

**A SURVEY OF THE DETERMINANTS OF THE SUCCESS OF INITIAL PUBLIC
OFFERINGS (IPOS) AMONG THE COMPANIES LISTED AT THE NAIROBI STOCK
EXCHANGE**

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**A research submitted in partial fulfilment of the requirements for the award of a degree in
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DECLARATION

This research is my original work and has not been submitted for examination in any other university.

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DEDICATION

I dedicate this project to my family members for the patience and persistence during the whole process.

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This project has been accomplished with the encouragement, support and contribution from a number of people whom I am deeply indebted.

I owe special thanks to my family members, who have supported me and are patient with me even when my studies quietly eating into the time meant to be spent with them.

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ABSTRACT

The study under investigation is a survey of the determinants of the success of initial public offerings (IPOS) among the companies listed at the Nairobi Stock Exchange (NSE) whose main objective was to determine the factors that influence a successful IPO.

On the methodology, this research problem was best studied through the use of a descriptive survey because it allows one to collect quantitative data which can be analysed quantitatively using descriptive and inferential statistics whose target population for this study were the companies listed on the NSE. There are 55 listed firms in Kenya. The sample size was the entire population i.e. all the 55 listed firms. Both causal and analytical approaches were used in data analysis. The data was analysed through use of analysis software SPSS.

Results obtained from analysis, are expressed in terms of the signs and statistical significance of the coefficients for the selected five independent variables. The results are categorized on the basis of the independent variables and focuses on their associations with the effects of determinants of a successful IPO on firm value. In this regard the discussion of the variables of the model supported the studies of effects of a successful IPO on firm value as in the case of Kenya firms, the exogenous variables also turn out to be significant, but are negatively related with the firm's performance. Although firm size as measured by sales revenue should have a positive relationship to the firms value due to the advantages of the economies of scale, organizational inefficiency called x- inefficiency leads to loss of profit, a likely situation in larger firms. A firm's age could work either way. Old firms have a reputation advantage, but they tend to be prone to inertia and bureaucratic rigidities. We found the coefficient of age to be negative, which means that younger firms (typically new age firms) command higher market valuation.

CHAPTER ONE

1.0

INTRODUCTION

1.1 Background of the study

Initial Public Offer (IPOs) is the first sale of stock by a company to the public. IPOs are often issued by smaller, younger companies seeking capital to expand but can also be done by large privately-owned companies looking to become publicly traded. In an IPO, the issuer obtains the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market Fama and French (2001). IPO is also referred to as a "public offering". Evidence of under pricing of initial public offerings (IPOs) has spawned a considerable theoretical literature attempting to explain the apparent contradiction to market efficiency Claessens, S., Djankov.

Initial public offering (IPO) firms typically go public on the promise of growth thereby conditioning investors to expect capital gains rather than dividends during the post-IPO phase. In fact, the offering prospectuses of most IPO issuers usually indicate that the firm is unlikely to pay dividends in the foreseeable future. IPO issuing firms are usually in their early stages of development and belong to rapidly growing, technologically oriented industries. They are expected to invest substantially in areas such as R&D, advertising, and capital expenditures, post-IPO, in an effort to gain market share and achieve technological dominance in their rapidly evolving industries. Issuing firms are often cash flow negative at the time of the IPO and are likely to continue to need substantial external financing during the post-IPO phase to sustain their high growth rates as well as help finance acquisitions. Further, the incidence of U.S. firms going public prior to achieving profitability has been growing over time. For instance, Ritter and Welch (2002) document that the proportion of firms going public with negative earnings in the 12 months prior to the IPO increased from 19% in the 1980s to 37% during the period 1995-1998 and rose to an astonishing 79% during the internet bubble. Similarly, Fama and French (2001) report a significant dispersion in the profitability of new listings and a tendency for left skewness.

Companies carry out IPOs to raise more capital through the public rather than constraining oneself to private capital only, improve the liquidity of the company's capital, reduce debt through acquisition of equity thus increase company's net worth and reduces risk by decreased leverage, bring about seasoned equity offers in future (SEOs), reduce the cost of capital because of diversified risk, help combat the agency problem through expanding the shareholder base by giving the stakeholders a chance to also own the company in question, the company's shares trade at regulated price through the forces of demand and supply at the stock exchange, there is no interest incurred on shares floated unlike debt, gives the company in question a chance to be credit rated and finally the company is in a better financial position and hence ability to meet its financial obligations

Companies would generally not issue IPOs because of several reasons which among others would include sharing of its profits with its outsiders, disclosure of information in accordance with the requirements of the Capital Markets Authority (CMA), Nairobi Stock Exchange (NSE) and the Companies Act (Kenyan cases) the company loses control of its issues due to the introduction of other shareholders when the IPO was made, IPO costs and expenses are significant compared to the net earnings got from the same and legal liabilities may occur both jointly and severally for example if the shares floated were overpriced (Legal suits prevention which is a theory advanced as a reason for under pricing).

IPOs are valued using several methods which are all subjective and depends on an individual company. Valuing of IPOs is based on some principle and fundamental assumptions cannot be ignored. A share can be valued using the discounted cash flows expected from it in future. It can also be valued using the company's earnings multiples or the book value multiples. There are other intangible values of a company which cannot be accurately quantified and hence accurately incorporated in the share value. For example, Safaricom is the most profitable company in the East and Central African region. However to what extent, the value cannot be quantified. Hence its shares were floated at a mere Kshs. 5 which may not represent their true value.

1.1.2 History of Nairobi Stock Exchange

The Nairobi Stock Exchange, which was formed in 1954 as a voluntary organization of stockbrokers, is now one of the most active capital markets in Africa. The administration of the

Nairobi Stock Exchange is located on the 1st Floor, Nation Centre, and Kimathi Street, Nairobi. As a capital market institution, the Stock Exchange plays an important role in the process of economic development. It helps mobilize domestic savings thereby bringing about the reallocation of financial resources from dormant to active agents. Long-term investments are made liquid, as the transfer of securities between shareholders is facilitated. The Exchange has also enabled companies to engage local participation in their equity, thereby giving Kenyans a chance to own shares. Companies can also raise extra finance essential for expansion and development. To raise funds, a new issuer publishes a prospectus, which gives all pertinent particulars about the operations and future prospects and states the price of the issue. A stock market also enhances the inflow of international capital. They can also be useful tools for privatization programmes.

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1.1.3. Expected determinants of successful IPO

Sue, Mark. 2001 discusses a few important findings on the success of an IPO:

- **Profits matter.** Most companies are making money at the time their IPO's were issued.
- **Management.** The way investors treat these public offerings was largely dependent on the business savvy of the executive in charge and his ability to put together a fundamental business strategy and direction. The financial success and ability of these firms to meet earnings targets, debt liabilities, and overall expectations garnered them future credibility in the market. "Accredited" managers are given a chance/break by investors, as they are aware of their "industry."

- **Product/Service.** Successful IPO companies were not entering the market based upon a newly developed concept/service or product. Their services were already being utilized and the products already on the shelves globally. Thus, these funds first served to expand their existing capabilities and core competencies (i.e. knowledge management) and second to be put to use in new developments. Thus, these offerings were not seen as pure “seed or venture capital” funding to help strengthen a promising business model or technology.

- **Finance.** Many start-ups and dot.coms choose to forecast about future potential for making profits; however, while many of these companies have struggled to simply stay afloat, the above companies had a proven business operations and sales projections. Investors desire to know that a firm will be able to meet (or in the above cases surpass) quarterly financial expectations, and that the business will function according to plan.

- **Company Strategy and Business Model.** The companies had direct plans/strategies for putting their future equity financing to use years before their actual IPO. These firms established that their proceeds would be used to: continue their acquisition and vertical/horizontal integration strategies, pay off high-interest rate debts (1 Tsuruoka, Doug. “How top IPO’s survived the shakeout? *Investor’s Business Daily*. May 29, 2001), expand shareholder base, and increase employee incentives/compensation through stock options, increase investment in R&D and other in-housing company functions.

- **Market Position.** The companies had an established brand name in the marketplace well before their public offering. Indeed, they might not have been the established leader in the industry; however, nonetheless they have been able to leverage the equity raised to expand the “total pie” in the market, while also increasing market share through investments in marketing, R&D and technology, and employee/executive compensation.

- **Organization and Infrastructure:** High performing companies were well established in the marketplace well before IPO. They had the proper logistical functions in place well before offering (accounting, CFO/finance, etc.) and acted like a public company well before they became one. As for the organizational culture, more research and information needs to be gathered through company interviews, chat rooms, etc.

