and Moody's .This will promote and sustain investor confidence.
 - vii. Corporate governance practices, the NSE should consider subjecting its management team frequent management training so as to maintain quality performance of the institution.
 - viii. Faster settlement of deals, currently if an investor disposes his/her shares it takes a week before the actual payment is made, this should be revised to the convenience of investors.

- ix. Public awareness campaigns, the NSE should educate the public on the investment opportunities available at the NSE thereby enabling them to reap the underlying benefits associated with such investments.

5.2 Limitations of the Study

Time constraints; the period for the study was limited to one semester only. Additionally there is inadequate literature addressing the research topic. The researcher also encountered the problem of procrastination from respondents who took too long to fill and return the questionnaires.

5.3 Recommendations for further Research

The researcher suggested that further research should be done in the following areas as concerns investment in securities.

- i. Factors that motivate investors to dispose off their investments in securities of companies quoted at the NSE.
- ii. The impact of listing a company in the NSE on its profitability and performance in the industry.
- iii. The reasons that prompt investors to invest in fixed income securities (treasury bills and bonds)
- iv. This study should be replicated say after five years to determine deviations from the current findings.
- v. Further research should also be conducted on factors considered by investors in preference shares.

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APPENDIX I

LETTER OF INTRODUCTION

October 19th, 2010

Dear Sir/Madam,

RE: ACADEMIC RESEARCH PROJECT

I am undertaking Master of Business Administration (MBA) students from the University of Nairobi. As a partial fulfillment of the award of MBA degree, the university expects me to submit a research project on the factors that motivate local individuals to invest in securities.

To achieve this mission, I intend to conduct a case study titled “ *A SURVEY ON THE FACTORS THAT MOTIVATE LOCAL INDIVIDUAL INVESTORS TO INVEST IN SHARES OF COMPANIES QUOTED AT THE STOCK MARKET (NSE)*” It is hoped that the findings will contribute to the pool of knowledge as well provide an insight to anyone interested in buying shares.

I am therefore writing to request you for an appointment to see you in your place of engagement for formal discussion during which I or my research assistants will leave the questionnaire with you for a formal interview. All information obtained through this questionnaire will strictly be used for academic purposes and will be treated confidential.

Yours truly,

Erick Pudha

Student

H. Ondigo

Supervisor

APPENDIX II

QUESTIONNAIRE FOR THE RESPONDENTS:

A: INVESTOR PROFILE

Kindly tick the space, [] provided with the correct answer or give the required information. For others please specify and elaborate

1. Name (optional)_____

2. Gender

- Male [] Female []

4. What is your age bracket?

- Between 18-25 years []
- Between 26-30 years []
- Between 31-40 years []
- Between 41-55 years []
- Above 55 years []

5. For how long have you invested in shares?

- Less than 5 years []
- Between 6-10 years []
- Between 11-15 years []
- Between 16-20 years []
- Between 21-25 years []

6. Range of shares held;

- Between 1,000-5,000 []
- Between 5001-10,000 []
- Between 10,001-50000 []
- Above 50,000 []

B: INVESTOR MOTIVATION

1. In the matrix below are some of the possible factors that motivate investors to invest in shares. List the extent to which each of the factors listed in the matrix motivated you to invest in shares.

The numbers in the matrix represent the following;

1-Not at all

2-To a less extent

3-Moderate

4-To a great extent

5-To a very great extent

Factor	Rating				
	1	2	3	4	5
1. To earn dividends					
2. To earn capital gains					
3. Profitability of the company					
4. Liquidity position of the company					
5. The asset structure of the firm					
6. Monetary and fiscal policies of the government					
7. To earn bonus					
8. The competitiveness of the company in the industry					
9. The caliber of top management of the company					
10. The responsiveness of the firm to new technology					

2. List other factors that motivated you to invest in the shares of the companies quoted at the Nairobi Stock Exchange.

Factor	Rating				
	1	2	3	4	5
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					

3. Did you purchase your shares through an IPO?

- Yes [] No []

If yes, can you explain?

.....

If no, can you explain?

.....

4. In your opinion what are the roles of the NSE to the Kenyan economy?

- i.
- ii.
- iii.
- iv.

C: OVERALL

1. Which segment have you invested in?

- Main market segment []
- Alternative investment market segment []
- Fixed income security segment []

2. Which sector in the Main market segment have you invested in?

- Agricultural []
- Commercial and Services []
- Finance and Investments []
- Industrial and allied []

Explain briefly why?

.....
.....

3. List the companies have you invested in their shares in the above categories?

.....
.....
.....
.....

4. What is your feeling about the future of the NSE? Elaborate.

.....
.....