

**AN INVESTIGATION OF THE FACTORS INFLUENCING THE  
DEVELOPMENT OF CORPORATE BONDS MARKET: THE CASE  
OF KENYAN FINANCIAL MARKET**

**BY**

**JAMES ALEX MALOBA WERE**

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## **DECLARATION**

This is to declare that this paper is my original work and has not been presented for the award of any degree in any University.

Signature: ..... Date: .....

**NAME: JAMES ALEX MALOBA WERE**

**REG NO: D61/70627/2008**

## **APPROVAL**

This Management Research project has been submitted for examination with my approval as the University supervisor

Signature: ..... Date: .....

**NAME: MR. J. L. BARASA**

**LECTURER**

**DEPARTMENT OF FINANCE AND ACCOUNTING**

**UNIVERSITY OF NAIROBI**

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To God Almighty, Thank You Very Much

## **DEDICATION**

*To my parents Mr. Gerald Were & Mrs. Mary Were*

*Whose love for education is beyond reach*

*Who believes so much in education and spend their life educating their family and other  
in society*

*And*

*To the rest of my family*

*Who constantly encouraged me to finish this research project*

## **ABSTRACT**

The role of corporate bonds in achieving the vision 2030 cannot be down played. Corporate bonds are considered as the source of diffusing stresses on the banking sector by diversifying credit risks across the economy, interest rate and refunding risk, Supplying long-term funds for long-term investment needs, lowering funding costs by avoiding a liquidity premium and providing products with flexibility to meet the specific. The main aim of this study was to investigate the corporate bond market development in companies listed in the NSE.

This study was descriptive in nature and a census method was used since the aim of this study is to investigate the factors influencing the development of corporate bonds market in Kenyan financial market. The researcher targeted the top management especially in the area of accounts, operations or finance. Data collected from respondents was both quantitative and qualitative in nature and analyzed using descriptive statistics. On the other hand, qualitative data was analyzed using factor analysis.

Based on findings, companies listed in NSE face the corporate bond market development challenge through inadequate disclosure of information on public debt issuance and statistics measures. The companies have insufficiently dealt with establishing repurchase (repo) market as well as setting up issuance calendars to improve transparency. Therefore, regulatory frame work in Kenya as advisory services should be enhanced to mitigate critical challenge to information availability as well as formulating policies to effectively enable, disclosure of information on public debt issuance and statistics measures.

## TABLE OF CONTENTS

Declaration .....	ii
Acknowledgement .....	iii
Dedication .....	iv
Abstract .....	v
Table of Contents .....	vi
List of Tables .....	ix
List of Figures .....	x
List of Abbreviations and Acronyms .....	xi
<b>CHAPTER ONE .....</b>	<b>1</b>
<b>INTRODUCTION.....</b>	<b>1</b>
1.1 Background of the Study.....	1
1.1.1 Companies Listed in the NSE.....	3
1.2 Statement of the Problem .....	4
1.3 Objectives of the Study .....	6
1.4 Importance of the study.....	6
<b>CHAPTER TWO .....</b>	<b>8</b>
<b>LITERATURE REVIEW .....</b>	<b>8</b>
2.1 Introduction .....	8

2.2	Theoretical Review .....	8
2.2.1	Agency theory .....	8
2.2.2	New institutional economics .....	9
2.2.3	Stakeholder theory .....	9
2.3	Empirical Review .....	10
2.4	Challenges to the development of corporate bond market .....	14
2.4.1	Under development of the stock market .....	14
2.4.2	Liquidity problems .....	15
2.4.3	Poor Information Flow .....	16
2.4.4	Crowding-out of issues and investors .....	18
2.4.5	Low professional advisory services .....	20
2.4.6	Poor regulatory environment .....	21
2.5	Conclusion .....	24
<b>CHAPTER THREE .....</b>		<b>25</b>
<b>RESEARCH METHODOLOGY .....</b>		<b>25</b>
3.1	Introduction .....	25
3.2	Research design .....	25
3.3	Target population and sample size .....	25
3.4	Data collection .....	26
3.5	Data Analysis .....	27

<b>CHAPTER FOUR.....</b>	<b>28</b>
<b>ANALYSIS AND INTERPRETATION .....</b>	<b>28</b>
4.1    Introduction .....	28
4.2    Demographic information .....	28
4.3    General Findings .....	30
4.4    Factor Analysis.....	37
<b>CHAPTER FIVE .....</b>	<b>43</b>
<b>SUMMARY, CONCLUSIONS AND RECOMMENDATIONS .....</b>	<b>43</b>
5.1    Summary and Findings.....	43
5.2    Conclusion.....	44
5.3    Recommendations .....	45
5.4    Suggestions for further studies .....	46
<b>REFERENCES.....</b>	<b>47</b>
<b>APPENDICES .....</b>	<b>51</b>



## LIST OF TABLES

Table 4.1: Gender of the respondents .....	28
Table 4.2: Length of time the company has been in existence .....	30
Table 4.3: Segments/section in which company is listed on the NSE .....	30
Table 4.4: Whether the company has issued any debt instruments .....	31
Table 4.5: Type of debt instruments issued by the company .....	31
Table 4.6: Whether the measures are being implemented in order to improve the liquidity of secondary markets .....	33
Table 4.7: Whether the company raised its long-term debt finance .....	34
Table 4.8: How significantly factors influences the attractiveness of the corporate bonds in the Kenyan financial markets .....	36
Table 4.9: Total variance explained for analysis on measures .....	37
Table 4.10: Rotated component of matrix measures .....	38
Table 4.11: Total variance explained of extent of agreement .....	39
Table 4.12: Rotated component matrix on extent of agreement .....	40
Table 4.13: Total variance explained on influence on bond market .....	40
Table 4.14: Rotated component matrix on influence on the bond market .....	41

## **LIST OF FIGURES**

Figure 4.1: Age of the respondents .....	29
Figure 4.2: Highest level of Education .....	29
Figure 4.3: Whether the company has raised long term debt through bonds in the last five years.....	32
Figure 4.4: Number of times the company has raised Debt capital in the last five years.	32
Figure 4.5: Whether there is a Regulatory frame work in Kenya.....	34
Figure 4.6: Stock Market is Attractive enough for issuing debt finance .....	36

## **LIST OF ABBREVIATIONS AND ACRONYMS**

OTC	-	Over-The-Counter
YTM	-	Yield to Maturity
YTC	-	Yield to Call
PTA	-	Preferential Trade Area
MTN	-	Medium Term Notes
CMA	-	Capital Market Authority
NSE	-	Nairobi Stock Exchange
GDP	-	Gross Domestic Product
GMM	-	Generalized Method of Moments
ABF	-	Asian Bond Fund
IPO	-	Initial Public Offer
IMF	-	International Monetary Fund

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

In any economy, a financial market is a mechanism that allows people to buy and sell (trade) financial securities (such as stocks and bonds), commodities (such as precious metals or agricultural goods), and other fungible items of value at low transaction costs and at prices that reflect the efficient-market hypothesis. In financial markets it is usual to price financial instruments relative to comparable investment alternatives (relative pricing) (Sand, 2000). When pricing a bond, one can use the market rate of comparable bonds as the basis, and price components that are specific to the individual bond. For example, the yield on a corporate bond could be priced as the yield on a government bond of the same duration with a premium corresponding to the credit and liquidity risk associated with the corporate bond. Corporate bonds are debt securities issued by private and public corporations (Roldos, 2004).

Companies issue corporate bonds to raise funds for a variety of purposes, such as building a new plant, purchasing equipment, or growing the business. A purchaser or “holder” of a corporate bond is a lender of funds to the "issuer," the company that issued the bond. In exchange, the company promises to pay back the face value of the bond, also known as "principal," on a specified maturity date. Until that date, the corporation usually pays interest at a stated rate, generally semiannually. While a corporate bond gives the investor creditor rights in the company, the holder does not have ownership interest in the issuing company unlike a shareholder of a company's stock (Reszat, 2003). The bonds of local authorities and supranational organizations do not fit in either category. Corporate bonds are often listed on major exchanges (they would be called "listed" bonds) and ECNs like Market Axess, and the coupon (i.e. interest payment) is usually taxable. Sometimes this coupon can be zero with a high redemption value. However, despite being listed on exchanges, the vast majority of trading volume in corporate bonds in most

developed markets takes place in decentralized, dealer-based, over-the-counter markets (Roldos, 2004).

Some corporate bonds have an embedded call option that allows the issuer to redeem the debt before its maturity date. Other bonds, known as convertible bonds, allow investors to convert the bond into equity. One can obtain an unfunded synthetic exposure to corporate bonds via credit default swaps. There are a variety of bond types that can be issued which includes: convertible bonds, zero-coupon bonds, floating rate bonds, variable /adjustable bonds, callable bonds, step up bonds, and step down bonds. However underlying institutional constraints restrict growth of corporate bond markets yet there has been little analysis of these factors (Roldos, 2004).

Worldwide, the majority of transactions in corporate bonds is conducted in the over-the-counter (OTC) market, while certain bonds are also listed on the Stock Exchanges. There are several yield figures to consider when evaluating a bond offering; these different yields take into consideration the coupon rate, the purchase price and the number of years to a bond's maturity or call date. Yield to maturity (YTM) represents the return an investor will receive if the bond is held to term. Yield to call (YTC) is the return earned if a bond is called prior to maturity.

The bond market in Kenya especially in the open market is not well developed. Over the years since 2001, only a few firms like Preferential Trade Area (PTA) bank – (720 million), Faulu Kenya (750 million), East Africa Development (1.134 billion), Shelter Afrique (133 million), Barclays bank (1000m), and Athi River Mining (800 million) and Sasini Tea (600 million) have floated medium term notes (MTN) through the Nairobi stock exchange – (April,2008). In 2009 Kengen issued an infrastructure bond (10 billion) for geothermal development. Many of the listed companies at the exchange have shied away from raising debt capital through market. The performance of the bond market has been poor as witnessed by a decline of 18.75% from shs. 40.1 billion to a turnover of only shs. 34.1 billion in 2004. The year 2005 witnessed the biggest decline in the turnover in the market of about 60.16% from shs. 34.1billion to shs 11.59 billion. During this period, the economy of Kenya was growing while the debt market was not. This

trend is curious and points to a problem in the market for fixed income securities and especially with regard to corporate debt securities (bond) (The NSE Handbook, 2008-2009).

### **1.1.1 Companies Listed in the NSE**

A stock market is a place where securities are traded. These securities are issued by listed companies and by the government, with the aim of raising funds for different purposes such as to fund expansion for the former, and development and finance budget deficits for the latter. Common securities traded on a stock exchange include company shares, corporate bonds, and government debt in the form of treasury bonds. The Nairobi Stock Exchange which was formed in 1954 as a voluntary organization of stock brokers is now one of the most active capital markets in Africa. The administration of the Nairobi Stock Exchange Limited is located on the 1st Floor, Nation Centre, Kimathi Street, Nairobi (The NSE Hand book 2008 -2009).

Companies quoted in the Kenya's Nairobi Stock Exchange (NSE) are diverse and are segmented as agricultural, commercial and services, finance and investment and industrial and allied, which forms the main investment market (MIM) comprising of forty companies. There is also the alternative investment market (AIM), which is considered a less active counter, with only eight quoted companies. Finally, there is the fixed income securities market segment comprising of only one quoted company. In summary, there are fifty four companies quoted in the NSE, twelve of them are group companies with a total of twenty seven subsidiaries operating in Kenya (The NSE Handbook, 2008-2009).

Publicly quoted companies are either single business or multi-business. Group or holding companies constitute subsidiary undertakings, this being multi-business companies which the group has either direct or indirect interest of more than 50 per cent or those in which it has power to exercise control over their operations. However, there are numerous companies in the NSE which have several subsidiaries but they do not refer themselves as "Groups" or "Holdings" companies. Companies adopt diversification strategy due to various motives, among them, to increase stock value of the firm, increase its growth rate, make better use of funds than internal investment, revenue earnings, and improve

stability and to increase efficiency and profitability. Diversification strategy therefore makes a company to change its structure from a single business to multi-business company where it is suppose to play the role of a parent. Depending on how it plays this new role, it can either create or destroy the value of its business units (The NSE Handbook, 2008-2009).

Majority of the publicly group quoted companies in Kenya have somewhat diversified on the areas related to their core businesses, a feature common to especially companies in the media industry. A few of these have also established subsidiaries in the East African region, in an effort to exploit opportunities created by the regional economic integration initiatives. Listing is the process of taking a privately owned organization and transforming it, into a publicly owned entity whose securities (equity or debt) can be traded on a securities exchange. As of December 2008, 52 companies and 67 government bonds were listed on the NSE. 48 companies have floated over 8 billion shares valued at over Kshs 900 billion. The remaining 4 companies have listed bonds worth Kshs 12 billion (The NSE Hand book 2008 -2009). The stock market consists of both the primary and secondary markets. In the primary or new issue market, shares of stock are first brought to the market and sold to investors. In the secondary market, existing shares are traded among investors (Ross *et al*, 2000).