1.2 Problem Statement

The current financial climate has impacted the IPO market but it is a good time to plan for a public listing according to Ernst & Young's (2008) survey, which identifies key performance measures for a successful IPO. The survey reveals that outperforming companies usually begin to act like public companies at least a year before going public and they understand that it is a transformational process from a private to public enterprise. Moreover, they treat the IPO as a milestone in their growth journey to market leadership.

Initial public offerings (IPOs) have received much attention in the academic literature. IPOs have been used as a platform to test theoretical hypotheses dealing with the costs to go public (Bhagat and Frost 1986; Ritter 1987; Barry, Muscarella, and Vetsuypens 1991; Aggarwal and Rivoli 1991; Lee et al. 1996; Chen and Ritter 2000); agency costs and ownership structure (Schultz 1993; Holthausen and Larcker 1996; Mikkelson, Partch, and Shah 1997; Goergen 1998; Stoughton and Zechner 1998; and Mello and Parsons 1998); governance issues (Frye 1998; Gomes 2000); optimal pricing strategies (Seguin and Smoller 1997; Kim and Ritter 1999); and the timing of the IPO as it pertains to the life cycle of the firm (Maug 2000). A common thread in the majority of this research is to concentrate on firms that go public via an IPO and are listed on a major exchange. This commonality inherently biases these studies to have samples composed of relatively large firms. Indeed, many studies on IPOs eliminate certain IPOs on the basis that they are too small.

Given that no study, known to me, of this nature has been done in Kenya, the present study seeks to fill the knowledge gap by establishing the determinant of success of IPOs in Kenya.

1.3 Objective of the study

To determine factors that influence successful IPOs.

1.4 Significance of the study

Policy makers

The policy makers will obtain knowledge of the financial sector dynamics and the responses that are appropriate; they will therefore obtain guidance from this study in designing appropriate policies that will regulate the industry.

Scholars

The study will provide information to potential and current scholars on IPOs in Kenya. This will expand their knowledge on IPOs and also identify areas of further study.

Financial analyst

The study will be a source of reference material for future researchers on other related topics; it will also help other academicians who undertake the same topic in their studies. The study will also highlight other important relationships that require further research.

CHAPTER TWO

2.0

LITERATURE REVIEW

2.1 Introduction

The Financial World has always been fascinated by the concept of the strong “bull” market. One of the biggest proponents of this fervor is the anticipation of the next “hot” IPO hitting the bourse. Ultimately, successful IPO’s bring capital and growth, but they also have their drawbacks. Specifically, numerous studies have shown the rapid decline of companies who achieved a satisfactory initial public offering. This chapter focuses on various studies done in this area.

In particular, what are the key ingredients that we can compare across industries in hypothesizing why those companies were able to raise a targeted amount of capital?

2.2 Empirical Study

This information asymmetry creates uncertainty in the investor who will then tend to underprice the issue. Baron (1982), Rock (1986) and Grinblatt and Hwang (1989) present models that suggest a positive relation between the degree of investor uncertainty over issue value and the extent of underpricing. Empirical evidence between value uncertainty and underpricing is provided in Ederington (1974), Bear and Curley (1975), Beatty and Ritter (1986), Miller and Reilly (1987), Johnson and Miller (1988), and Carter (1992). Firms may also use underpricing as a signal of quality (Welch, 1989). However, Garfinkel (1993) does not find evidence to support the signaling hypothesis.

While under-pricing of an issue is related to uncertainty, the valuation of the security is also related to the fundamentals of the firm. Since Graham and Dodd's (1934) seminal work on determining the fundamental worth of a company, various articles have examined the link between accounting numbers and valuation. For example, Ball and Brown (1968) demonstrate the usefulness of accounting income by showing the association between the accounting income number and stock price. Ou and Penman (1989) show that current accounting numbers can be used to predict the probability of the direction of future earnings, and this prediction of future

earnings is associated with future returns. Chan, Hamao and Lakonishok (1993) examine the relationship between four fundamental variables and expected returns in the Japanese stock market. The four variables are earnings yield, cash flow yield, size (market capitalization of equity) and book-to-market ratio. They find that the book-to-market ratio and cash flow yield are associated with expected returns.

Prior research examines the link between the value of securities and fundamentals of the firm (the price test). This article extends prior research by using the volume test on initial public offerings. That is, this article examines the link between demand for new issues and fundamentals of the firm.

Ernst & Young (2008) canvassed the views of corporate-level executives at outperforming companies as well as the external perspective of global institutional investors. The results provide insights into pre- and post-IPO practices associated with an outperforming public company as well as the “measures that matter” to institutional investors. According to institutional investors, on average 60% of their IPO investment decisions are based on financial performance measures and 40% on non-financial. The three most important financial measures are earnings per share growth (selected by 45% of investors), EBITDA growth (44%), and profitability growth (41%).

Ninety-five percent of investors cite management credibility and experience as a key non-financial metric. Half of investors cite effectiveness of performance-based compensation policies as an investment factor, due to its bearing on a firm’s ability to recruit and retain highly talented senior management. Reflecting this, over half of executives surveyed said building a strong management team is an important factor in building and realizing shareholder value post-IPO. Twenty percent began building the right team more than 20 months before the IPO, while 33% had started 12 to 24 months before listing.

Investors also identified corporate strategy execution (87%), quality of corporate strategy (79%), corporate governance (74%) and brand strength (74%) as key non-financial measures. Two-thirds of companies surveyed had implemented strategic planning, corporate tax planning, internal control systems, financial accounting and reporting issues at least 12 months prior to the IPO. Seventeen percent had started strategic planning more than 20 months prior. Senior

executives cited the importance of building financial and accounting systems early, but identified numerous challenges. The three most cumbersome issues were adjusting historical financial statements to comply with local requirements (selected by 40% of respondents); dealing with consolidated subsidiary financial statements (35%); and adjusting historical financial statements to comply with foreign listing requirements (34%).

Executives of outperforming companies cite the change in composition and structure of the company board as one of the most beneficial changes for post-IPO value. However, only a third had prepared board composition more than six months prior to listing. Many executives found recruiting independent board members more difficult than anticipated and suggested more time should have been allocated to this. The three most challenging corporate governance issues are recruiting qualified independent board members (selected by 48% of respondents); enhancing internal controls (47%); and forming a qualified audit committee (31%).

Building an investor relations team is generally one of the later steps in the IPO process. However 24% of executives surveyed had already started to build an investor relations team more than six months prior to the IPO. Two-thirds of institutional investors cited quality of investor relations guidance as a key measure in their portfolio allocations but only half of executives felt well prepared on this front. High performing companies quickly delegate communications responsibilities to their investor relations team, focus on creating a high-quality road show (identified as a key non-financial metric by 88% of investors), and keep investors well-informed.

Gil Forer adds: “Executives who have overseen successful IPOs focus on being a public company - not just becoming one. They position themselves as public entities long before the event. Post-IPO, they deliver shareholder value by meeting targets consistently, attracting the right investors, effectively communicating to stakeholders and most importantly by delivering operational excellence. The IPO may be the most important transaction in a company’s history to date, but for an exceptional enterprise it’s often just one more milestone along the road to market leadership.”

2.3 Review of Theories

Academic theory suggests four motivations for going public. First, the cost of capital literature (for example, Scott (1976) and Modigliani and Miller (1963)) argues that firms conduct a public offering when external equity will minimize their cost of capital (thereby maximizing the value of the company). Based on asymmetric information and possible stock price misvaluation, Myers and Majluf (1984) and Myers (1984) further argue for a pecking order of financing: internal equity, debt financing, and then external equity.

Second, Zingales (1995) and Mello and Parsons (2000) argue that an IPO allows insiders to cash out. Ang and Brau (2003) demonstrate that insiders opportunistically sell shares in the IPO for personal gain. Additionally, Black and Gilson (1998) argue that the IPO gives VCs the opportunity to exit, providing an attractive harvest strategy.

Third, IPOs may facilitate takeover activity. Zingales (1995) argues that an IPO can serve as a first step toward having a company taken over at an attractive price. Brau, Francis, and Kohers (2003) argue that IPOs may be important because they create public shares for a firm that may be used as “currency” in either acquiring other companies or in being acquired in a stock deal.

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

2.3.1 Signaling theory

Due to asymmetric information between IPO insiders and potential investors, signaling theory continues to be an important component of IPO research. Early papers, such as Leland and Pyle (1977), argue that selling insider shares and selling a large portion of the firm in the IPO served as negative signals to potential investors. Since that time, other researchers have used the context of IPOs to advance signaling theory. Within signaling theory is the idea of certification. Generally, using prestigious underwriters (for example, Booth and Smith (1986), Carter and

Manaster (1990), Carter, Dark, and Singh (1998)), using a reputable accounting firm (for example, Titman and Trueman (1986), Beatty (1989), Michaely and Shaw (1995)), and having VC backing (for example, Megginson and Weiss (1991) and Barry, Muscarella, Peavy, and Vetsuypens (1990)) serve as strong signals or certification that the firm going public is a good firm.

Three other positive signals are proposed in the literature. First, Welch (1989), Allen and Faulhaber (1989), and Chemmanur (1993) model that only good firms can afford to dissipate wealth by underpricing. Second, Courteau (1995) and Brau, Lambson, and McQueen (2004) model that insiders who commit to a long lockup—a period of time after the IPO in which insiders agree not to sell personal shares—signal firm quality. Third, Teoh, Welch, and Wong (1998) suggest that a history of strong earnings signals future strong performance.

2.3.2 Prospect theory

Loughran and Ritter (2002) adopt behavioral perspective in their development of a ‘prospect theory model’ of complacency about banks ‘leaving money on the table’ among decision-makers at firms involved in IPOs. They assume that the decision-maker’s initial valuation beliefs are reflected in the mean of the indicative price range reported in the issuing firm’s IPO registration statement. This belief serves as a benchmark against which the gain or loss from (as opposed to the expected utility of) the outcome of the IPO can be assessed. Thus the decision-maker is said to ‘anchor’ on the mean of the indicative price range. The offer price for an IPO routinely differs from this anchor value, either because the bank ‘manipulated’ the decision-maker’s expectations by low-balling the price range, or in reflection of information revealed during marketing efforts directed at institutional investors.

Assuming the latter is the case, offer prices appear only to ‘partially adjust’ (Hanley (1993)) to such information in the sense that large positive revisions from the anchor value are associated with large initial price increases from the offering price during the first day of trading.

2.4 Initial Public Offerings (IPOs)

An initial public offering involves four groups - the issuing firm, the underwriter/investment bank, the initial buyers and the larger set of investors in the secondary market. These groups have varying amounts of information regarding the issuing firm. It may be the case that the issuer has better information on the value of the security than do the investors or underwriters (example, Downes and Heinkel, 1982; Ritter, 1984; Hwang, 1988). Alternatively, it may be the case that the underwriters possess information superior to the issuer and investors (example, Baron, 1982; Rees, 1987). It may also be the case that the most important informational asymmetry may arise within a market group rather than between different groups (example, Rock, 1986). That is, investors are differentiated by their levels of information about the true value of the issue into "informed investors" and "uninformed investors", with the former having perfect information. As a result of this asymmetry, informed investors compete with uninformed investors only for "good" issues, creating adverse selection in which the probability of obtaining shares in "bad" issues is higher for uninformed investors. This adverse selection proposed by Rock (1986) is analyzed by Ritter (1984), Beatty and Ritter (1986), Koh and Walter (1989), Carter and Manaster (1990), McStay (1992), Keloharju (1993) and Lee, Taylor and Walter (1996; 1999).

To measure IPO success, the existing literature uses initial mispricing (for example, Beatty and Ritter 1986; Muscarella and Vetsuypens 1989a and 1989b; Hanley 1993) and the long-run market performance (for example, Ritter 1991; Loughran and Ritter 1995; Brav and Gompers 1997; Loughran and Ritter 2000). However, because aftermarket trading data are not available for our sample of micro-IPOs, we are not able to use these measures of success. Instead, we define a successful offering as one that breaks escrow and allows the firm to receive at least the minimum capital sought.

An IPO is deemed successful if there is a 100% uptake of the shares floated. On listing of the share, trading is vigorous as a sign of the investor appetite that would have generated a full or over subscription.

2.5 Institutional Features of IPO market

This section presents some of the key features of the listing requirements and institutional features of the IPO market. These are described in considerable detail in Koh and Walter (1989) and Lee, Taylor and Walter (1996). Firms seeking listing on the stock exchange market must fulfil certain criteria. They must have been in operation for at least five years, show profits in the last three years, disclose past and future dividends, show healthy working capital, debt-equity ratio and asset backing.

The firm commitment method is used in underwriting in Kenya. The firm that invites the public to apply for its shares must state the offer price in the prospectus. In the event that the share issue is oversubscribed, the underwriter will allocate the shares in an even-handed manner to all share applicants. Underwriters do not allocate shares to preferred clients as practised in the United States, where offer prices are based on indications of interest made prior to the issue (Hanley and Wilhelm, 1995). Details of the rationing process, which is conducted by way of a public ballot, are publicly disclosed for most initial public offerings.

2.6 The butterfly effect

The butterfly effect, was first described by Lorenz at the December (1972) meeting of the American Association for the Advancement of Science in Washington, D.C. The engine of the butterfly effect is driven by the snowball effect hidden in weather systems, more formally known as positive feedback loops. In case of the weather, temperature changes lead to convection currents which lead to more temperature changes which lead to stronger convection currents, this process continues for days and sometimes for months until you have mild storms in most cases and sometimes hurricanes and in extreme cases tornadoes. In case of the actual snowball from the snowball effect, the bigger the snowball gets, the more snow it accumulates as it rolls down the hill and hence the rate of increase in its size increases with each successive roll down the slope. The stock markets work in somewhat of a similar fashion. Good news on the economic and corporate earnings front creates buying euphoria which increases stock prices, higher stock prices through the wealth effect stimulate greater consumption and which in turn boosts the economy resulting in more good economic news and more buying euphoria. The length of this market cycle ranges between, two to six years.

Running in parallel to the market cycle is the IPO cycle, the jury is still out on the whether it is IPO activity that drives the market or the market that drives IPO activity. However, there is a relative consensus on the fact that a large highly successful IPO, or a series of relatively successful IPOs have a positive impact on the overall market sentiment. And since the market is a non linear complex dynamical system, under the right conditions a bad IPO at the peak or a good IPO at the bottom can reverse the direction of the market.

Like all activities in the market, IPO are driven by agents or financial intermediaries, and as most people here would suspect, the track record and incentive structure of the agent has some bearing on how successful the IPO is going to be. IPOs backed by institutional private equity investors are more successful in terms of post IPO price appreciation as compared to non-PE IPOs. According to a study covering 3,485 IPOs from 1988 to 1999, private equity backed IPOs yielded an average return of 29% in any given year compared to 15% return provided by non PE-backed IPOs (Abraaj Capital, 2005).

2.7 Steps to ensuring successful IPO

Giannini (1999) provides 12 steps to assure a successful IPO. The first step is cleaning up the balance sheet. The first financial statements given to potential investors or buyers set the stage. Subsequent revisions are at best viewed with scepticism. If owners want to pull out excess cash or retain personal ownership of real estate, equipment, copyrights or patents, get them off the balance sheet now. Loans to the company from shareholders should be replaced by bank debt, even if the shareholder has to pledge the company's payoff as additional collateral for the new bank loan. Receivables due from officers or shareholders should also be cleared up.

The second step is doing tax planning now. Taxes can total over 50% of the proceeds of a sale. Devastating tax bills down the road can be significantly reduced. Electing to be taxed as a subchapter S corporation, if qualified, can make a big difference if done early enough, as can transferring stock or assets to trusts, partnerships or family members early, while values are defensively lower. Six months before going public or selling at Ksh.10/share is not the time to try to move stock out at Ksh2 Clarkson, P., and Simunic, D. 1994.

The third step is to have auditable financials. Audited financials add value and may make the difference between doing the deal or not. (For almost all IPO's at least two full years of audited

statements are mandatory.) If your financials aren't audited, at a minimum have a credible CPA observe year-end inventory and file it away. The cost is nominal, and it usually makes a retroactive audit possible if other accounting records are in order. A "big five" auditor adds perceived quality and value, but count most in an IPO. Some will give emerging companies reasonable "starter" rates. It doesn't cost to ask. Established regional auditors can do the same job, usually with less bureaucracy and lower fees Garfinkel, J. 1993.. The trade-off is prestige and image. Also remember that auditors don't necessarily replace your accountants.