## **1.2 Statement of the Problem**

The role of corporate bonds in achieving the vision 2030 cannot be down played. Corporate bonds are considered as the source of diffusing stresses on the banking sector by diversifying credit risks across the economy, Diffusing foreign exchange, interest rate and refunding risk, Supplying long-term funds for long-term investment needs, Supplying long-term investment products for long-term investors, Lowering funding costs by avoiding a liquidity premium Providing products with flexibility to meet the specific needs of investors and Borrowers, Allocating capital more efficiently, and Reducing reliance on foreign funds, the flow of which can be highly volatile (Bhaumik *et al*, 2003). Herring and Chatusripitak (2001) and PECC (2004/5) for example, argue that bond markets are central to the development of an efficient economic system, and there would

be additional significant benefits if bond markets are developed. They provide greater investment opportunities for both retail investors and financial institutions, and help deepen financial markets. This is particularly the case if foreign investors are attracted.

Then the question arises, the economic growth of Kenya is not balanced looking at all the sectors of the economy. Could this unbalanced growth be explained by having under developed corporate bond market? And how should the governance ensure a well distributed development of the economy?

Corporate bonds market development as a possible cheaper source of medium and long term debt financing has not been significantly exploited in Kenya. Though corporate bonds market is largely under developed given the “third world” economic tendencies for Kenya, this study hopes to specifically establish if market benchmarks, infrastructure, regulation, policy, local and foreign investor base coupled with corporate governance and transparency could be inhibitors to corporate bonds market development at Nairobi Stock Exchange (Bhaumik *et al*, 2003).

Past studies have attempted to establish the relationship between corporate bonds and different financial parameters. For example, Maditinos *et al*. (2007) examined the techniques and methods used by six different groups of Greek investors: official members of the Athens Stock Exchange, mutual fund management companies, portfolio investment companies, listed companies, brokers, and individual investors. Roldos *et al* (2004) examined emerging local bond markets in emerging local securities and derivatives markets. The aim of this study is to test alternative theories of corporate hedging and determine which of them accurately identify determinants of hedging.

Locally, Okoola (2006) did an investigation into the actual investment performance of bonds listed at the NSE .While Gakuru (2004) on the other hand looked at the Relationship between stock returns & bond returns in the NSE. All these mentioned studies however failed to establish the factors that determine corporate bond market development at the NSE.



This study is therefore intended to identify the main shortfalls for corporate bond market under development in Kenya. The vision 2030 to become a reality all Kenyans should be involved. The corporate bond market should be one of the main sources for the financing of the vision 2030 and this shall create such an avenue for citizens' involvement. Consequently a thorough study on the existing void shall be of great validity to help in making the Kenyan corporate bond market grow and contribute to economic development and the vision 2030.

### **1.3 Objectives of the Study**

- i. To determine the extent to which corporate market bond is developed in at NSE
- ii. To determine factors influencing bond market development at the NSE

### **1.4 Importance of the study**

This study is important to the following;

#### **Corporations**

The study will enlighten management of corporations on bottlenecks to cheaper financing options through issuance of corporate bond at NSE that lead to over dependence on traditional bank loans and overdrafts. Cheaper business financing opportunities through issuance of medium and long term corporate bonds would help in containment of cost of debt and improve shareholder value.

#### **Policy Makers**

These include stock market regulators (CMA and NSE) and the government. The study will highlight impediments experienced by issuers of corporate bond to the regulators who can use the information to remove barriers to entry and create an enabling environment for a vibrant corporate bond market through formulation of an informed regulatory framework. The relevant Ministry of Finance can benefit from the study to aid legislative agenda, policy formulation and implementation.

### **Financial Analysts and Stock Brokers**

Since these benefit from, and have a role to play in realization of a vibrant corporate bond market, the research study will make recommendation on likely issues that need to be addressed to expand the corporate bond market and make it efficient and vibrant. In addition, finding in this research shall contribute to their understanding and application of their skill in digging for information from financial audit reports and provide the right framework for corporate bond development.

### **Researchers and Academicians**

The academicians in the fields of Finance, Accounting and Investment shall benefit from this research as it shall provide them with various important facts. To finance academicians, the finding shall shed some light on corporate bond market characteristics in the Kenyan stock market and further be studied in future. For the Accountants, they shall gain an inside on how the accounting factors count much on the decisions about investing in a firm. The investment scholars, from the finding, they shall get the understanding of the relationship between risk and return and how the development of corporate bond market will help in wealth diversification and management.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The chapter review literature on corporate bond markets and the necessary conditions relevant to the development of bond markets. Specific literature is reviewed on factors affecting issuance of bonds such as market benchmarks, market infrastructure, regulation and policy, local and foreign investor base, corporate governance and transparency. A conceptual framework is then provided as derived from the stated problem and augmented by the relevant literature review.

#### **2.2 Theoretical Review**

##### **2.2.1 Agency theory**

Agency theory extends the analysis of the firm to include separation of ownership and control, as well as managerial motivation. In the field of corporate risk management, agency issues have been shown to influence managerial attitudes toward risk taking and hedging (Smith and Stulz, 1985). Agency theory also explains a possible mismatch of goals between shareholders, management and debt-holders caused by asymmetries in earnings distribution, which can result in the firm taking too much risk or not engaging in positive net value projects (Mayers and Smith, 1987). Consequently, agency theory implies that defined hedging policies can have important influence on firm value (Fite and Pfleiderer, 1995). Managerial motivation factors which influence the implementation of hedging have been investigated empirically in a few studies to an overall negative effect (Faff and Nguyen, 2002). Notably, positive evidence was found by Tufano (1996) in his analysis of the gold mining industry in the USA.

### **2.2.2 New institutional economics**

New institutional economics theory is investigated empirically in the context of corporate hedging in this study for the first time. New institutional economics shifts the focus to governance processes and socio-economic institutions that guide these processes, as explained by Williamson (1998). Although no empirical studies of the new institutional economics approach to risk management have been carried out so far, this theory offers an alternative explanation of corporate behaviour. Namely, it predicts that risk management practices may be determined by institutions or accepted practice within a market or industry. In emerging markets, as managers and investors become more educated and institutions that support hedging develop, it can be expected that hedging will gain popularity with time. Moreover, the theory links security with specific assets purchase (Williamson, 1987). This implies that risk management can be important in contracts that bind two non-diversified parties, such as large financing contracts or close cooperation within a supply chain.

### **2.2.3 Stakeholder theory**

Stakeholder theory, originally developed by Freeman (1984) as a managerial instrument, has since evolved into a theory of the firm with high explanatory potential. Stakeholder theory focuses explicitly on an equilibrium of stakeholder interests as the main determinant of corporate policy. The most promising contribution to risk management is the extension of implicit contracts theory (a part of stakeholder theory) from employment to other contracts, including sales and financing (Cornell and Shapiro, 1987). In certain industries, particularly high-tech and services, consumers' trust in a company can substantially contribute to the company's value (*H4a*). The value of implicit claims is highly sensitive to expected costs of financial distress and bankruptcy. Since corporate risk management practices lead to a decrease in these expected costs, company value rises (Klimczak, 2005). The more sensitive a company's value is to financial distress, the higher the motivation for hedging. Nevertheless, stakeholder theory has not been tested directly yet. Investigations of the financial distress hypothesis (Smith and Stulz, 1985) provide only indirect evidence (e.g. Judge, 2006).

### **2.3 Empirical Review**

Most studies on the growth effect of specific types of private capital flows focus on the overall effects of corporate bonds on an economy and little have looked at the factors influencing corporate bond market development. Firm-level studies of particular countries provide contradictory evidence on the role played by corporate bonds in economic growth. Willmore (1986), looking at a sample of 282 pairs of firms belonging to 80 industries in Brazil, finds that corporate bonds has a beneficial impact on growth, since foreign firms are more efficient than domestic ones. Moreover, Blomstrom (1986) finds that corporate bonds enhance productivity growth of Mexican sectors. On the other hand, Haddad and Harrison (1993) find no evidence of positive spillovers from corporate bonds in Morocco. Aitken and Harrison (1999) get a similar result with respect to Venezuela in the period 1979-1989.

A large body of literature has documented the relationship between stock market developments,

investment, and growth, with different metrics for stock market development, including the value of stock market as a share of GDP, value of shares traded as percent of GDP, value of shares traded as a share of market capitalization (turnover), the number of listed firms divided by GDP, and the number of listed firms per million of population. Atje and Boyan (1993) found a significant correlation between economic growth and the value of the stock market as a share of GDP for 40 countries during the period 1980–88. Lynch (1995) also observed a positive relationship between stock market capitalization and investment efficiency and growth. Henry (2000) found a strong link between the growth rate of investment and changes in stock market valuation measured as returns on stock market, turnover, and value of shares traded divided by GDP. Wurgler (2000) found that the size of stock market measured as stock market capitalization to GDP is positively associated with increased investment.

Research on the link between bond issuance and stock market development in SSA point to conflicting conclusions. Osinubi and Amaghionyeodiwe (2003) and Ndebbio (2004) did not find any significant relationship between stock market capitalization to GDP and

economic growth for Nigeria and SSA countries. However, Yartey and Adjasi (2007) found that the stock market development measure of total value of shares traded relative to GDP, had a positive statistically significant relationship with growth along with investment and past growth levels.

Roldos *et al* (2004) examined emerging local bond markets in emerging local securities and derivatives markets. The aim of this study is to test alternative theories of corporate hedging and determine which of them accurately identify determinants of hedging. The dataset for this study comprises annual report data for 150 Polish listed companies in the period 2001-2005. During this period Polish companies were already accustomed to the rules of a free-market economy, and were continuing to develop their financial management practices. They had ready access to derivatives, and were subject to national regulation based on International Accounting Standards 32 and 39. However, only one third used hedging, far fewer than in developed European or overseas markets. There is no evidence that the frequency of hedging was growing with time, nor that Poland's accession to the European Union in 2004 influenced hedging behaviour. Since hedging is less popular in Poland than in the USA, the UK or Germany, the investigation of Polish listed companies provides a new insight into determinants of corporate hedging.

Mirshekary and Saudagaran (2005) assessed how different users of financial statements use the information items disclosed in the annual reports, as well as the importance of financial bond investments. They distributed a questionnaire to seven different groups of users of financial statements in Tehran including stockbrokers, bank investment officers, and institutional investors. In general, respondents ranked the annual reports as the main influential source of information to make investment decisions. The second most influential source of information was oral information and the third was published daily share price. On the other hand, the respondents ranked the least influential factors in sequence of importance: advice of friends and acquaintances, tips and rumors, and stockbrokers' advice. Mirshekary and Saudagaran concluded that the annual reports are used regularly in Iran as a basis for making investment decisions.

Maditinos *et al.* (2007) examined the techniques and methods used by six different groups of Greek investors: official members of the Athens Stock Exchange, mutual fund management companies, portfolio investment companies, listed companies, brokers, and individual investors. The results revealed that on average the participants ranked their instinct/experience as the most important factor followed by fundamental analysis and the movement of foreign financial markets. Noise in the market and portfolio analysis was considered the least important.

Unlike the microeconomic evidence, macroeconomic studies generally suggest that corporate bonds exert a positive impact on economic growth in particular contexts. For example, Balasubramanyam *et al.* (1996) find that the effects on growth of corporate bonds are more significant in the presence of trade openness, and Borensztein *et al.* (1998) argue that corporate bonds is an important channel for the transfer of technology and contributes to economic growth when the country has a highly educated workforce. In turn, Alfaro *et al.* (2003) find that corporate bonds are beneficial for economic growth when the country has sufficiently developed financial markets. However, Levine and Carkovic (2002) conducted a Generalised Method of Moments (GMM) panel analysis on pooled data from 72 countries in the period 1960-1995 and suggest that corporate bonds flows do not exert a positive impact on economic growth.

Very few studies examine the growth effect of portfolio equity flows. Bekeart and Harvey (1998; 2000) find that portfolio equity inflows increase economic growth in 14 out of 19 lower-income countries under study. Durham (2004) suggests that portfolio equity flows promote economic growth in countries with relatively large equity markets and limited corruption. Levine and Carkovic (2002), instead, find that portfolio inflows have no impact on economic growth.

Locally, there is very little specific study on corporate bonds. This category of capital inflows is fully taken into account in recent studies investigating simultaneously the growth impact of different types of capital flows. Gakuru (2004) looked at the relationship between stock returns & bond returns in the NSE. The results indicated that there is direct relationship between the two and also a big effect on economic growth. On

the other hand, Okoola C.A. (2006) did an investigation into the actual investment performance of bonds listed at the NSE. He found that only developing countries that have reached a minimum level of economic development and absorptive capacity are able to capture the growth-enhancing effects of both forms of investment inflows through bonds.