Beekes, W., and Brown, P., (2006), posts that the fourth step is to manage income statements. Investors, buyers and underwriters all look for consistent earnings and growth. Peaks and valleys make them nervous. Earnings and growth to a degree can be managed within the bounds of generally accepted accounting principles (GAAP). Tax deferral is no longer the main objective. Spikes and dips in year to year profits reduce credibility and value, but in a smaller company can be smoothed out by increasing or decreasing reserves, giving or postponing bonuses or capitalizing or expensing, where the option exists. Also, within bounds of accounting rules it is perfectly legitimate for financial reports to be different from tax returns. Income statements can be "recast" after the fact to add back discretionary expenses such as excess owners' compensation and perks. If an IPO is the objective, however, high-ticket perks should be eliminated now because you can't use recast financials in an IPO. If private investment or sale is a more likely goal, at least keep discretionary expenses readily identifiable so recast statements are easy to track and reconcile. Try recasting past years now to see how they look.

The other step is to fill gaps in management. Most investors, underwriters and buyers consider management their top priority. Fill gaps in management, either internally or from the outside, sooner rather than later, and give people already on board the right titles. Companies with no Vice Presidents make management look thin, and managers with 60 days tenure aren't particularly inspiring. Also, credentials are important. Blue chip business pedigrees add value, other things being equal. Also, there should be at least the blueprint of a succession plan in place, and senior management should have meaningful and well thought-out answers as to their future intentions and expectations. Key executives should have professionally prepared employment, option and incentive agreements in place before discussions start. Seek outside help to determine what's customary given your circumstances and considered acceptable to investors, buyers or

underwriters. Also, consider using "phantom" stock instead of conventional options or issuing actual shares, but in either case have a clear understanding as to how vesting will be affected by a sale or change of control.

The sixth step is to add outside directors. Outside directors are an economical way to obtain valuable advice, contacts and insight from the objective perspective of people not involved in the day to day crunch. For an IPO, "name" outside directors with attention-getting credentials, affiliations or accomplishments enhance perceived value and marketability Caramanolis-Cötelli, B., (1995). They should not, however, have just joined the board and should own some stock or at least options. Finding and recruiting the right outside directors requires focused time and effort. Also, easing friends and family lacking ownership or bona fide business credentials off the board should be done, but is delicate and can require more time than you think. A "name" law firm can also add credibility and value, and a "name" firm attorney on the board is a plus, if they will do it. The trade-off is that they can be overly conservative as well as expensive. If your present attorney isn't seasoned in securities transactions or acquisitions, meet with one or more others respected in the financial circles in which you anticipate dealing. Then try one for some nominal corporate work before you really need them.

Raising the company's public profile is the seventh step. Good, credible, business publicity beyond just trade press adds value. A smaller but interesting private company can orchestrate more coverage in the business press than it would ordinarily expect. Local newspapers and business publications are good, but many relatively small companies also show up in national publications, such as Inc., Forbes, and Business Week; and not by accident. Enlist the services of a financial or business PR firm or consultant who knows the ropes, or make it a priority and do it yourself. Also, household name customers, the more the better, add perceived credibility, even if they only account for a small percentage of sales. Have as many as you can.

The eighth step is to position the company for the right comparison. Investors and buyers judge by comparison. Maintain a running comparison of your operating and financial statistics vs. those of your peers and competitors. Prospectuses, IOK's and annual reports are excellent sources, as are trade associations and bankers' industry profile books. A fair comparison may require changing your accounting categorizations. If so, do it before giving out financials

showing unfairly, for example, that your gross margins don't measure up to others in your industry.

Study security analysts' Caramanolis-Cötelli, B., (1995) reports on companies in your industry and determine: a) which similarities you want to reinforce, b) which you should distance yourself from; and c) how to accomplish that. Also, try to determine a range of values for your business in the context of a sale, financing or IPO, based on what you can glean from public and trade sources. Do not, however, fall into the trap of believing your company will be valued at the same multiple as public companies many times its size and/or with other significantly different characteristics.

The ninth step is to document the competition. Many company descriptions or business plans lack a truly realistic assessment of the competition. Investors can sense when a company is in denial. A product or service with no meaningful competition is extremely rare. Even if it is unique, there usually are or will be alternatives to fill the need. Accordingly document the facts on actual and potential competitors and an objective comparison of similarities and differences, strengths and vulnerabilities, in a form understandable by someone outside your industry and believable by someone in it.

Then, examine your company as an investor would. Be the first to do "due diligence" on your own company. Investors, buyers and underwriters all have comprehensive evaluation screens that go well beyond financial records. Put your company through such a process before an investor does. Make it one that covers operations, marketing, personnel and technology as well as legal, regulatory, environmental, insurance, contractual, credit and accounting issues. Have a professional outsider do it to make it objective, and develop a program to fix what the exercise indicates needs attention. Contemplating an IPO? Make a dry run. Try drafting parts of a prospectus, providing the data required by regulations. The result will show what needs to be done and what will have to be disclosed when the time comes.

Then, one needs to understand investors' needs. Every investor, buyer or underwriter has certain criteria which they are not going to negotiate away. A buyer, lender or private investor has requirements for returns on investment or debt service; minority equity investors need an exit

strategy, and underwriters a stock that's going to perform. Specific criteria will vary by industry, the economy and the type of investor, but they are always there. Understanding such criteria well before negotiations begin will give you time to arrange things to maximize the probability of a transaction meeting both your objectives and the investor's or buyer's needs.

Lastly, one should be prepared for the unsolicited approach. Unsolicited approaches by bona fide buyers do occur, and range from bargain hunters to the opportunity of a lifetime. Since the latter are usually motivated by a buyer's or investor's immediate needs or circumstances, they tend not to wait around Caramanolis-Cötelli, B., (1995). You always can prepare yourself by having established relationships with financial advisors who know your business, whom you trust and to whom you can turn for counsel on a quick reaction basis, post Child, J., and Rodriguez,. Even with an offer in hand, it's seldom downhill to the finish line. An expression of interest or an offer is just the beginning of the process. How it's handled can make a huge difference in how it turns out. Even the largest corporations almost invariably retain an investment banker as a financial advisor (in addition to attorneys and accountants), even when they already know the investor or buyer.

2.8 Factors affecting success of IPOs

In this section, we review the current theoretical literature as it pertains to the IPO factors analyzed in this study. The specific areas addressed are: (1) the costs of going public; (2) ownership structure and governance issues; (3) pricing issues; and (4) the stage at which firms go public via an IPO.

2.8.1 The Cost to Go Public

Bhagat and Frost (1986), Ritter (1987), Barry, Muscarella, and Vetsuypens (1991), Aggarwal and Rivoli (1991), Lee et al. (1996), and Chen and Ritter (2000) have all studied the costs of raising capital. All of these studies find evidence of economies of scale in the offering process. That is, very large issues tend to enjoy a relatively lower cost of going public and very small issues tend to pay a relatively larger price to conduct an IPO. Additionally, for issues that are neither very large nor very small, Chen and Ritter (2000) document that over 90 percent of the issues pay a gross underwriter spread of exactly 7 percent.

The literature on the costs of going public cost is descriptive in nature. As such, this study reports the summary statistics of the total expenses required to take the firm public.

Jensen and Meckling (1976) argue that agency costs exist with the separation of ownership and management. In a recent article, Ang, Cole, and Lin (2000) provide compelling evidence for Jensen and Meckling's theoretical arguments using small business data. Among the evidence provided in Ang, Cole, and Lin (2000), it is reported that the ownership share of the primary owner, the insider ownership, and whether a firm is family-owned all decrease agency costs. In an IPO setting, and specifically addressing insider ownership, Mikkelsen, Partch, and Shah (1997) (using U.S. data) and Goergen (1998) (using U.K. and German data) show that operating performance over the first ten years of public trading is unrelated to the ownership position of officers and directors.

Extending the work of Jensen and Meckling (1976) and Ang, Cole, and Lin (2000), we hypothesized that firms with greater insider ownership and family-owned firms would be positively related to the probability of success. Extending the work of Frye (1998) who finds that large block-holdings lead to more uncertainty, we predicted the size of the largest block of ownership to be negatively related to the probability of success.

2.8.2 Governance Issues

Board of director literature (for example, Lipton and Lorsch 1992; and Jensen 1993) argues that the optimal size of corporate boards is between seven and nine members. The function for the optimal size is concave downward. As such, the extant theory suggests that the utility of the board size increases until at least seven members are reached.

Thus, due to the firms in our sample and the concave nature of board of director utility functions, we hypothesize that there will be a direct relationship between the number of directors and the likelihood of a successful offer. This prediction is an extension of the empirical findings of Frye (1998) who finds a positive relationship between the number of outside board members and firm performance of large IPOs.