## **2.4 Challenges to the development of corporate bond market**

### **2.4.1 Under development of the stock market**

The capital market is crucial for the trading purposes of these securities. In an economy where the capital market is developed in terms of depth of securities, the trading in corporate bonds excels. In order to verify the extent of depth (or lack of depth, to be specific) of the secondary corporate bond market, the study shall investigate the bond concentration ratio for frequency of trading over time. To be precise, the focus shall be on the concentration ratio between corporate bonds and the stock market capitalization and corporate bonds with the government bonds.. Clearly, if the *corporate* bond concentration ratio turns out to be high in relation to capital market capitalization and government bonds value, one may safely conclude that the market has depth (Roldos, 2004).

An important class of investors that is missing from most African markets is foreign investors, including global financial intermediaries. In general, myriad market impediments discourage them from participating in the local markets. Among the impediments are withholding taxes and the lack of a market for hedging instruments, such as currency swaps. Policymakers in Africa are aware of these. In setting up the Asian Bond Fund 2 (ABF2), as (Roldos, 2004) explain, central banks in Asia were able to reduce some of these impediments. The Philippines, for example, recently removed documentary stamp taxes on the secondary trading of fixed income securities, which had discouraged foreign investors from participating in its local market.

In Kenya stock issues are done with restrictions on foreign investors in terms of the maximum shareholding allowed to them an indication that the Kenyan stocks market is still in the infancy stage because in the developed world. Although the East African Common market development expands the investor's scope for providing the financing needs of the corporations within the region. The debt financing through corporate bonds may be one of the financing options that are going to be developed (Roldos, 2004).

A diversity of investors fosters trading activity. With such diversity, it becomes less likely that different investors will find themselves on the same side of the market, either as sellers or buyers. They are more likely to disagree on the credit quality of an issuer and thus be more willing to trade, and they are less likely to need liquidity at the same time. In Kenya, such diversity seems to be rather limited. Here the investor base for corporate bonds tends to be dominated by government-controlled provident funds, insurance companies and banks. Once a bond is issued, it normally disappears into the portfolios of buy-and-hold investors. Those who might trade more actively, such as fixed income funds and hedge funds, are typically missing from these markets or are only allowed very limited credit risk exposures (Vuong, 1997).

#### **2.4.2 Liquidity problems**

There are two scenarios to look at liquidity; the borrower point of view and the investor point of view. The borrower (corporations) desires to get debt financing either from the banks or the general public. However the banks due to regulatory requirements are compelled to maintain a certain liquidity ratio. Due to portfolio management banks have specific thresholds to lending to various sectors of the economy. This acts as a hindrance to banks in meeting the developments needs in a country (Zervos, 2004).

From the investor point of view, he/she needs a security to hold maturity or for trading purposes. An investor is interested in understanding the number of buyers and sellers readily available in the market so as to cater for needs arising in the future. The investor liquidity therefore becomes crucial in decision making about in which security to invest. Chaos in banking sector in the late 1990s also means that commercial banks fail to address the financing need when they are most needed, justifying the motivation for firms to look up their ways, especially those belonging to the private sector (Mihaljek, 2002). The banking system in Kenya continues to provide loans based on the value of collaterals and guarantees by corporations. Plus, the fast-increasing credit needs in the growing economy of Kenya almost guarantees a shortage of credit capital in the future, at any time. The majority of private-sector firms and even state-owned ones continue to spend large amount of time on seeking additional debt finances. This is the fertile land for corporate bonds (Moody's Investor Service, 2002).

For the time being, Kenya Stock Market is only an infant. Any priority for this market should be place on generating liquidity in the initial years of operation. Fund raising through primary stock market would unlikely be of importance since we cannot expect major funds-raising through IPO or seasoned offerings. In addition, even if the Kenyan Stock Market could address the financing needs for listed firms, the growing population of small- and medium-sized enterprises would still not see this as a financing vehicle since the majority of them would not qualify for listing (Vuong, 1997).

Another fact is that other financing option like financial leasing could hardly become a very important alternative to bank loans (Vuong, 1997). This further exacerbates the overwhelming capital shortage in the economy. The underdevelopment of the equity market would likely continue for a while, despite the existence of a number of investments by funds in Kenya's emerging equity market. In fact, the majority of offshore investment funds have made loss over past five years in Kenya, and their shares are traded at deep discount on some international exchanges (Mathieson *et al*, 2004). Therefore, investments by funds would never be able to finance the big gap of needs, not to mention other conditions that make their *modus operandi* difficult for domestic enterprises to tap the finance. Clearly, the large and fast-growing debt financing needs of domestic enterprises and failure to address the need by the banking system, investment and finance firms would ultimately lead to the development of corporate bonds, as one of the major financing tools in the economy (IOSCO, 2004).

### **2.4.3 Poor Information Flow**

The focus is on how timely does information reach the potential investors in a target market? How literate is the Kenyan general public about corporate bonds? And another critical aspect is how the firms desiring to issue corporate bonds would assess sufficiency in the target market ability to avail the desired debt financing (Ball & Robin 2003). According to IMF, (2005) many corporate bond markets in Africa seem to have a limited flow of timely information about issuers. In markets such as those for corporate bonds, much liquidity can be generated by the activity of investors who disagree about fundamentals. Such information based trading provides spillover benefits to those who are in the market for purely liquidity reasons. And such trading tends to be active when

there is a significant flow of information about the credit quality of issuers, with every new piece of information creating a new reason to disagree (Herring *et al*, 2000).

In the United States, the flow of market-relevant information takes various forms. Issuers themselves provide quarterly financial reports and profit warnings; the financial press and information services report on major transactions and important corporate events, and credit rating agencies make various announcements about changes in their views about rated companies. Trading in corporate bonds tends to pick up around these information events. However, in developing countries such as Kenya accessibility to such information is limited and advisory services are not available thus posing a critical challenge to information availability (Baz *et al* 1999; IOSCO, 2002).

The market reactions to rating agency announcements illustrate the importance of timely information. Rating agencies have chosen to be very careful and deliberate about changing a credit rating, and hence rating changes tend to lag significantly the arrival of the relevant information in the markets. In their effort to be timely, rating agencies have devised “review” announcements – “Watch-list” in the case of Moody’s and “Credit Watch” in the case of Standard & Poor’s. These announcements are made immediately after the arrival of significant information, and they signal the possibility of a rating change within a few months. Micu *et al* (2004) have documented that price reactions to rating agency announcements are strongest for these review announcements. In Kenya the development of credit rating agencies started last year (2009) which is a right step. Much emphasis should be on fully fledged development to facilitate investor accessibility to important information about a corporation.

Such information flows are often more limited for example in Asian markets. A large number of issues carry one form of government guarantee or another, making the credit quality of the issuer on a standalone basis less relevant. In addition, Ball *et al* (2003) find a pattern in which financial reporting in some Asian markets tends not to recognize losses in a timely way. One reason given for this is the lack of incentives for timely reporting in the Asian context where personal networks in business are so important. Local credit rating agencies do exist in Asia, and often ratings are mandatory for bond issues. Many

such rating agencies, however, are quite new and need more time to develop a historical record on which to build a reputation. While a handful of foreign agencies are active in Asian markets, they often do not provide ratings across the full array of bond issuers in individual countries (Asian Development Bank, 2002).

Looking at developed countries U.S.A and Asians countries is clear indication that information flow is crucial about investors' decision making about investing in various forms of securities. The development of credit rating agencies in Kenya and confidence building around shall be of vital role to development of corporate bonds in the market (Campbell, 2002).

#### **2.4.4 Crowding-out of issues and investors**

African countries do not have investment policy documents that are clear and specific on guiding the investment environment. This builds in the investors the risk-averse attitude towards investing in the public offerings in either debt or stocks. The investment industry growth is heavily pegged on the development of the professional, legal, political and economic environment to facilitate this to happen. Currently Kenya is working on developing the credit bureaus which shall be a key step towards developing the investment data base for firms and individuals appraisal on investments (EMEAP, 2002).

Looking at the researches done in Asian by (Bhattacharya et al (2003), the evidence presented demonstrate that investments in corporate bonds in very attractive to the investors both the local and the international. However the firms that most investors are attracted to put their resources in are those that have a history of good performance truck record. The firms have a strong sense and understanding that issuance in most of Asian markets is dominated by issuers with high credit quality. In the markets where this pattern persists, it is likely that institutional investors have internal guidelines that limit them to investing only in highly rated securities. Nonetheless, such guidelines may merely reflect the fact that the publicly available information may not be adequate for investors to assess the creditworthiness of potential issuers with significant default risk. Indeed, this possibility is supported by Bhattacharya et al (2003), who report measures of the capacity of earnings releases that tend to be higher for Asian countries. Moreover,

Fan and Wong (2002) argue that such releases in Asia tend to be less informative because of cross-holdings and pyramid ownership structures.

This clearly explains even the risk averse character of the Kenyan citizens who shy of from investing in stock of companies that don't have acceptable past history on investment performance. The reduction by the government borrowing may be a vital signal to the public to rethink of the available investment opportunities and thus this may facilitate the growth of the corporate bonds debt investment. This then shall call for a good legal environment and political will from the top leadership in the country (Fan and Wong 2002).

It's quite elaborate that the presence of foreign issuers may indicate how well developed a market is. It may also reflect the efforts of policymakers in a small economy to find ways to enlarge their market and make it more viable. Again looking at Asian markets like New Zealand, Hong Kong and Singapore dollar markets host the highest proportions of non-resident issuers, with these issuers comprising 86%, 56% and 36% of the market respectively. The Australian dollar market also has a relatively high proportion of 28%. These proportions include non-residents who issue local currency bonds offshore, in London for example. Also, data on onshore and offshore issuance are not fully comparable and so these proportions might overstate the non-resident share. Nevertheless, they suggest that, by this metric, these four markets may be the best developed in the region (Capulong, *et al*, 2002).

The international experience suggests market liberalization alone is an insufficient condition for increasing foreign participation. While Colombia's restrictions on shorter-term holdings by foreign investors have clearly been a barrier to the development of the local corporate bond market, the situation in Korea is less obvious. Even though foreigners are allowed to invest in all types of listed bonds in Korea's local market, they currently hold only about 0.4 percent of listed domestic bonds (compared with foreign participation of over 40 percent in the Korean stock market). The situation may partly be explained by the lack of a developed repo market and hedging instruments. In many emerging markets, the existence of withholding taxes and the threat of discretionary

increases in other taxes and capital controls act as a strong deterrent to foreigners buying domestic securities (Capulong, *et al*, 2002). In contrast, foreign interest in Mexico's longer-term government bonds rose sharply in 2004, as the local market started to realize the benefits from ongoing reform efforts to establish a credible benchmark yield curve, improve transparency, and promote liquidity in the market. Similarly, in Malaysia, foreign investor interest in the local markets has been higher with the government taking new initiatives to make investments into local markets easier and more attractive, and to improve the market infrastructure (Cha, 2002).

#### **2.4.5 Low professional advisory services**

In very profession there is need for professional guidelines for effective operation and working. Now in Kenya this is the fundamental challenge as there are few if any investment professionals to guide the country well on the trends and objective decision making about investment. Mostly people operate with instinct and chance decision models in the choice for the investment to go for. The knowledge and appraisal skills by the investors are the main reason why the developed markets have many individual investors in the corporate bonds. For the case of the US, Households' corporate bond holdings have increased by a factor of 12X over the past two decades. In contrast, the share held by banks was either flat or declining from 1980 until 1999, although it has been in a rising trend since 2000 (Jin *et al*, 2002).

According to a survey by the IMF, (2005), 90% of bond funds in the US are owned by individuals. This means that, as of end-2008, nearly a quarter of US corporate bonds outstanding were held by either households or individuals, based on adding together the household share of 14% and the 90% of the mutual fund share of 11% owned by households, which is 10%, for a total share of 24%. In the US, 40-50% of the mutual funds bought and held by households and individuals are done so through defined contribution (DC) pension plans, which have played a major role in encouraging greater ownership of mutual funds by households and individuals in the US. This is knowledge and advisory services driven trend about investing and wealth growing by individual investors (IMF, 2005). And that role has not only been evident in quantitative terms. From the perspective of the fiduciary responsibility of those managing the pension plans,

the thinking is that the requirement to offer employees an ample choice of investments, namely a continuous range of products across the entire risk-return spectrum, has also helped to raise awareness of corporate bond funds. The same scenario is required in the Kenyan context for diversity about investing especially by the individuals. The case is true to banking as most Kenyan think mostly about banking their excess income per their current expenditure than thinking of investing. The acceptability of a security is determined through thorough fundamental analysis. These skills and experiences is what most developing countries need to avail informative information to the public. This shall facilitate objective investing by the public (IMF, 2005; Rakkestad *et al*, 2004).

#### **2.4.6 Poor regulatory environment**

A reliable regulatory framework is critical for instilling investor confidence. Regulations in securities markets are normally justified by one or more of the following objectives: (i) fair and equal treatment of investors (investor protection); (ii) market integrity; and (iii) containment of systemic risk. The experience from advanced economies shows that regulatory policies have played a role in the development of corporate bond markets, by either encouraging or inhibiting the development of these markets (Schinasi and Smith, 1998). Generally, while regulations governing the issuance of securities should ensure a level playing field for all, they should not interfere with the terms of issuance.