2.8.3 Pricing Impacts on Going Public

Seguin and Smoller (1997) provide evidence that an inverse relationship exists between the offering price of an IPO and subsequent market performance. Specifically, they find that lower priced stocks have higher mortality rates. This study extends their research to determine whether a similar relationship exists between the offering price and success of IPOs (measured by aftermarket returns in Seguin and Smoller (1997) and by a successful offer in this study). Relying upon the Seguin and Smoller (1997) logic and results, we predict a positive relationship between the offering price and the probability of a successful IPO.

Additionally, Seguin and Smoller (1997) posit that the market capitalization of the firm will be directly related to the success of the IPO. They were surprised by their empirical results that indicate market capitalization is not related to IPO performance. Relying on the original logic of Seguin and Smoller, the study predicted a positive relationship between market capitalization and issue success. However, remembering their empirical finding, the study was prepared to find no such relationship.

2.8.4 The Business Life Cycle and Going Public

In a theoretical model, Maug (2000) argues that the optimal time for insiders to take a firm public is when they have lost comparative advantage over outside investors in gathering information pertaining to the firm's growth prospects. Maug argues that in life cycle phases where firm-specific information is most critical (for example, developmental and startup phases), insiders have an advantage in gathering information about the company. When this is not the case, outside investors have the advantage, and it is more likely that the firm will go public once the insider advantage is lost.

Prior to operations and finishing the development stage, insiders maintain a competitive informational advantage. Following Maug's logic, the study predicts firms in the early stages of the life cycle will be in the optimal position to stay private and will thus be associated with failed public offerings.

The final set of variables the study considers relates to the signaling literature (for example, Leland and Pyle 1977). The basis for the signaling argument is that insiders in the firm can

provide a costly or verifiable signal that validates firm quality. Investors can observe these signals and mitigate the classic adverse selection lemons problem noted by Akerlof (1970). The signalling variables include the current number of employees; the after-tax earnings from the prior year; the net tangible book value; total debt; and executive remuneration in the previous year.

Firms with more employees (often used as a proxy for size in the literature) may be viewed by potential investors as more established/less risky businesses and as such should be positively related to the chance of success. Assuming a risk averse utility function, investors should prefer firms with a successful track record. To measure the historical performance of each company, the study uses after-tax earnings from the prior year and net tangible book value. Because the after-tax earnings captures only one year of performance, the study includes tangible book value in an effort to cumulate historical performance. Tangible book value is defined as total assets (exclusive of copyrights, patents, goodwill, research and development, and similar intangible items) minus total liabilities.

The acquisition of external debt financing sends two signals to potential investors, depending on the source of the debt. In the case of institutional lending, firms must have successfully gone through the borrowing process. This includes presenting enough information (and perhaps collateral) to the institution to convince the bank loan officer that any asymmetry of information has been reduced to an acceptable level. That is, the firm has already convinced an institution that the marginal costs associated with adverse selection and moral hazard are less than the marginal benefits of making the loan. Potential equity investors can free-ride, essentially using the bank's screening process to screen the small firm at no cost.

Personal outstanding debt can be seen as a signal that the firm's management is confident in its ability to pay back the debt over some specified amount of time. All of the firms in our sample with outstanding personal debt owed it to either a member of management, a member of the board, or both. Thus, by taking a risk with their personal wealth (and potentially risking financial ruin), these managers signal that they are extremely confident in future firm performance. In both cases (that is external and personal debt), the study predicted a direct relationship between the amount of debt held by the firm and the probability of acquiring outside equity capital.

CHAPTER THREE

3.0

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presented the methodology of the study. It outlined how the study was carried out. The chapter presented the research design, the population, sample and sampling technique, data collection method and instruments and data analysis.

3.2 Research design

There are several research designs ranging from exploratory studies, descriptive studies, explanatory studies. Within each of these designs are strategies that can be applied such as experiment, survey, and case study. This research problem was best studied through the use of a descriptive survey. Descriptive research portrays an accurate profile of persons, events, or situations (Robson, 2002). Surveys allow the collection of large amount of data from a sizable population in a highly economical way. It allows one to collect quantitative data which can be analysed quantitatively using descriptive and inferential statistics (Saunders et al., 2007). Therefore, the descriptive survey was deemed the best strategy to fulfil the objectives of this study.

3.3 Population and sample

The target population for this study were the companies listed on the NSE. There are 55 listed firms in Kenya. The sample size was the entire population i.e. all the 55 listed firms. Both causal and analytical approaches were used in data analysis. The data was analysed through use analysis software SPSS. The data was coded, analyzed and interpreted in terms of factor determinant of a successful IPO. The research then obtained a central measure of performance levels. The different results were compared using tools such as rank correlation coefficient to test the strength of the relationship of the profits from performance.

This study focused on firms listed in the main market segment of the Nairobi Stock Exchange during the period 2005-2009.

3.4 Data collection

Secondary data was collected on the issues of IPO from the companies as well as the NSE and the CMA. Secondary data included data on level of equity/debt, number of Directors on the board, profitability, and length of operation.

3.5 Data analysis

Both descriptive and analytical approaches was utilised in data analysis. The researcher intends to use analysis software such as Microsoft Excel and SPSS. The data collected will be used to analyse the research questions. The researcher got a central measure of impact levels. The two was compared using tools such as rank correlation coefficient to test the strength of the relationship on the turn of the month effect

The following model was used for the logistic regression analysis:

$$\text{Success} = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \dots + \beta_j X_j + \varepsilon \text{ for } j = 1, 2, \dots, k$$

Where:

Success = 1 if the offer was successful and 0 otherwise

β_0 is the intercept of the model

β_j are coefficients where $j \neq 0$

X_j are the repressors of a given model with maximum $j = k$, and

ε is the error term of the model.

In this case X_1 - Corporate governance index, X_2 -Sales/Revenue, X_3 - Age of the firm, X_4 -level of Debt /Equity

Afterward, the data was analysed through descriptive statistics such as percentages, ranking, scales and averages. For each listed firm, factor determinant index was computed as an equal sum of the 4 determinant items. This was coded into a computer using Software Package for social sciences (SPSS) version 17.0. The results were then presented in form of charts, tables and graphs and it is from these presentations that conclusions were drawn.

CHAPTER FOUR

4.0 DATA ANALYSIS, PRESENTATION, INTERPRETATION AND DISCUSSION

In this chapter, data is presented using non-text approaches such as tables, pie charts and graphs. The data was analyzed quantitatively using the Statistical Package for Social Sciences (SPSS). The analysis was done per code sheets that were used to collect data. Data was categorized in terms of the factor that determine a successful initial purchase offering (IPO) among Nairobi stock exchange listed companies.

4.1 Chapter Discussion and Interpretation.

This chapter provides an analysis of data collected from the secondary. The results are presented in tables to highlight the major findings. They are also presented sequentially according to the research object. Mean scores Kurtosis, Jarque-Bera, Probability analysis and standard deviations are used to carry out analysis of data collected. The raw data was coded, evaluated and tabulated to depict clearly the results to explore the role the determinants of a successful IPO on the value of firms in Kenya. This chapter consist of this section 4.1 as the introduction, section 4.2 presents summary of statistics of the sample data, section 4.3 summary of output, section 4.4 the analytical model, Section 4.5 discussion of the results and 4.6 contains a brief summary of the results.

4.2 Summary Statistics

The following table (4.2.1) demonstrates the summary statistics for the variables used in this analysis and the descriptive statistics which covers all the five variables enumerated in the model to determine a successful IPO. As observed Initial public offering (IPO) firms typically go public on the promise of growth thereby conditioning investors to expect capital gains rather than dividends during the post-IPO phase. In fact, the offering prospectuses of most IPO issuers usually indicate that the firm is unlikely to pay dividends in the foreseeable future. IPO issuing firms are usually in their early stages of development and belong to rapidly growing, technologically oriented industries. They are expected to invest substantially in areas such as R&D, advertising, and capital expenditures, post-IPO, in an effort to gain market share and achieve technological dominance in their rapidly evolving industries.

Table 4.2.1 Summary Statistics' of the Relevant Variables Pooled

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation	Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error
Tobin Q	55	.11	.76	.4250	.22178	-1.496	.992
AGE OF THE FIRM	55	2.40	4.57	3.5535	.62661	-.324	.992
CG-INDEX	55	3.10	5.40	4.1900	.64392	-.407	.992
SALES/REVENUE	55	7.13	11.18	9.2690	1.22355	-.841	.992
DEBT/EQUITY	55	.32	7.89	2.4015	2.42779	.507	.992
Valid N (listwise)	55						

SOURCE: Research Findings (2010)

A share can be valued using the discounted cash flows expected from it in future. It can also be valued using the company's earnings multiples or the book value multiples. There are other intangible values of a company which cannot be accurately quantified and hence accurately incorporated in the share value.

Table 4.2.2 Correlations

	Tobin Q	CG-INDEX	SALES/REVENUE	AGE OF FIRM	DEBT/EQUITY
Pearson Correlation Tobin Q	1.000				
CG-INDEX	-.341	1.000			
SALES/REVENUE	-.403	.225	1.000		
AGE OF FIRM	-.228	.100	.220	1.000	
DEBT/EQUITY	-.880	.297	.261	.290	1.000

Source: Research Findings (2010)

Collinearity is the term used to explain the dependence of one variable to other. When variables are highly correlated they both express basically the same information. Statistically we do not need multicollinearity because if they exist, then independent variables are redundant and do not add any predictive value over each other. In general, independent variables having collinearity at -0.52 or less would not be included in regression analysis. In the data the highest correlation value is 0.88 (Table 4.2.2) that means collinearity should not constitute a problem in this regression analysis. The table shows that all variables are negatively correlated with each other.

4.3 Summary Output

Intercept is β_0 in the equation. Standard error measures the variability in our approximation of the coefficient and lower standard error means coefficient is closer to the true value of coefficient. Tobin Q is dependent variable and G-score, Sales/Revenue, Age of the Firms in the market, are independent variables. Result shows that Sales/Revenue and Debt to Equity are not statistically significant, G-score and Age of the firms are significant at 5%. R square represents the percent of the movement of the dependent variable is captured by the intercept and the dependent variable(s). Our results explain roughly 81% of the variation in leverage which is captured by independent variables. F-value shows that overall model is satisfied at the 1% level.

4.4 The Analytical Analysis

A Multiple regression model was obtained after regressing the variables in respect of the dependent variable that is Tobin Q for the 55 Kenya listed firms.

The analytical model was obtained as follows:

$$\text{TOBIN Q}(Y) = \beta_0 + \beta_1 \text{G-SCORE} + \beta_2 \ln \text{SALES} + \beta_3 \ln(\text{AGE}) \text{AGE} + \beta_4 (\text{DEBT} / \text{EQUITY}) + \varepsilon_{i,t} \dots \dots \dots (2)$$

$(y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon_{i,t})$ Where:

$\beta_0, \beta_1, \beta_2, \beta_3$ and β_4 are constants

Q = Tobin's Q

G-SCORE = CG Score,

SALES = Gross sales/Revenue of the firm

AGE = Year of observation minus Year of incorporation

DEBT/EQUITY = Total debt of the firm divided by the total paid-up capital of the firm

ε = The error term for the FIRM_i in the period t.

Coefficients

Model		Unstandardized Coefficient		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.791	.228		3.474	.003
	CG-INDEX	.044	.044	.127	1.002	.332
	SALES/REVENUE	-.041	.022	-.227	-1.909	.076
	AGE OF THE FIRM	.006	.044	.016	.128	.900
	DEBT/EQUITY	-.078	.011	-.857	-7.316	.000

a. Dependent Variable: Tobin Q

From the analysis of the model from Table 4.3 the following analytical model was obtained in respect to the various variables Tobin Q as the Endogenous variable of the model while the exogenous variables are G-score, Sales, and Age of the firms in the market and Debt to Equity ratio.

The following analytical model was obtained:

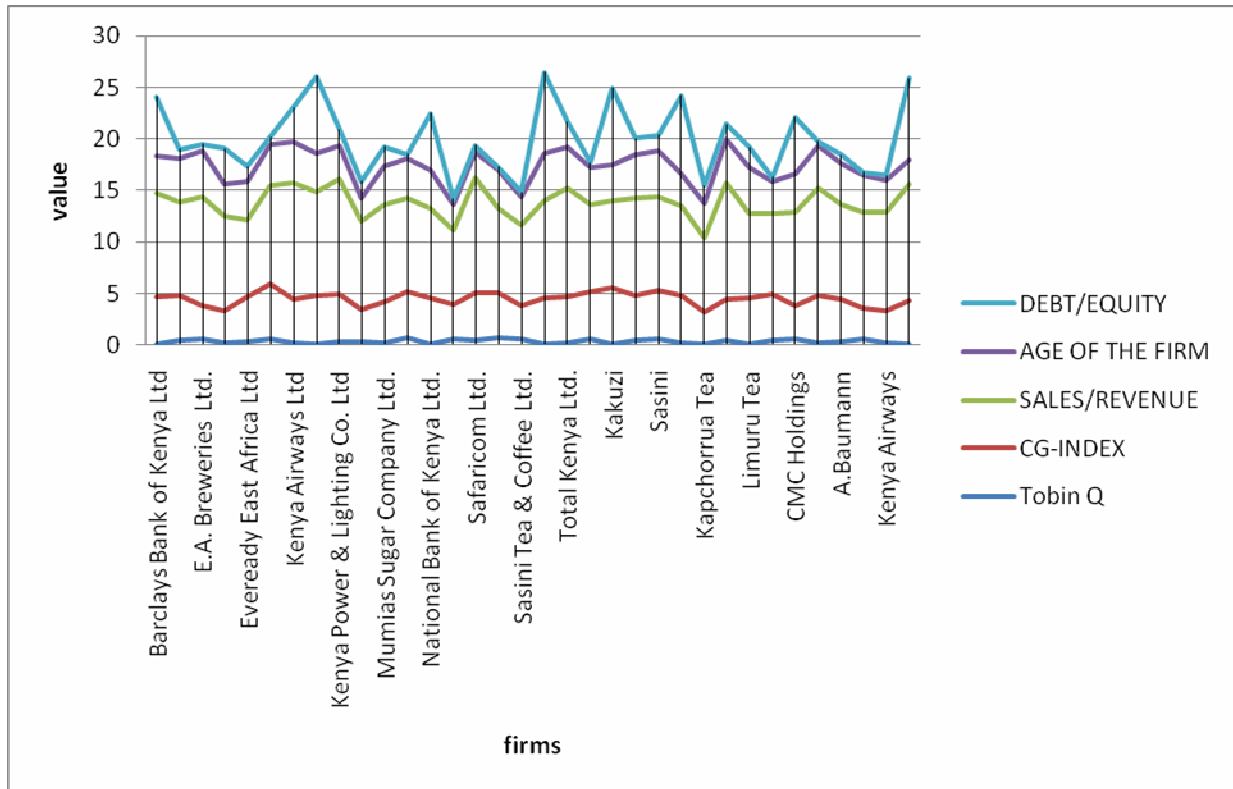
$$Q = 0.594 + 0.01G\text{-SCORE} - 2.12\text{SALES/REVENUE} + 0.0004\text{AGE OF FIRMS} - 0.081\text{D/E} + \epsilon \dots \dots (2)$$

From the above Analytical model, G-score, sales/revenue, age of the firm in the market, and debt to equity ratio of firms in Kenya constants, Tobin Q for the sampled firms would be 0.594. It is established that a unit increase in G-score of the firms would cause an increase in Tobin Q by a factor of 0.01, a unit decrease in sales /revenue would cause an decrease in Tobin Q by a factor of 2.12, also a unit increase in age of the firm in the market would cause an increase in Tobin Q by a factor of 0.0004, further unit decrease in debt to equity ratio would cause an decrease in Tobin Q by a factor of 0.081.