The regulatory process must also be efficient: market timing is of the utmost importance to both issuers and investors in securities markets, since any regulatory delay would be tantamount to prohibitive regulation. In Germany, for instance, the legal requirements for a private sector bond issue has historically made this option more expensive than raising funds through a bank loan. The permission process was time consuming and impeded the ability of corporate to issue when market conditions were favorable. Although the regulatory burden was reduced during the 1990s, much of the deutsche mark corporate bond market had already been established in London. Similar rigidities in regulatory policy in France appear to have had similar results (Rakshit, 2000).

In Mexico, the authorities are working on improving the regulatory framework for the repo and securities lending markets in order to make it consistent with international best



practice. In August 2003, a new regulation, which requires the use of standard contracts—and enabled both corporate bonds to be traded and foreign investors to finance their positions in the repo market—was implemented. The repo regulation will soon complement the new regulation for securities lending. This progress in regulatory reform appears to have provided a much needed boost to the corporate debt market (Rakshit, 2000).

Many countries still maintain tight regulation over asset allocations by institutional investors to prevent excessive risk taking, but this may be a double-edged sword (Roldos, 2004). In Mexico, factors such as the restrictions and limits placed on pension funds, the lack of high-quality corporates (only about 10 local “blue chips” are considered investible), the risk aversion of local investors, and the shortage of interested players, have hindered liquidity in the secondary corporate debt market. As a result, the general portfolio composition in the pension industry currently consists of around 85 percent in federal government bonds. That said, states and municipalities, which were previously reliant on development banks for financing, have also been active in the local bond market; this has added breadth to the market and improved the transparency of their operations, thus improving the credibility of, and interest in, these securities (Roldos, 2004).

In Brazil, tight regulatory requirements have prevented investors other than local buy-and hold pension and mutual funds from participating actively in the market, thus limiting demand for corporate issues. In Chile and other markets, regulatory restrictions that prevent banks from doing repos with corporate bonds also represent an obstacle for the development of a liquid secondary market. The corporate bond market in Colombia remains very small, partly due to the lack of demand for lower-rated debt from pension funds. Although pension funds in Colombia are, in theory, able to invest in securities rated A-minus or above, in practice they tend to require a AAA rating, especially for big issues. As a result, local corporate that are not AAA-rated have been reluctant to issue new securities locally. In Malaysia, life insurance companies, which are important players in fixed-income markets, cannot invest more than 15 percent of their portfolio in

unsecured bonds and loans and may invest only in highly rated corporate bonds (Sand, 2000).

In most mature markets, there are few restrictions on foreign investment in local bond markets. This openness, together with established market infrastructure and governance have seen foreign participation rates in local debt markets increase significantly in the past decade. For example, the most recent survey shows that 46 percent of long-term U.S. treasury securities and 16 percent of outstanding corporate debt securities were held by foreigners as at June 2003 (Alworth *et al*, 2004). These shares have doubled in the past 10 years.

In Poland, a number of regulatory and cost obstacles make private placements the only cost efficient way to issue corporate bonds (Roldos, 2004a). For example, a prospectus has to be issued for each bond issue, ruling out medium-term note programs, and prospective issuers must wait a long time for the approval of the authorities, in addition to paying high fees for issuances. Similarly, the cost of public issuance in Hong Kong Special Administrative Region is estimated to be four times that of a private placement. In contrast, Malaysia's Securities Commission introduced a series of measures to streamline the capital raising process, which has minimized the time and work required in the issuance process and lowered the cost of bond issuance to below that of bank loans. Not surprisingly, bond issuance has dominated bank lending as a source of funding in Malaysia since 1997 (Moody's, 2002).

Kenya's legal environment on investment is still in the infancy state and this clearly gives a message that market liberation i.e. having proper legal free playing grounds shall facilitate transparency and build confidence in the investment industry. Asian markets still have some challenges but the growth of their capital markets demonstrate that legal frameworks are fundamental in the expected success of the development of the corporate bond debt as a source of financing for development (Moody's, 2002).

In conclusion, there are major gaps about the corporate bond development in Kenya compared with the developed markets. This clear motivates this research to be done as a way to unearth the basis as to why the corporate bond debt is lowly used as a source of

financing for corporations. Practically looking at the availability and accessibility to information, market size, debt size in the Kenyan market, regulatory and legal environment, and professional advisory services availability out rightly shows that it's wanting. Therefore this research should be undertaken so as to unravel the ways that shall act as the foundation for developing the corporate bonds market in Kenya.

## **2.5 Conclusion**

Corporations raise substantial financing in the bond markets. A better understanding of the liquidity of these markets may help corporations identify ways to lower their costs of capital. We examine secondary trading costs in the corporate bond market using improved methods and more comprehensive data than earlier studies. We find that bond price transparency lowers transaction costs. Thus, additional bond transparency may lower corporate costs of capital. Corporate bond transaction costs are much lower for institutional-sized transactions.

The strongest arguments against transparency in bond markets involve concerns about an increase in the difficulty of dealers to manage inventory, especially in higher credit risk bonds. However, the management of inventory problems is easier in the debt markets than in the equity markets, both because credit risk is smaller in the former than the latter and because credit risk can be hedged in the equity markets. Accordingly, given the great liquidity observed in the relatively more transparent equity markets and our empirical results, we believe that it would be extremely unlikely that increased bond market transparency would lower liquidity.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The method to be employed in this inquiry is census. Then location target population and sampling technique described to guide the study. Data collection instruments and procedure is stated and including how is to be organized, Classified and analyzed. The casual relationship between bond issuance and stated factors is to be established.

#### **3.2 Research design**

This study was descriptive in nature and a census method was used since the aim of this study is to investigate the factors influencing the development of corporate bonds market in Kenyan financial market. Descriptive research according to Kothari (1990) is a powerful form of quantitative analysis. This design is preferred because it enables the researcher describe the area of research and explain the collected data in order to investigate the differences and similarities with our frame of reference within a given period of time (time of research). In addition, the method permits gathering of data from the respondents in natural settings resulting in a description of the data, whether in words, pictures, charts, or tables. Moreover, much of the data collected from the respondents was quantitative in nature. On the other hand a census is the procedure of systematically acquiring and recording information about the members or items of a given population. This design gave the researcher a comprehensive picture of the variable relationship since the method is the only means of accurately measuring and giving statistical inferences.

#### **3.3 Target population and sample size**

The population comprised of the 55 listed companies listed in the Nairobi Stock Exchange. Since the population of the study was not very large, the the study was a census and thus the researcher focused on the whole population. This ensured that all elements of the population are targeted and interviewed and as such was highly

representative of the Kenyan financial market. The population of the study is given under Appendix III

### **3.4 Data collection**

The study used both the primary and secondary data. Primary data consisted of a semi structured questionnaire comprising of both open-ended and close-ended questions. Open ended questions were addressing the essential concepts, processes, and skills that go beyond the specifics of instruction as well as those areas that the researcher would wish to get deeper explanation from the respondents. At the same time, these questions encouraged the respondents to give a full, meaningful answer using their own knowledge and/or feelings on corporate bond market development. Close ended questions on this study enabled the researcher to capture quick information from the respondents as well as those that are express in meaning and thus did not require explanations beyond what is stated. These set of questions also assisted the researcher in saving time for data collection. Secondary data was in form of literature review sourced from the relevant NSE database. The researcher targeted the top management especially in the area of accounts, operations or finance.

To ensure validity of the research instruments, the questionnaires were pre-tested among 5 listed companies. This confirmed if the questions were well understood by the entire group of respondents. The questionnaires were improved depending on the outcome of the pre-testing. For reliability, split-half techniques were used at piloting to determine the reliability of the questionnaire. This was used for the Likert type items. According to Cohen, and Manion, (1989) split half technique involves splitting the statement of the test into two halves (odd and even items), then calculating the Pearson's correlation coefficient ( $r$ ) between the two halves of the test. The Pearson Product Moment formula was applied to establish the extent to which the contents of the questionnaires were consistent.

### **3.5 Data Analysis**

Data collected from respondents was both quantitative and qualitative in nature. Data was analyzed using descriptive statistics, which includes measures of central tendency, measures of variability and measures of frequency among others such as frequencies, mean scores and the standard deviations. The basis of using descriptive approach enable meaningful description of a distribution of scores or measurements using a few indices or statistics. Measures of central tendency were given the expected score or measure from a group of scores in a study. Measures of variability such as standard deviation, informs the analyst about the distribution of scores around the mean of the distribution. Frequency distribution shows a record of the number of times a score or record appears. The findings were then be presented using tables, pie charts, and bar graphs for easier interpretation. These served to portray both descriptive and pictorial impression of the results. The percentages and means generated also served to portray the weight of each response in fulfilling the objective of this study. The quantitative data was coded and analyzed using SPSS package.

On the other hand, qualitative data was analyzed using factor analysis. The method is preferred because it allows for both quantitative and qualitative operations as well as providing valuable historical/cultural insights over time through analysis of texts. In addition, content analysis enabled examination of text, which can alternate between specific categories and relationships and also statistically analyzes the coded form of the text at the same time the method allowed respondents to express their feelings on certain issues to a larger extent as compared to the quantitative analysis.

## **CHAPTER FOUR**

### **ANALYSIS AND INTERPRETATION**

#### **4.1 Introduction**

This chapter discusses the data analysis, findings, interpretation and presentation. The objective of this study was to study strategies to enhance the development of corporate bonds in the country, where the data was analyzed using analytical tools, presented by tables, pie charts and bar graphs and interpreted with frequencies and percentages. Likert-type findings were further processed to yield meaning interpretation using mean and the standard deviation. The researcher targeted managers in accounts, operations or finance with a response of 36 companies registered in Kenya.

#### **4.2 Demographic information**

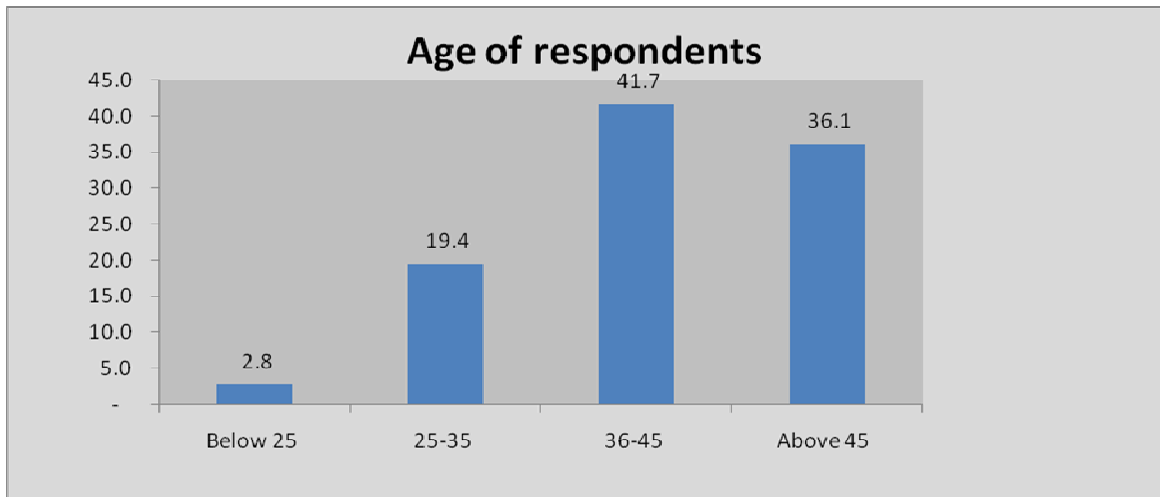
The demographic outlook of the target respondents was based on gender of the respondents, Age of the respondents, highest level of Education and length of time the company has been in existence.

**Table 4.1: Gender of the respondents**

<b>Gender of the respondents</b>		
	<b>Frequency</b>	<b>Percentage</b>
Male	25	69.4
Female	11	30.6
<b>Totals</b>	<b>36</b>	<b>100.0</b>

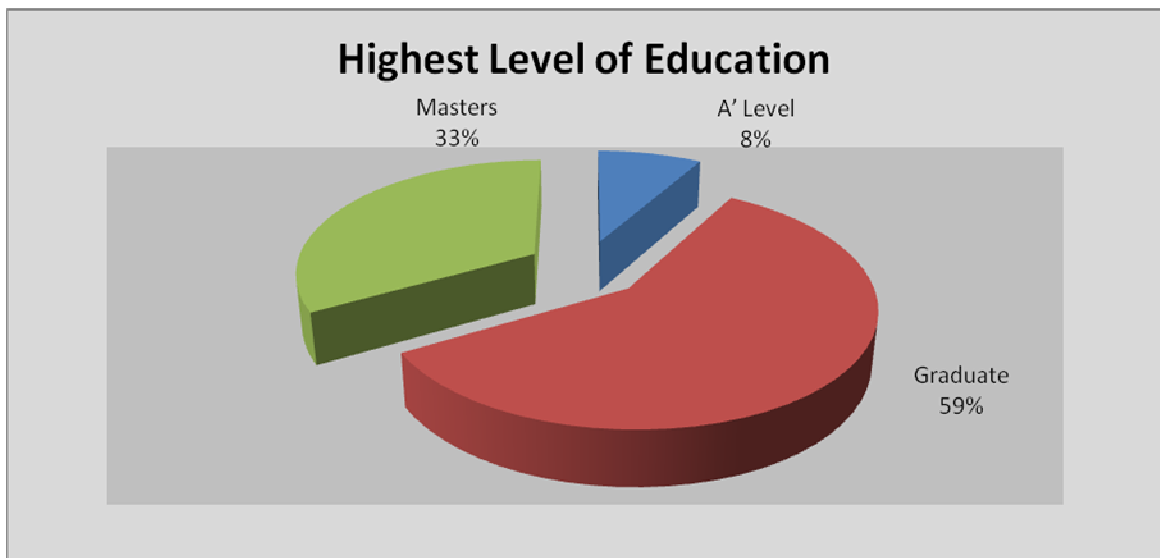
Table 4.1 illustrates gender of the respondents where majority 69.4% of the respondents were male while 30.6% were female. This indicates that most of the senior managers in various departments were men.