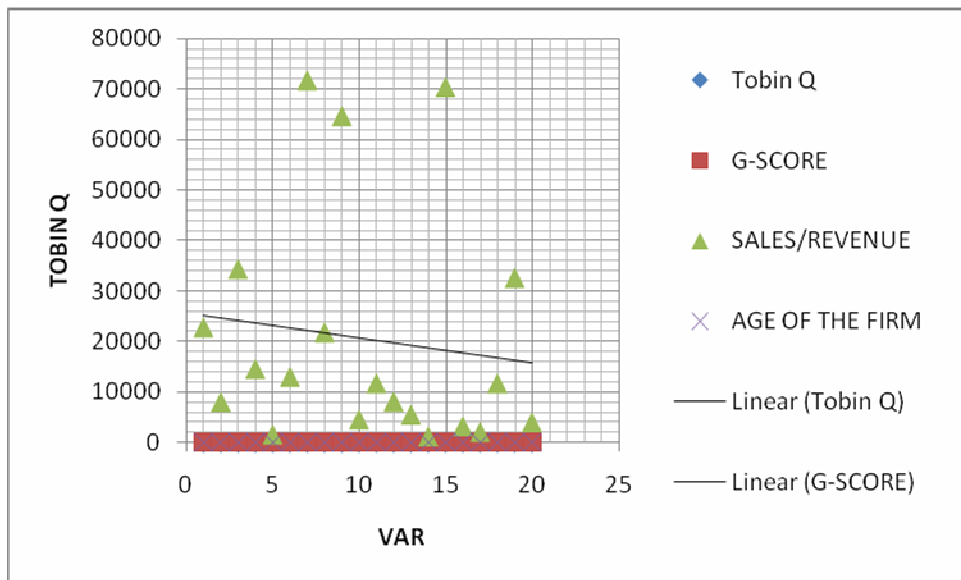
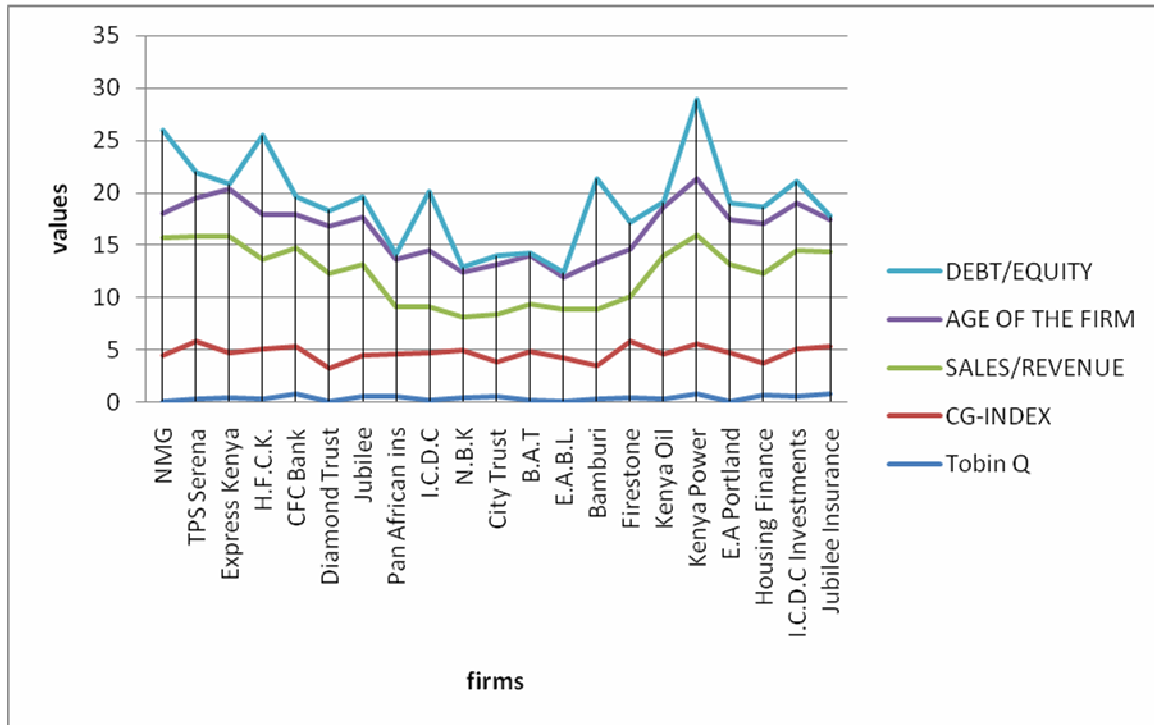
GRAPH 1-LINE OF BEST FIT OF THE MODEL PERFORMANCE, CORPORATE GOVERNANCE AND TOBIN'S Q

Scatter plot of corporate governance Score (G-score) versus Tobin's Q. The fitted line is estimated using all 55 observations for data on C-Score and Tobin's Q. Extreme values (highest and lowest 5% of values for Tobin's Q) are suppressed in the scatter plot for better visual presentation.

Distribution chart of corporate governance index



Distribution chart of corporate governance index



Source: Research Findings (2010)

4.5 Discussion of the Results

Results obtained from analysis, expressed in terms of the signs and statistical significance of the coefficients for the selected five independent variables are presented in table 3. Result discussion below is categorized on the basis of these independent variables and focuses on their associations with the effects of determinants of a successful IPO on firm value. Morck et al. (2005) offer a review of literature on connection between country-level rules affecting corporate governance and firm behavior and the strengths of securities markets. Klapper and Love (2004) analyze connection between a measure of firm-level governance and share price on a cross-country basis. Bernard S. Black made a seminal contribution to the study of the impact of governance on firm valuation in Russia and other emerging markets (Black, 2001; Black et al., 200). Caprio et al. (2003) deal specifically with the link between the value of a firm and shareholder protection devices and state-imposed controls. Choi and Hasan (2005) examine the effect of ownership and governance on bank performance in Korea. Staryuk (2008) used value-based management concept to research how corporate governance has driven stock market valuation of Russian ‘blue chip’ companies. (Bokov, Vernikov, 2008) made an attempt to explain the differences in the valuation of Russian banks from a quality of governance point of view.

In this regard the discussion of the variables of the model supported the studies of effects of a successful IPO on firm value as in the case of Kenya firms, the exogenous variables also turn out to be significant, but are negatively related with the firm’s performance. Although firm size, as measured by sales revenue, should have a positive relationship with firm’s value due to the advantages of economies of scale (Baumol, 1959), organizational inefficiency called x-inefficiency (Leibenstein, 1966) leads to loss of profit, a likely situation in larger firms. A firm’s age could work either way. Old firms have a reputation advantage, but they tend to be prone to inertia and bureaucratic rigidities. We found the coefficient of Age to be negative, which means that younger firms (typically new age firms) command higher market valuation.

In a Modigliani-Miller framework, the market value of any firm is independent of its capital structure. If tax shields are precious, then the firm value should increase with the amount of leverage. However, high level of indebtedness may negatively impact investors’ psychology. If the firm fails to credibly project its investment decision leading to a positive NPV, then a higher amount of debt may drive down the value of the firm.

In determining the performance of a recent IPO, a survey of Safaricom IPO indicates confusion of the value of a firm by the investing public.

According to Market Research report by Standard Bank – Equities Research (Safaricom; Steadier ARPU and costs – Mkesho traction , August 2010) Safaricom’s Share price valuation as at August 2010 was Kshs 6.64. This varies from the IPO price of Kshs 5.00.

The enhanced valuation was underpinned by the following factors which may have been overlooked at the time of the IPO

- A leading operator with 84% share (by revenue) of the voice market
- Safaricom’s voice ARPU (average revenue per user) is the highest in the industry, voice will continue to be the biggest contributor to revenue and net profit in the years ahead. Even with projected ARPU decline due to competition this would be off-set by increase in voice subscribers.
- Transformation of the market such as growth of data revenues streams: internet services, M-PESA and SMS (text messaging). Broadband internet is considered to have significant potential, given that internet penetration is still below 10% in Kenya and a majority of the populace cannot afford laptops. Collectively, data is expected to comprise at least 30% of total revenue by 2013, up from 19% as at March 2010. Add-on products such as M-KESHO are expected to help Safaricom retain customers M-PESA is expected to have a 30% EBITDA margin within the next two to three years
- New products such as M-KESHO, the mobile phone-based Equity Bank account, are expected to help Safaricom retain customers and record the highest proportion of net adds in the industry.

These factors together with variables such as

- Terminal growth rate of 6%. The company's sustainable growth will be closely linked to adult population growth and penetration levels (voice and data), as well as the long-term growth prospects for the economy.
- Weighted average cost of capital of 12.11%. (cost of equity of 12.90% and an after-tax cost of debt of 7.7%.) and a target debt ratio (debt-to-total capital) of 15.10% over the next three years. Safaricom is, however, much less leveraged than its peers and has considerable scope to acquire additional debt and make its balance sheet more efficient.

Mobile phone penetration in Kenya is set to increase significantly over the next four years, helping maintain voice as Safaricom's main revenue and profit generator

The foregoing shows that the value of the firm may not be adequately factored in the IPO price thus leading to inaccurate perception of the firm's value by the investing public. This is particularly evident in the telecommunications industry which is experiencing rapid transformation and investors may not be able to accurately map the business life cycle.

This perception (and lack of adequate knowledge of determinants of a successful IPO) has to an extent contributed to the investing public's apathy /disappointment with the recent Safaricom IPO.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND SUGGESTIONS

5.1 Introduction

This final chapter of the research provide a brief summary of the study's findings that are discussed in light of its objectives. The chapter also provides the researcher with documented conclusions and recommendations thereof.