**Figure 4.1: Age of the respondents**



Regarding age of respondents most of the respondents 41.7% were between 36 to 45 years while 36.1 were above 45 years old 19.4% were between 25 to 35 years and 2.8 percent were below 25 Years. This shows that most managers were over 36 years old.

**Figure 4.2: Highest level of Education**



The researcher wanted to know highest education level of the respondents where majority (59%) were graduates, 33% had masters and 8% were A levels. This shows that that most of the managers were highly educated as graduates and masters level of education as they were specialized in their respective departments.



**Table 4.2: Length of time the company has been in existence**

How long has the company has been in existence		
	Frequency	Percentage
Less than 5 years	2	5.6
Between 5 and 10 years	6	16.7
Between 10 and 20 years	12	33.3
Between 20 and 30 years	9	25.0
Over 30 years	7	19.4
<b>Totals</b>	<b>36</b>	<b>100.0</b>

In addition the researcher was interested to know the length of time the company has been in existence where 33.3% between 10 to 20 years old, 25% were between 20 to 30 years old, 19.4% were over 30 years old while 16.7% were between 5 to 10 years old. This indicates that most companies were over 10 years old with a majority between 10 to 20 years, which shows that that the companies are well established and had been trading in the stock exchange.

### **4.3 General Findings**

**Table 4.3: Segments/section in which company is listed on the NSE**

Segment/section in which company is listed on the NSE		
	Frequency	Percentage
Agricultural segment	7	19.4
Commercial and services	12	33.3
Finance and investment	6	16.7
Industrial and Allied	7	19.4
Alternative investment	4	11.1
<b>Total</b>	<b>36</b>	<b>100.0</b>

Table 4.3 illustrates segments or sections the companies were listed on in the Nairobi stock exchange where 33.3% were registered in commercial and service, 19.4% were registered in the industrial and allied, 19.4% were registered in the Agricultural segment,

while 16.7% were registered in finance and investment, which shows that most respondents were in the commercial and services sector, agricultural and industrial and allied sector.

**Table 4.4: Whether the company has issued any debt instruments**

<b>Has your company issued any debt instruments</b>		
	<b>Frequency</b>	<b>Percentage</b>
Yes	17	52.8
No	19	47.2
Totals	36	100

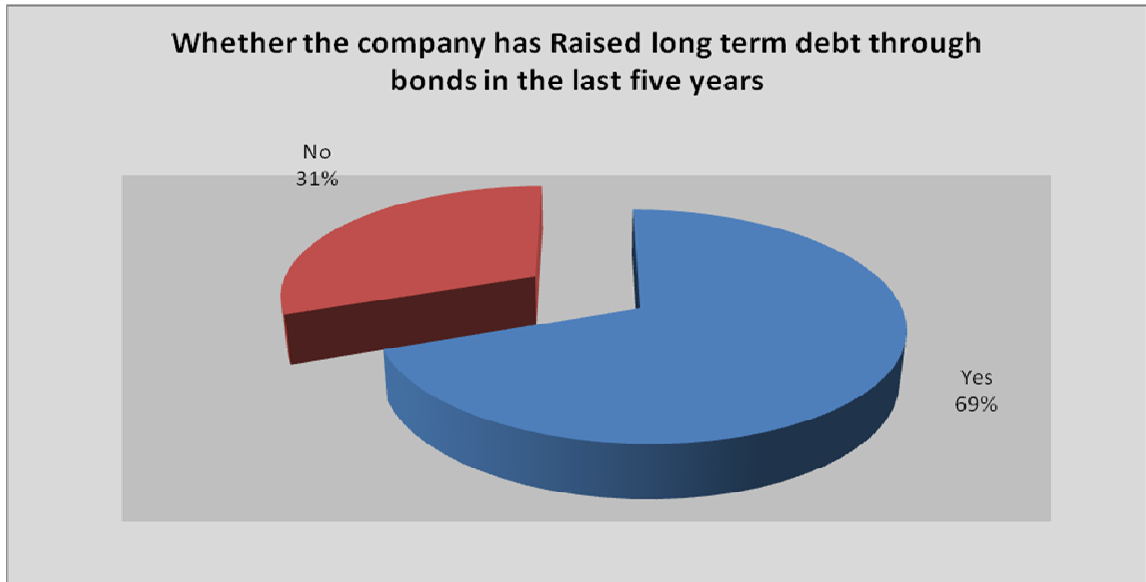
Regarding whether the company has issued any debt instruments majority (52.8%) agreed that they had issued debt instrument while 47.2 disagreed that they had not issued any debt instrument. This shows that most companies trade with bond and other debt instruments.

**Table 4.5: Type of debt instruments issued by the company**

<b>Type of debt instruments issued by the company</b>		
	<b>Frequency</b>	<b>Percentage</b>
Convertible bonds	10	27.8
Zero-coupon bonds	4	11.1
Floating rate bonds	6	16.7
Variable/adjustable bonds	6	16.7
Callable bonds	6	16.7
Step up bonds	3	8.3
Step down bonds	1	2.8
Totals	36	100.0

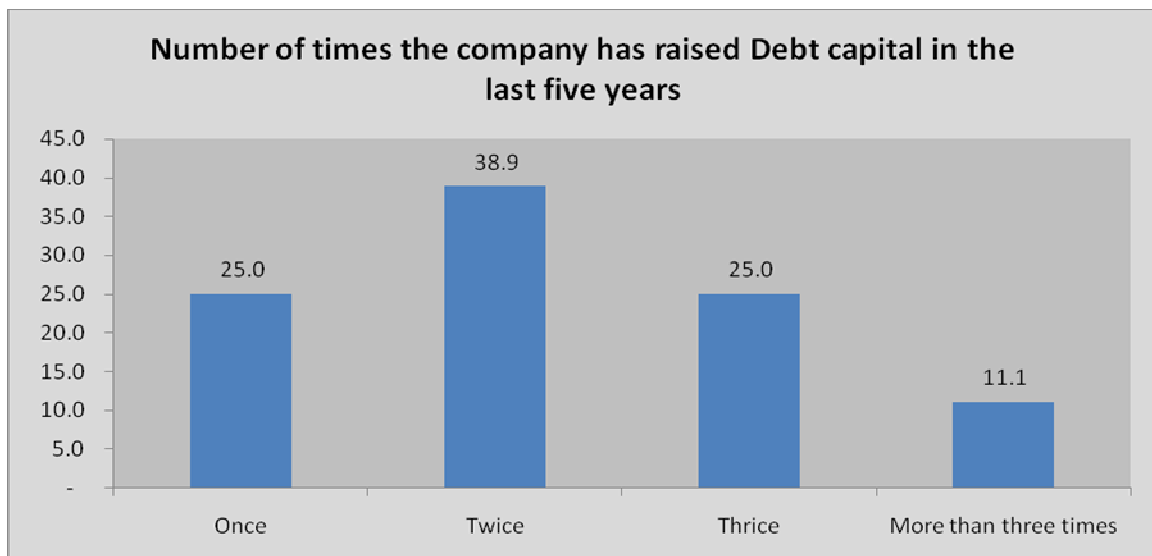
The researcher was interested to know the type of debt instruments issued by the company where 27.8% issued convertible bonds, 16.7% issued Floating rate bonds, 16.7% issued Variable/adjustable bonds, 16.7% issued Callable bonds while 11.1% issued Zero-coupon bonds, while 8.3% issued step up bonds, which shows the most companies trade with bond and other debt instruments

**Figure 4.3: Whether the company has raised long term debt through bonds in the last five years**



Furthermore the researcher was interested to know whether the company has raised long term debt through bonds in the last five years where majority (69%) agreed that they had raised long term debt through bonds in the last five years while 31% disagreed that they had raised long term debt through bonds in the last five years. This indicated that most companies raised long term debt through bonds in the for a period of five years

**Figure 4.4: Number of times the company has raised Debt capital in the last five years**



Regarding the number of times the company has raised Debt capital in the last five years 38.9% said that they had raised debt capital twice in the last five years while 25 % had raised debt capital thrice in the last five years, 25% had raised debt capital once in the last five years which shows that most respondents had raised debt capital twice in the last five years, This was indication of growth as debt financing through corporate bonds may be one of the financing options that are going to be developed (Roldos, 2004) in the future.

**Table 4.6: Whether the measures are being implemented in order to improve the liquidity of secondary markets**

Whether the measures are being implemented in order to improve the liquidity of secondary markets							
Measures	Strongly disagree	Mildly disagree	Neutral	Mildly agree	Strongly agree	Mean	Std. Dev
Extending the yield curve	5.6	11.2	42	22.4	19.6	3.4	1.05
Setting up issuance calendars to improve transparency	2.8	14	39.2	25.2	19.6	3.5	1
Increasing the disclosure of information on public debt issuance and statistics	-	11.2	33.6	36.4	19.6	3.7	0.9
Holding regular meetings with dealers, institutional investors and rating agencies	8.4	22.4	33.6	19.6	16.8	3.2	1.2
Introducing a system of primary dealers	8.4	14	30.8	25.2	22.4	3.4	1.2
Establishing repurchase (repo) market	5.6	11.2	33.6	30.8	19.6	3.5	1.05

Table 4.6 illustrates the extent whether respondents agreed with certain statement where strongly disagree had one point, disagree had two points, neutral had three points, mildly agree had 4 points, strongly agree had 5 points. From the findings respondents mildly agreed with the measures that increasing the disclosure of information on public debt issuance and statistics measures, Establishing repurchase (repo) market and Setting up issuance calendars to improve transparency with a mean of 3.7, 3.5 and 3.5 respectively.

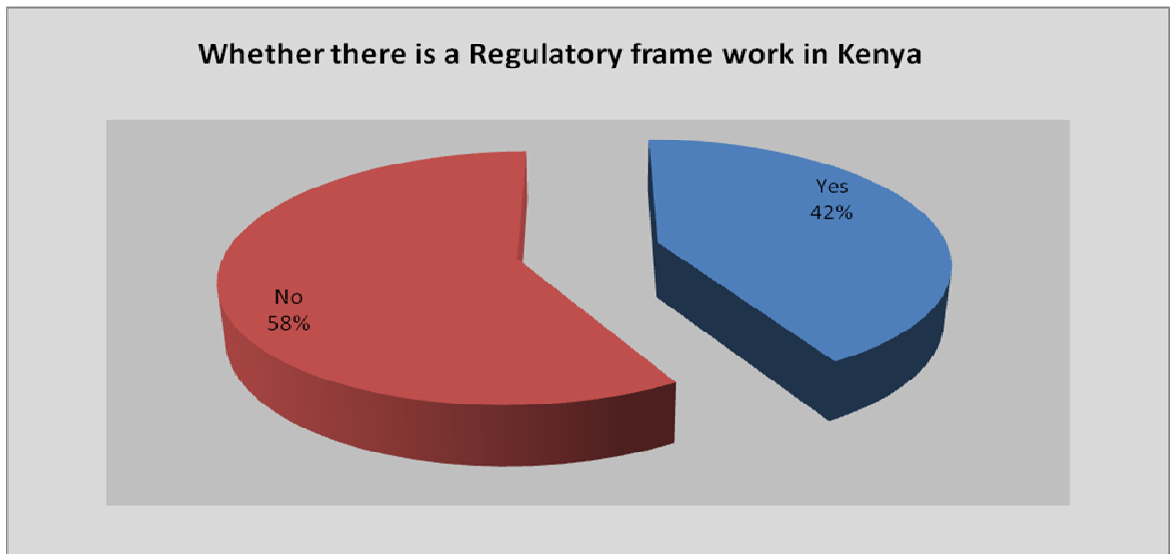
While respondents were neutral on measures like introducing a system of primary dealers, extending the yield curve, Holding regular meetings with dealers, institutional investors and rating agencies with a mean of 3.4, 3.4, and 3.2 respectively this shows that respondents agreed that increasing the disclosure of information on public debt issuance and statistics, and Establishing repurchase (repo) market and Setting up issuance calendars to improve transparency were measures being implemented in order to improve the liquidity of secondary markets.

**Table 4.7: Whether the company raised its long-term debt finance**

Whether the company raised its long-term debt finance		
	Frequency	Percentage
Open market (NSE)	21	58.3
Private placement	15	41.7
Totals	36	100

Table 4.7 illustrates whether the company raised its long-term debt finance where majority 58.3% indicated that they had raised long-term debt finance in the open market (NSE) while 41.7% had raised long-term debt finance in private placement. This indicated the wide usage of open market (NSE) by companies.

**Figure 4.5: Whether there is a Regulatory frame work in Kenya**



Regarding whether there is a regulatory frame work in Kenya majority 58% disagreed with the statement that there was a regulatory frame work in Kenya while 42% agreed that there was no regulatory frame work in Kenya this shows that most respondents disagree that there is a regulatory frame work in Kenya as advisory services are not available thus posing a critical challenge to information availability (Baz *et al* 1999; IOSCO, 2002).

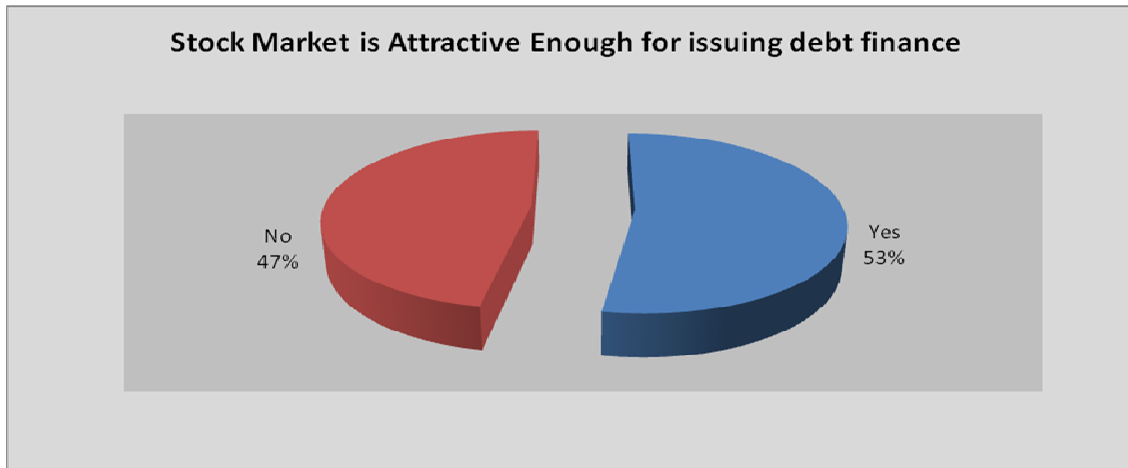
**Table 4.8: The extent the Respondents agreed with the following statements**

The extent to which the respondents agreed with the following statements							
	Strongly disagree	Mildly disagree	Neutral	Mildly agree	Strongly agree	Mean	Std.d ev
The law treats all investors fairly and equally	11.2	14	36.4	22.4	16.8	3.22	1.16
The integrity of the bond market has improved due to improved regulations	2.8	14	33.6	25.2	25.6	3.60	1.03
The regulatory framework has enabled the control of systematic risk in the market	3	5.6	28	36.4	28	3.84	0.94
There is a longer lad between handover and complete payment which raises the risk of non-delivery of payment and therefore an impediment to the corporate bonds market development	8.4	11.2	33.6	30.8	16.8	3.39	1.097
Lack of enforcement of rules to guarantee the protection of rights and claims through the life of the contract or in case of its dissolution is a major hindrance to corporate bonds market development in Kenya	8.4	22.4	39.2	19.6	11.2	3.052	1.063

Table 4.8 illustrates the extent whether respondents agreed with certain statement where strongly disagree had one point, disagree had two points, neutral had three points, mildly agree had 4 points, strongly agree had 5 points. From the findings the managers mildly agreed that regulatory framework had enabled the control of systematic risk in the market, and the integrity of the bond market had improved due to improved regulations with a mean of 3.8 and 3.6 respectively while respondents were neutral on if there is a longer lad between handover and complete payment which raises the risk of non-delivery of payment and therefore an impediment to the corporate bonds market development, The law treats all investors fairly and equally and finally lack of enforcement of rules to guarantee the protection of rights and claims through the life of the contract or in case of

its dissolution is a major hindrance to corporate bonds market development in Kenya with a mean of 3.4, 3.2 and 3.1 respectively. This shows that respondents agreed that regulatory framework enabled the control of systematic risk in the market, and the integrity of the bond market had improved due to improved regulations

**Figure 4.6: Stock Market is Attractive enough for issuing debt finance**



In addition the researcher was interested to know whether the stock market is attractive enough for issuing debt finance, where majority (53%) agreed with the that stock market is attractive enough for issuing debt finance while 47% disagreed that stock market is attractive enough for issuing debt finance as illustrated by figure 4.6. This indicates that most of the companies were in favor of the stock market to issue debt finance.

**Table 4.8: How significantly factors influences the attractiveness of the corporate bonds in the Kenyan financial markets**

How factors influences the attractiveness of the corporate bonds in the Kenyan financial markets							
Factors	Very significant	Significant	Indifferent	Not significant	Insignificant	Mean	Std. dev
Under development of the stock market	11.2	14	28	36.4	11.2	3.3	1.12
Liquidity problems	19.6	33.6	25.2	14	2.8	2.3	1.2
Crowding out of issues and investors	20	33.6	36.4	11.2	-	2.4	0.89
Low professional advisory services	5.6	25.2	30.8	22.4	16.8	3.2	1.12
Poor regulatory environment	5.6	16.8	28	33.6	16.8	3.4	1.07

Regarding how factors influence the attractiveness of the corporate bonds in the Kenyan financial markets. Crowding out of issues and investors Liquidity problems, were significant with a mean of 2.4, 2.3 respectively while respondents were indifferent on Poor regulatory environment factor, Under development of the stock market factor, Low professional advisory services factor, with a mean of 3.41, 3.25, and 3.22 respectively as shown in table 4.9. This shows that crowding out of issues and investors Liquidity problems were significant in attracting of the corporate bonds in the Kenyan financial markets.

#### 4.4 Factor Analysis

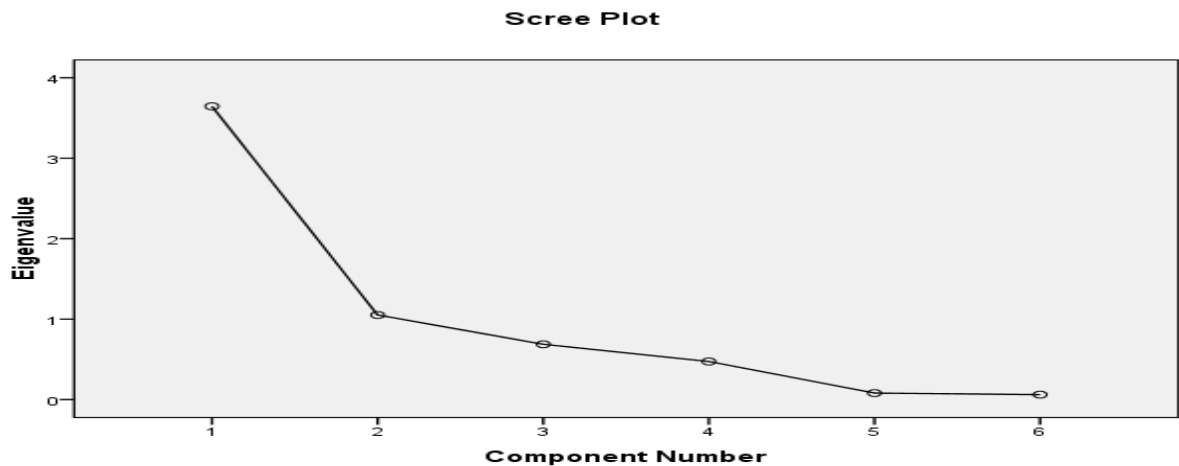
**Table 4.9: Total Variance Explained for Analysis on measures**

Component	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.645	60.752	60.752	3.098	51.628	51.628
2	1.051	17.522	78.273	1.599	26.646	78.273
3	.687	11.458	89.731			
4	.473	7.891	97.622			
5	.081	1.355	98.978			
6	.061	1.022	100.000			

Extraction Method: Principal Component Analysis.

From the table above there are two factors representing 78% of the variables. Factor one alone represents 51.6% which is a very large proportion; hence it means it is contributing the largest explanation of the variance within the variables. The Eigen value is also greater than three which is also an indicator of how important it explains the variance. The variables with an Eigen value of less than one were not considered because their contribution to the explanation of variance within the variables is low and can be considered to be redundant compared to the other variables. More explanation on how the factors come about can be found in the Scree plot below which is a diagrammatic representation.





The Scree plot above shows the level at which the factors are chosen. The variables that are at the level where the graph becomes less steep or it evens out were not chosen. This is because these variables are considered to be less important in explaining variances as seen above (Eigen values).

**Table 4.10: Rotated Component Matrix of measures**

	Component	
	1	2
Extending the yield curve	<b>.837</b>	.479
Issuance calendars to improve transparency	<b>.811</b>	-.231
Disclosure of information on public debt/statistics	<b>.807</b>	.513
Regular meetings with stake holders	<b>.654</b>	.042
Introducing a system of primary dealers	.030	<b>.915</b>
Establishing REPO	<b>.813</b>	.462

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 3 iterations.

Factor one; availability of information has five variables extending the yield curve, issuance of calendars, disclosure of information on public debt, meetings of stakeholders and establishing repurchase market. Factor two is introducing a system of primary dealers which is the only variable in that factor.

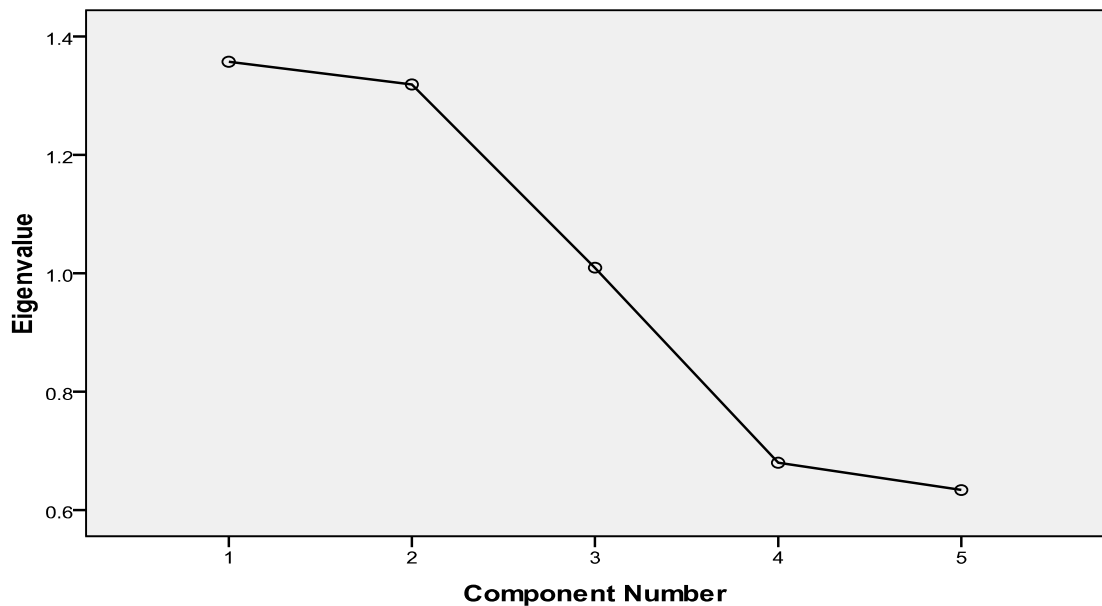
**Table 4.11: Total Variance Explained on extent of agreement**

Component	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	1.358	27.152	27.152	1.346	26.921	26.921
2	1.319	26.386	53.538	1.331	26.617	53.538
3	1.010	20.191	73.729			
4	.680	13.596	87.325			
5	.634	12.675	100.000			

Extraction Method: Principal Component Analysis.

From the table above there are three factors derived with a contribution to explanation of variance of 53.5% cumulative percentage. Although the Eigen value gives the factors as three, that is factors that have an Eigen value greater than one, only two factors are derived to ensure a better analysis and interpretation of the outcome.

**Scree Plot**



The Scree plot above shows the level at which the factors are chosen. The variables that are at the level where the graph becomes very steep were not chosen. Hence the Eigen Value is not used to determine the number of factors and the two values above the steep slope are chosen.