5.2 Summary of the findings and conclusion

The study explores the determinants of a successful IPO. It singles out four key items that are critical in assisting an investor determine the fair value of a firm and hence informs the investment decision. These items were derived after reviewing the path followed by 55 firms listed in the NSE. Successful IPO is relatively under-researched area. One possible reason behind the fact is lack of global consensus on the definition and imperative list of constituents of good corporate governance. Equally important, there is no widespread corporate governance composite which would be applied consistently and freely available to all capital market participants.

It may be the case that the issuer has better information on the value of the security than do the investors or underwriters. Alternatively, it may be the case that the underwriters possess information superior to the issuer and investors. It may also be the case that the most important informational asymmetry may arise within a market group rather than between different groups. That is, investors are differentiated by their levels of information about the true value of the issue into "informed investors" and "uninformed investors", with the former having perfect information. As a result of this asymmetry, informed investors compete with uninformed investors only for "good" issues, creating adverse selection in which the probability of obtaining shares in "bad" issues is higher for uninformed investors

Numerous studies have focused on the relationships between corporate governance practice and firm performance i.e IPO with mixed results indicating that good corporate governance practices may not necessarily lead to better firm performance. The divergence of findings may be because it is difficult to measure corporate governance; a detailed review of changes can be found in Patterson

(2000). In the U.S., evidence of correlation between a firm's corporate governance attributes and its value is weak.

5.3 Limitations of the study

The study faced a number of limitations, which are discussed as follows. One of the limiting factors was the time to carry out research especially could use a longer period to capture the effects of determinants of a successful IPO on firm value, an empirical assessment of Kenya firms. Another difficulty has to do with interpreting the results.

Interpretations are more difficult in the context of international standards than from domestic perspective because the number of confounding factors multiplies when moving out of a strictly domestic setting. Thus, Kenya is still at infant stage of development and growth; it is therefore faced with problems of measuring Corporate Governance in terms of acceptable Corporate Governance Quotient and Governance Metrics International. Therefore, this finding may not be easily generalized to international context.

The above research involved data analysis, which may have incurred a lot of errors in the analysis and hence deduction may not be satisfactory. Finally the data utilised was a secondary data gathered from the 55 companies listed on the NSE chat which may be prone to errors.

5.4 Suggestions for further research

In the context of Kenya, some areas are worth further research. The unique institutional environment in the Kenyan market whereby there is high (share) block holding and government ownership, weak legal investor protection and lack of active market local investors have affected success IPOs. There is a need to explore alternative model where the roles of foreign institutional investors, fund managers, firm reputation, proxy contest and other voluntary mechanisms may be emphasized.

There are successful family owned or controlled companies in Kenya. More in-depth empirical study on the merits and demerits of family ownership structure and how it has impacted firm value.

May be the resource dependency theory can better explain the success of these companies. If so, how successful IPO may evolve in these companies and what can be done to better align the interest of controlling family ownership and other shareholders? Also the Empirical multi-country study on the differences in legal environments, such as legal investor protection merits and takeover codes and how these differences affect firm liquidity and valuation.

In view of the critical role of corporate governance as a determinant factor for a successful IPO, specific studies on the effects of corporate governance in such firms could be done. Studies on corporate governance have been done elsewhere, whereby indices and weights are applied to specific parameters of corporate governance (Esmeralda et al, 2005),

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Appendix 1

Secondary data

FIRMS	Tobin Q	CG-INDE X	SALES/REVENUE	AGE OF THE FIRM	DEBT/EQUITY
Barclays Bank of Kenya Ltd	0.15	4.6	10.04	3.47	5.82
E.A Portland Cement Co. Ltd.	0.51	4.3	8.99	4.23	0.97
E.A. Breweries Ltd.	0.58	3.3	10.45	4.45	0.74
Equity Bank Ltd.	0.23	3.1	9.14	3.18	3.4
Eveready East Africa Ltd	0.4	4.3	7.41	3.71	1.53
Kengen Ltd.	0.58	5.4	9.48	3.99	0.72
Kenya Airways Ltd	0.23	4.3	11.18	3.99	3.36
Kenya Commercial Bank Ltd.	0.12	4.8	9.99	3.64	7.55
Kenya Power & Lighting Co. Ltd	0.38	4.6	11.09	3.22	1.63
Kenya Re-Insurance Ltd.	0.4	3.1	8.44	2.4	1.53
Mumias Sugar Company Ltd.	0.29	4	9.38	3.61	1.97
Nation Media Group Ltd.	0.71	4.5	9.01	3.89	0.41
National Bank of Kenya Ltd.	0.15	4.5	8.63	3.69	5.5
Rea Vipingo Ltd.	0.69	3.3	7.13	2.56	0.45
Safaricom Ltd.	0.56	4.5	11.16	2.4	0.79
Sameer Africa Ltd.	0.76	4.4	8.1	3.66	0.32
Sasini Tea & Coffee Ltd.	0.69	3.2	7.69	2.83	0.45
Standard Chartered Bank Ltd.	0.11	4.5	9.37	4.57	7.89
Total Kenya Ltd.	0.28	4.5	10.39	3.97	2.52
TPS (Serena) Ltd.	0.68	4.6	8.31	3.61	0.48
Kakuzi	0.15	5.4	8.44	3.47	7.55
Rea Vipingo	0.51	4.3	9.38	4.23	1.63
Sasini	0.58	4.8	9.01	4.45	1.53

	0.23	4.6	8.63	3.18	7.55
G. Wiliamson					
Kapchorrua Tea	0.15	3.1	7.13	3.47	1.63
Eaagads	0.51	4	11.16	4.23	1.53
Limuru Tea	0.15	4.5	8.1	4.45	1.97
Uchumi	0.51	4.5	7.69	3.18	0.41
CMC Holdings	0.58	3.3	8.99	3.71	5.5
Standard News	0.23	4.6	10.45	3.99	0.45
A.Baumann	0.4	4.1	9.14	3.99	0.79
Marshals	0.58	3.1	9.14	3.64	0.32
Kenya Airways	0.23	3.1	9.48	3.22	0.45
NMG	0.12	4.3	11.18	2.4	7.89
TPS Serena	0.38	5.4	9.99	3.66	2.52
Express Kenya	0.4	4.3	11.09	4.5	0.48
H.F.C.K.	0.29	4.8	8.44	4.4	7.55
CFC Bank	0.71	4.6	9.38	3.2	1.63
Diamond Trust	0.15	3.1	9.01	4.5	1.53
Jubilee	0.51	4	8.63	4.5	1.97
Pan African ins	0.58	4	4.5	4.6	0.41
I.C.D.C	0.23	4.5	4.4	5.4	5.5
N.B.K	0.4	4.5	3.2	4.3	0.45
City Trust	0.58	3.3	4.5	4.8	0.79
B.A.T	0.23	4.6	4.5	4.6	0.32
E.A.B.L.	0.12	4.1	4.6	3.1	0.45

Bamburi	0.38	3.1	5.4	4.5	7.89
Firestone	0.4	5.4	4.3	4.5	2.52
Kenya Oil	0.29	4.3	9.37	4.6	0.48
Kenya Power	0.71	4.8	10.39	5.4	7.55
E.A Portland	0.15	4.6	8.31	4.3	1.63
Housing Finance	0.69	3.1	8.44	4.8	1.53
I.C.D.C Investments	0.56	4.5	9.38	4.6	1.97
Jubilee Insurance	0.76	4.5	9.01	3.1	0.41

Appendix 11

Barclays Bank of Kenya Ltd.
E.A Portland Cement Co. Ltd.
E.A. Breweries Ltd.
Equity Bank Ltd.
Kengen Ltd.
Kenya Airways Ltd.
Kenya Commercial Bank Ltd.
Kenya Power & Lighting Co. Ltd.
Kenya Re-Insurance Ltd.
Mumias Sugar Company Ltd.
Nation Media Group Ltd.
National Bank of Kenya Ltd.
Rea Vipingo Ltd.
Safaricom Ltd.
Sameer Africa Ltd.
Sasini Tea & Coffee Ltd.
Standard Chartered Bank Ltd.
Total Kenya Ltd.
TPS (Serena) Ltd
Eveready East Africa Ltd
Brooke Bond
Kakuzi
Rea Vipingo
Sasini
G. Wiliamson
Kapchorrua Tea
Eaagads
Limuru Tea
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CMC Holdings
Standard News
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Diamond Trust
Jubilee
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I.C.D.C
N.B.K
City Trust
B.A.T
E.A.B.L.
Bamburi
Firestone
Kenya Oil
Kenya Power
E.A Portland
Housing Finance
I.C.D.C Investments
Jubilee Insurance
Bamburi Cement
British American Tobacco

SOURCE: RESEARCH DATA (2010)