**Table 4.12: Rotated Component Matrix on extent of agreement**

	Component	
	1	2
No discrimination of investors by Law	-.001	<b>.418</b>
Integrity of bond MKT improves due to regulation	.169	<b>.786</b>
Regulatory framework has enabled the control of systematic risk in the market	<b>.756</b>	-.048
Longer lag leads to impediment of bond MKT development	-.564	<b>.610</b>
Lack of enforcement of rules is an hindrance	<b>.654</b>	.405

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 3 iterations.

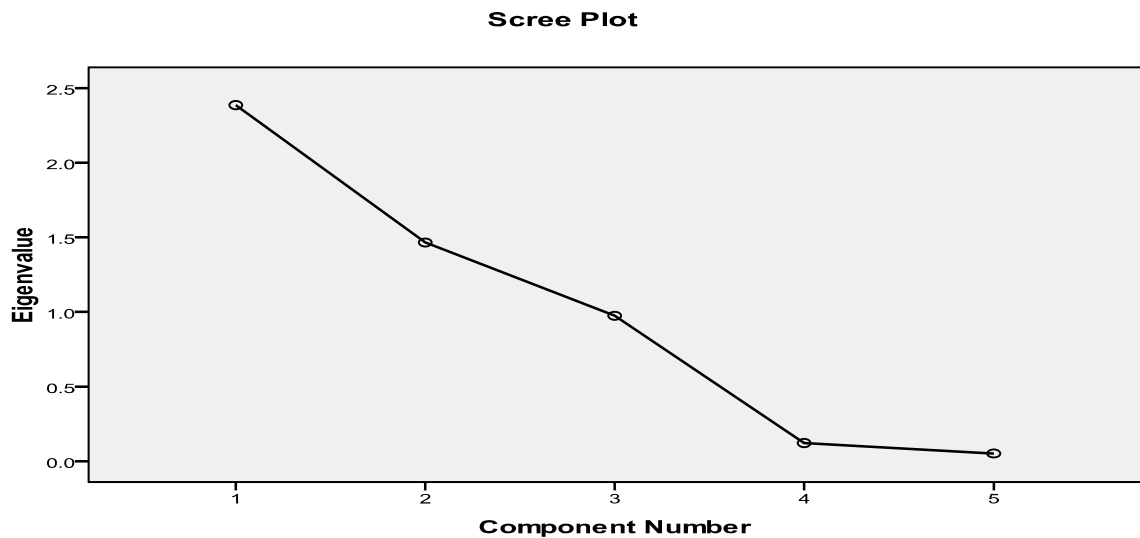
Factor one; Regulation has two variables; regulatory framework at 75.6% and lack of enforcement of rules at 65.4%. Factor two; improvement of bond market has three variables; no discrimination of investors by law at 41.8%, integrity of bond market improves due to regulation 78.6% and shorter lag time leads to no impediments of bond market development 61%.

**Table 4.13 Total Variance Explained on influence on the bond market**

Component	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.386	47.716	47.716	1.982	39.644	39.644
2	1.466	29.315	77.031	1.869	37.387	77.031
3	.975	19.499	96.530			
4	.122	2.438	98.968			
5	.052	1.032	100.000			

Extraction Method: Principal Component Analysis.

From the table below there are two factors representing 77% of the variables. Factor one alone represents 47.7% cumulative percentage which is a very large proportion; hence it means it is contributing the largest explanation of the variance within the variables. The Eigen value is also greater than two which is also an indicator of how important it explains the variance. The variables with an Eigen value of less than one were not considered because their contribution to the explanation of variance within the variables is low and can be considered to be redundant compared to the other variables.



The Scree plot above shows the level at which the factors are chosen. The variables that are above the elbow were chosen. This is because these variables are considered to be less important in explaining variances as seen above (Eigen values).

**Table 4.14 Rotated Component Matrix on influence on the bond market**

	Component	
	1	2
Under development of stock MKT	.031	-.262
Liquidity problems	<b>.983</b>	.010
Crowding out of Issues and Investors	<b>.977</b>	.137
Low Professional advisory services	.204	<b>.940</b>
Poor Regulatory Environment	.136	<b>.948</b>

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser

Normalization. Rotation converged in 3 iterations.

Factor one; Liquidity has two variables; liquidity problems and crowding out of issues and investors hence both factor tend to bring out the fact that there is low investor confidence in the corporate bond market. Factor two; inadequate knowledge; due to low professional advisory services and poor regulatory environment. The first variable is ignored because its contribution to either factor is very low.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Summary and Findings**

This study sought to investigate the factors influencing the development of corporate bonds markets in Kenya. Regarding gender of the respondents majority 69.4% of the respondents were male while 30.6% were female. Regarding age of respondents most of the respondents 41.7% were between 36 to 45 years while 36.1% were above 45 years old. Majority (59%) of the respondents were graduates, 33% had masters. The length of time the company has been in existence where 33.3% have been in existence between 10 to 20 years, 25% were between 20 to 30 years old, 19.4% were over 30 years old. Majority (52.8%) agreed that they had issued debt instrument while 47.2 disagreed that they had not issued any debt instrument. |Regarding type of debt instruments 27.8% issued convertible bonds, 16.7% issued Floating rate bonds, 16.7% issued Variable/adjustable bonds, 16.7% issued Callable bonds.

Regarding the number of times the company has raised Debt capital in the last five years 38.9% said that they had raised debt capital twice in the last five years while 25 % had raised debt capital thrice in the last five years, 25% had raised debt capital once in the last five years. The extent whether respondents agreed with the following statement where strongly disagree had one point, disagree had two points, neutral had three points, mildly agree had 4 points, strongly agree had 5 points.

Majority 58.3% indicated that they had raised long-term debt finance in the open market (NSE) while 41.7% had raised long-term debt finance in private placement. Majority 58% with the statement that there was a regulatory frame work in Kenya while 42% disagreed that there was no regulatory frame work in Kenya.

Managers mildly agreed that regulatory framework had enabled the control of systematic risk in the market, and the integrity of the bond market had improved due to improved

regulations with a mean of 3.8 and 3.6 respectively. Majority (53%) agreed that stock market is attractive enough for issuing debt finance while 47% disagreed that stock market is attractive enough for issuing debt finance. Regarding attractiveness of corporate bonds crowding out of issues and investors Liquidity problems, were significant with a mean of 2.4, 2.3 respectively while respondents were indifferent on Poor regulatory environment factor, under development of the stock market factor, and Low professional advisory services factor with a mean of 3.41, 3.25, and 3.22 respectively

## **5.2 Conclusion**

Based on the findings, companies listed in NSE face the corporate bond market development challenge through inadequate disclosure of information on public debt issuance and statistics measures. The companies have insufficiently dealt with establishing repurchase (repo) market as well as setting up issuance calendars to improve transparency. At the same time there is scarce regulatory frame work in Kenya as advisory services are not available thus posing a critical challenge to information availability.

Law in Kenya in addition do not treat all investors fairly and equally while inadequacy in enforcement of rules to guarantee the protection of rights and claims through the life of the contract or in case of its dissolution is a major hindrance to corporate bonds market development in Kenya. Moreover, crowding out of issues and investors liquidity problems are also major impediments to development of corporate bond market

From the study it is clear that, regulatory frameworks enable the control of systematic risk in the market, and the integrity of the bond market had improved due to improved regulations. Most of the companies were in favour of the stock market to issue debt finance while crowding out of issues and investors' liquidity problems were significant in attracting corporate bonds in the Kenyan financial markets.

### **5.3 Recommendations**

Financial market is a mechanism that allows people to buy and sell (trade) financial securities (such as stocks and bonds), commodities (such as precious metals or agricultural goods), and other tangible items of value at low transaction costs and at prices that reflect the efficient-market hypothesis. Corporate bonds are particularly effective means of capital advancement in many corporations. Towards this end and based on the findings, the researcher recommends that,

Companies listed in NSE should embark on creating awareness to the public on what are corporate bonds and how they are beneficial to the investor.

Regulatory frame work in Kenya as advisory services should be enhanced to mitigate critical challenge to information availability

Regulatory bodies should formulate policies to effectively enable, disclosure of information on public debt issuance and statistics measures, establishing repurchase (repo) market and Setting up issuance calendars to improve transparency. In addition, regulatory framework should enable the control of systematic risk in the market, and the integrity of the bond market had improved due to improved regulations

Companies issue corporate bonds to raise funds for a variety of purposes, such as building a new plant, purchasing equipment, or growing the business. While corporate bonds are not well developed in Kenya companies should be cautious when raising debt equity from the market as it has been stagnant.

Companies should take advantage of corporate bonds in the long term as they will be the source of diffusing stresses on the banking sector by diversifying credit risks across the economy, Diffusing foreign exchange, interest rate and refunding risk, Supplying long-term funds for long-term investment needs, Supplying long-term investment products for long-term investors, Lowering funding costs by avoiding a liquidity premium providing products with flexibility to meet the specific needs of investors and borrowers, allocating capital more efficiently, and reducing reliance on foreign funds.



#### **5.4 Suggestions for further studies**

The study also suggested areas for further study:

There is need to carry the same study in other parts of the country to find out whether the same results will be obtained.

A study research should be carried on individual industries in the market to find out the effects of raising long term capital through bonds and other means of raising capital.

A study research should be carried out on other securities traded by companies in the NSE.

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## **APPENDICES**

### **Appendix I: Letter of Introduction**

To whom it may concern

I am a Masters of Administration (MBA) student of University of Nairobi and currently conducting a survey research for a Finance project regarding the corporate bond issuance in the Kenyan Financial markets. My request is to ask you to fill in this questionnaire attached here completely and honestly so that it may assist me in the analyzing the findings thereafter to reflect a true picture of the situation in the market. I wish to promise that this information will only be used for the purpose stated and no other. Should you wish to access my findings, then place a request in writing and it shall be made available to you.

I shall appreciate it very much if you do it as soon as possible and return it to me by the mail reply or inform me to collect.

Thanks,

Yours truly,

Alex Maloba,

## Appendix II: Questionnaire

2) Job \_\_\_\_\_ title

### SECTION A: Demographic Information

1) Name of the company

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3) What is your age?

Below 25 [ ]

36-45 [ ]

25-35 [ ]

Above 45 [ ]

4) What is your highest level of education?

A' Level [ ]

O' Level [ ]

Graduate [ ]

Primary level [ ]

Masters [ ]

5) How long has the company been in existence?

Less than 5 years [ ]

Between 20 and 30 years [ ]

Between 5 and 10 years [ ]

Over 30 years [ ]

Between 10 and 20 years [ ]

6) In what segment/section is your company listed on the NSE?

Agricultural segment [ ]

Industrial and Allied [ ]

Commercial and services [ ]

Alternative investment [ ]

Finance and investment [ ]

## SECTION B: General Information

7) Has your company issued any debt instruments?

Yes ☐ No ☐

8) If yes, which debt instruments has your company issued?

Convertible bonds ☐ Callable bonds ☐

Zero-coupon bonds ☐ Step up bonds ☐

Floating rate bonds ☐ Step down bonds ☐

Variable/adjustable bonds ☐

Others (specify)

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–

9) Has the company raised long term debt through bonds in the past 5 years?

Yes ☐ No ☐

If yes, how many times has debt capital been raised in the 5 years? Check one

Once ☐ Thrice ☐

Twice ☐ More than three times ☐

10) Do you agree that the measures in the table below are being implemented in order to improve the liquidity of secondary markets?

✓ 1 means strongly disagree

✓ 4 means mildly agree

✓ 2 means mildly disagree

✓ 5 means strongly agree

✓ 3 means neutral



Measure	1	2	3	4	5
Extending the yield curve					
Setting up issuance calendars to improve transparency					
Increasing the disclosure of information on public debt issuance and statistics					
Holding regular meetings with dealers, institutional investors and rating agencies					
Introducing a system of primary dealers					
Establishing repurchase (repo) market					

11) Where does the company raise its long-term debt finance? Check one

- i. Open market (NSE)
- ii. Private placement
- iii. Other, specify & main

Reason \_\_\_\_\_  
\_\_\_\_\_

12) Do you agree that there is a reliable regulatory framework in Kenya has instilled more investor confidence?

Yes [ ] No [ ]

13) Please explain the extent to which you agree with the following statements:

- ✓ 1 means strongly disagree
- ✓ 2 means mildly disagree
- ✓ 3 means neutral
- ✓ 4 means mildly agree
- ✓ 5 means strongly agree

<b>Measure</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
The law treats all investors fairly and equally					
The integrity of the bond market has improved due to improved regulations					
The regulatory framework has enabled the control of systematic risk in the market					
There is a longer lag between handover and complete payment which raises the risk of non-delivery of payment and therefore an impediment to the corporate bonds market development					
Lack of enforcement of rules to guarantee the protection of rights and claims through the life of the contract or in case of its dissolution is a major hindrance to corporate bonds market development in Kenya					

14) Do you think the stock market is attractive enough for issuing long-term debt finance? Tick one,

i. Yes

ii. No

(b) If No, why? Explain .....

.....

15) Please, indicate by a tick (✓) how significantly each of the following factors influences the attractiveness of the corporate bonds in the Kenyan financial markets.

<b>FACTOR</b>	<b>Very significant</b>	<b>Significant</b>	<b>Indifferent</b>	<b>not significant</b>	<b>Insignificant</b>
Under development of the stock market					
Liquidity problems					
Crowding out of issues and investors					
Low professional advisory services					
Poor regulatory environment					

16) In your opinion, what can be done to attract more corporate bonds to the stock market  
in Kenya?

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**Thanks for your cooperation**

## **Appendix III: Companies Listed in NSE**

### **MAIN INVESTMENTS MARKET SEGMENT (MIMS)**

#### **AGRICULTURAL**

Unilever Tea (K) Ltd.  
Rea Vipingo Ltd.  
Sasini Tea & Coffee Ltd.  
Kakuzi Ltd.

#### **COMMERCIAL & SERVICES**

Car & General Ltd.  
Cmc Holdings  
Hutchings Biemer Ltd (Currently Suspended)  
Kenya Airways  
Marshalls E.A. Ltd.  
Nation Media Group  
Tps (Serena) Ltd.  
Uchumi Supermarkets Ltd.

#### **FINANCE AND INVESTMENT**

Barclays Bank of Kenya Ltd.  
Cfc Bank Ltd.  
Diamond Trust Bank Of Kenya Ltd.  
Housing Finance Company Of Kenya Ltd.  
Icdc Investment Company Ltd.  
Jubilee Insurance Co. Ltd  
Kenya Commercial Bank Ltd.  
National Bank Of Kenya Ltd.  
National Industrial Credit Bank Ltd.  
Pan Africa Insurance Holdings Co. Ltd  
Standard Chartered Bank Ltd.

#### **INDUSTRIAL AND ALLIED**

Athi River Mining  
Boc Kenya Ltd.  
Bamburi Cement Ltd.  
British American Tobacco Kenya Ltd.  
Carbacid Investments Ltd.  
Crown Berger (K) Ltd.  
Olympia Capital Holdings Ltd.  
E.A. Cables  
E.A Portland Cement Co. Ltd.  
E.A. Breweries Ltd.  
Sameer Africa Ltd.

Kenya Power & Lighting Co. Ltd.  
Kenya Oil Ltd.  
Mumias Sugar Company  
Total Kenya Ltd.  
Unga Group Ltd.

**ALTERNATIVE INVESTMENTS MARKETS SEGMENT (AIMS)**

A. Baumann And Company Ltd.  
Citytrust Ltd.  
Eaagads Ltd  
Express Kenya Ltd.  
Williamson Tea Kenya Ltd  
Kapchorua Tea Co. Ltd.  
Kenya Orchards  
Limuru Tea Co. Ltd.  
Standard Newspapers Ltd.

Appendix IV Raw Data																
yieldcurv	isocaulata	discolor	regiment	xympndent	reps	bevinuata	integ	naghtame	longlod	lockrates	unntender	liquid	Crowding	lowaditise	poorreg	
3	3	1	3	3	3	1	3	4	3	3	1	3	3	5	5	
4	4	4	1	4	4	2	4	2	4	1	2	2	2	2	4	
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3	4	3	3	3	4	4	3	4	4	3	5	2	2	5	5	

## Appendix v: Factor Analysis

### Factor Analysis on measures to improve the liquidity of secondary markets

**Communalities**

	Initial
Extending the yield curve	1.000
Issuance calendars to improve transparency	1.000
Disclosure of information on public debt/statistics	1.000
Regular meetings with stake holders	1.000
Introducing a system of primary dealers	1.000
Establishing REPO	1.000

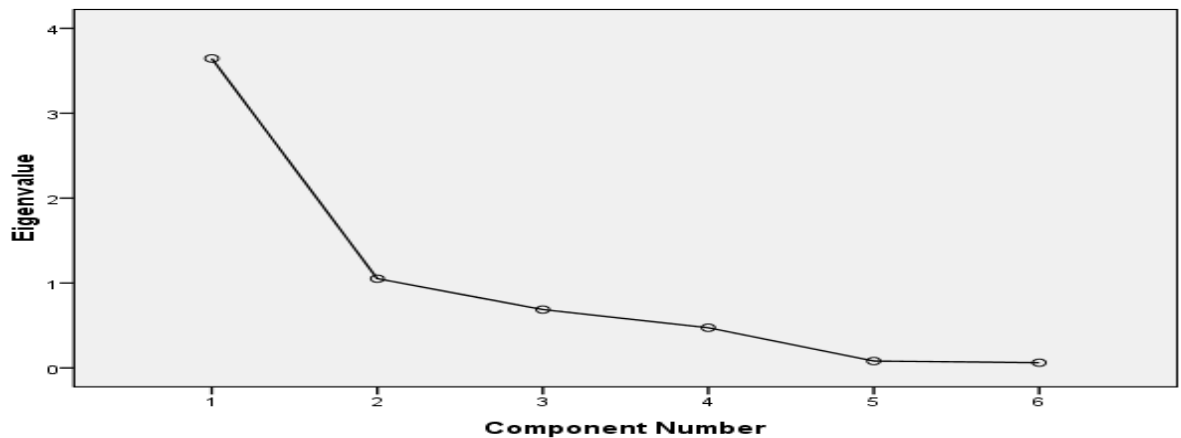
Extraction Method: Principal Component Analysis.

**Total Variance Explained**

Component	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	3.645	60.752	60.752	3.098	51.628	51.628
2	1.051	17.522	78.273	1.599	26.646	78.273
3	.687	11.458	89.731			
4	.473	7.891	97.622			
5	.081	1.355	98.978			
6	.061	1.022	100.000			

Extraction Method: Principal Component Analysis.

**Scree Plot**



### Rotated Component Matrix

	Component	
	1	2
Extending the yield curve	.837	.479
Issuance calendars to improve transparency	.811	-.231
Disclosure of information on public debt/statistics	.807	.513
Regular meetings with stake holders	.654	.042
Introducing a system of primary dealers	.030	.915
Establishing REPO	.813	.462

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 3 iterations.

### Component Transformation Matrix

Component	1	2
1	.888	.459
2	-.459	.888

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

## Factor Analysis on extent of agreement with the measures using Eigen values

### Communalities

	Initial
No discrimination of investors by Law	1.000
Integrity of bond MKT improves due to regulation	1.000
Regulatory framework has enabled the control of systematic risk in the market	1.000
Longer lag leads to impediment of bond MKT development	1.000
Lack of enforcement of rules is an hindrance	1.000

Extraction Method: Principal Component Analysis.

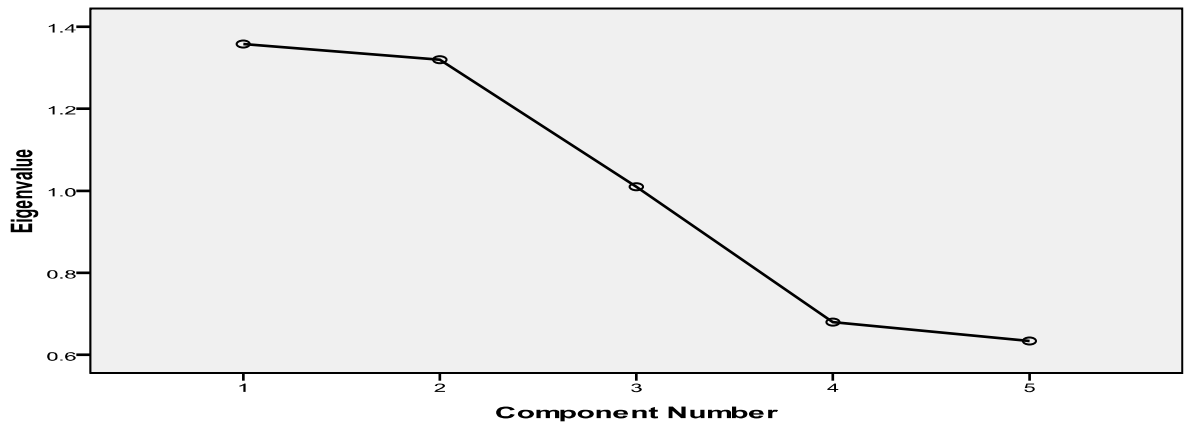


### Total Variance Explained

Comp onent	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	1.358	27.152	27.152	1.312	26.246	26.246
2	1.319	26.386	53.538	1.300	25.995	52.241
3	1.010	20.191	73.729	1.074	21.488	73.729
4	.680	13.596	87.325			
5	.634	12.675	100.000			

Extraction Method: Principal Component Analysis.

### Scree Plot



### Rotated Component Matrix

	Component		
	1	2	3
No discrimination of investors by Law	-.002	-.009	.945
Integrity of bond MKT improves due to regulation	-.270	.790	.125
Regulatory framework has enabled the control of systematic risk in the market	.749	.214	.287
Longer lead leads to impediment of bond MKT development	-.765	.184	.265
Lack of enforcement of rules is an hindrance	.305	.772	-.110

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 5 iterations.

**Component Transformation Matrix**

Component	1	2	3
1	.469	.846	.252
2	-.854	.363	.372
3	.223	-.389	.894

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

## Factor Analysis on extent of agreement with measures using 2 factors

**Communalities**

	Initial
No discrimination of investors by Law	1.000
Integrity of bond MKT improves due to regulation	1.000
Regulatory framework has enabled the control of systematic risk in the market	1.000
Longer lag leads to impediment of bond MKT development	1.000
Lack of enforcement of rules is an hindrance	1.000

Extraction Method: Principal Component Analysis.

**Total Variance Explained**

Comp onent	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	1.358	27.152	27.152	1.346	26.921	26.921
2	1.319	26.386	53.538	1.331	26.617	53.538
3	1.010	20.191	73.729			
4	.680	13.596	87.325			
5	.634	12.675	100.000			

Extraction Method: Principal Component Analysis.



**Rotated Component Matrix**

	Component	
	1	2
No discrimination of investors by Law	-.001	.418
Integrity of bond MKT improves due to regulation	.169	.786
Regulatory framework has enabled the control of systematic risk in the market	.756	-.048
Longer lag leads to impediment of bond MKT development	-.564	.610
Lack of enforcement of rules is an hindrance	.654	.405

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 3 iterations.

**Component Transformation Matrix**

Component	1	2
1	.836	.549
2	-.549	.836

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

## Factor Analysis on factors influencing the corporate bond market

### Communalities

	Initial
Underdevelopment of stock MKT	1.000
Liquidity problems	1.000
Crowding out of Issues and Investors	1.000
Low Professional advisory services	1.000
Poor Regulatory Environment	1.000

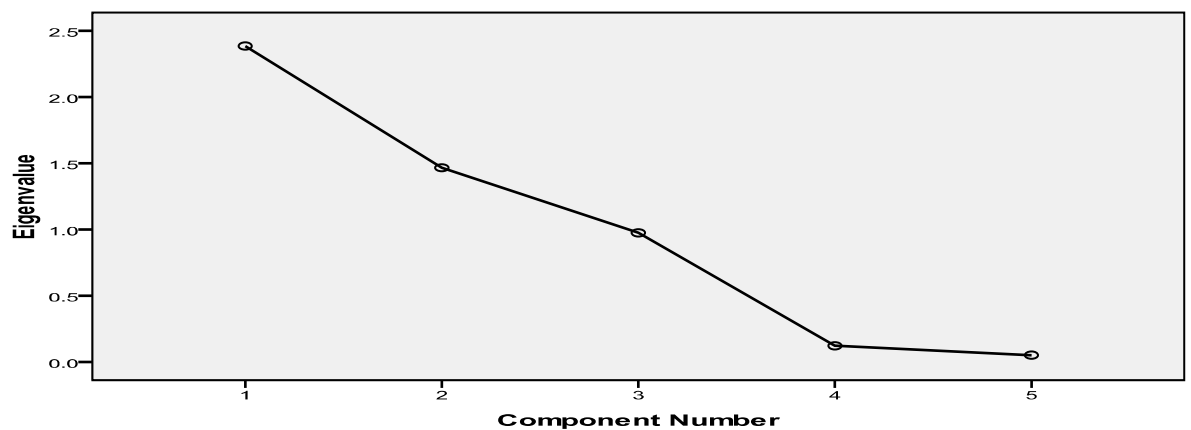
Extraction Method: Principal Component Analysis.

### Total Variance Explained

Comp onent	Initial Eigen values			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	2.386	47.716	47.716	1.982	39.644	39.644
2	1.466	29.315	77.031	1.869	37.387	77.031
3	.975	19.499	96.530			
4	.122	2.438	98.968			
5	.052	1.032	100.000			

Extraction Method: Principal Component Analysis.

### Scree Plot



**Rotated Component Matrix**

	Component	
	1	2
Underdevelopment of stock MKT	.031	-.262
Liquidity problems	.983	.010
Crowding out of Issues and Investors	.977	.137
Low Professional advisory services	.204	.940
Poor Regulatory Environment	.136	.948

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 3 iterations.

**Component Transformation Matrix**

Component	1	2
1	.749	.662
2	.662	-.749

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.