THE EFFECT OF INITIAL PUBLIC OFFERS ON THE FINANCIAL PERFORMANCE OF FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

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DECLARATION

I declare that this research project is my original work and it has not been submitted to this or any other university or institution for any examination or other purposes.

Signed…………………….   Date……………………………

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D63/60127/2013

This research project has been submitted for examination with my approval as the University supervisor.

Signed……………………….   Date……………………………..

Supervisor: Prof. Josiah Aduda

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My sincere gratitude goes to my supervisor Dr. Josiah Aduda who was very supportive. His professional advice and encouragement throughout the time of this research project was very instrumental.

DEDICATION

This research work is dedicated to my family and friends: Special dedication goes to my parents and siblings for their love and support. Their encouragement and support has assisted me greatly in completion of this project.

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ABSTRACT

The study sought to investigate if there is significant difference in profitability, liquidity, leverage and the overall financial performance of companies before and after going public. The study analyzed fourteen companies which went public before 2000. The study used balance sheets and the Income statements to compute financial ratios which were the basis of the study. The ratios which were analyzed include: profitability, liquidity and leverage ratios. The data was analyzed using the MS Excel. Trend analysis findings showed that profitability, liquidity, leverage and the overall financial performance increased after IPO. Generally the finding showed that the overall financial performance after going public improves in terms of trend analysis but not significantly though the profitability increases significantly. The decision to go public affected not only the profitability but also the overall financial performance. The study concludes that private companies should start thinking of going public to reap the benefits associated with it. Though there substantial costs associated with going public, companies should not shun from the process since it has numerous benefits.

ABBREVIATIONS

AIMS	Alternative investment market segment
CMA	Capital Market Authority
EPS	Earnings per share
FISMS	Fixed income security market segment
IAS	International accounting standard
IPO	Initial public offer
MIMS	Main investment market segment
NSE	Nairobi Stock exchange
ROA	Return of asset
ROE	Return on investment

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Financial performance is a subject measure of how well a firm can use assets from its primary mode of business and generate revenues. It can be used to measure a firms overall financial health over a given period of time. This can be used as a basis for comparison of similar firms across the industry, or to compare industries or sectors in aggregation. To know the financial performance of a company, one has to conduct a financial analysis. Financial analysis is the use of financial statements to analyze a company's financial position and performance and to assess the future financial performance (Halsey, 2001).

The source of capital for an entrepreneur that is least subject to problems caused by information asymmetries is self-financing. Entrepreneurs contribute their own money with limited resources, however, the ability to grow rapidly will be constrained if external sources of capital are not used (Ritter, 1991).

1.1.1 Initial Public Offering

An initial public offering can be defined as the first selling of a company's stock to outside investors and then letting the stock trade in public markets (Brigham & Ehrhardt, 2005). When going public, firms are faced with the difficult decision of how to determine the offer price for their shares. This continues to be a considerable practical and theoretical importance for investors and academicians. However, despite considerable research efforts, IPO valuations are still largely mysterious (Giordano et al, 2008).

A private or state owned corporation can choose to sell its shares to members of the public in a securities market through an Initial Public Offer (IPO) among many other forms of stock introduction. An initial public offer is a type of public share sale where a portion of the equity of a privately held company is sold to the public with the expectation that a liquid market will develop (Ritter, 1998). This usually converts a business from one that is privately owned to one that is publicly owned. Going public has various advantages, the primary advantage being that it helps a company raise capital that it may then use to fund research and development, capital expenditure or even to pay off existing expensive debt in its books (KPMG, 2008). It also helps 2 increase public awareness of the company and this may generate publicity for their products and help increase their market share (Ernst and Young, 2012). In the case of Kenya, the relevant security market is Nairobi Securities Exchange (NSE). The NSE can be defined as the meeting place between those who want to sell securities and those who want to buy securities in the Kenyan market.

As a firm becomes large, private financing through self-financing or use of debt may be in adequate to raise capital to fund expansion; this is the point in which it is optimal to go public, even though there are substantial costs associated with "outside" equity. Private firms therefore can raise money by offering securities for sale to the public for the first time. This is called an initial public offering, securities for sale to the public for the first time and through the initial public offering a firm is said to have gone public (Ritter, 1991).

Mbui (2001) explains that the decision to list is explained mainly by the need to raise funds for expansion and growth without the interest burden of funds borrowed from lending institutions, to improve the liquidity of their securities and also to increase the public awareness about the company and its products.

Ritter (1991) argues that an initial public offering is generally perceived as one of the most important milestones in a firm's lifecycle. Going public is the first public offering of equity (seasoned offering)- An issue of additional securities from an established company whose securities already trade in the secondary market and typically the first public offering of any security undertaken by the firm. Going public allows the firm access to the public capital markets for the first time in its life and hence may have important implication for its ex ante characteristics such as profitability, leverage and liquidity. It not only satisfies the immediate capital requirements of the firm, but also paves the way for the firm to make unseasoned offerings (subsequent public offering of equity and other corporal securities).

Museum (2008) said that as people walk in the investment maze with the analysts yapping their buy and sell slogans in the trading floor, the market is really looking good, and more than ever before, it is the best time to turn to the stock market for long term financial independence. Companies planning to get listed should act quickly while the markets not just driven by the company's specifics but speculative aspects, otherwise, the fore may not be as exciting as today is.

1.1.2 Financial Performance

Financial Performance is a subjective measure on how well a firm uses its assets from its primary mode of business to generate revenue. Financial performance refers to the degree to which financial objectives being or has been accomplished. It is the process of measuring the results of a firm's policies and operations in monetary terms. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare industries or sectors in aggregation (Trivedi, 2010).

The financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the balance sheet and profit and loss account. The first task is to select the information relevant to the decision under consideration from the total information contained in the financial statements. The second is to arrange the information in a way to highlight significant relationships. The final is interpretation and drawing of inferences and conclusions. In short, "financial performance analysis is the process of selection, relation, and evaluation." (Trivedi, 2010). Accountants and economics have derived and used various financial ratios to assess company financial performance. These ratios mainly involve the company liquidity – cash flow liquidity ratios debt management – financial leverage index, asset management – returns on total assets profitability – cash flow margin and return on investment – dividend yield (Brealy, 2003).

According to Waymond (2007), profitability is associated with the results of management performance ROE and ROA are the most commonly used ratios and the quality level of ROE is between 15% and 30%, for ROA is at least 1%. The purpose of ROE is to measure the amount of profit generated by the equity in the firm. ROE is also an indicator of the efficiency to generate profits as well.

1.1.3 Measures of Financial Performance

Reilly and Brown (1997) say that, performance is the extent to which organizational goals and objectives are achieved. It looks at both efficiency and effectiveness. Measures of performance include both financial and non-financial measures. Financial performance measures involve analyzing the financial statements of organization. The financial statements provide information on the resources available to the management, how these resources are financed, and what the company accomplishes with them. According to Bernstein (1983), performance is the source of

rewards required to compensate investors and lenders for the risks that they are assuming.

1.1.4 Effect of IPO on Financial Performance

The reason for going public involve the trade – offs benefits of being publicly traded and the associated costs. Financial economists have proposed several benefits of going public for example overcoming borrowing constraints, greater bargaining power with banks, liquidity and portfolio diversification (Pagano, Panetta, and Zingales (1998) say that the decision to go public affects the liquidity of a company's stock as well as the scope for diversification by the initial holders of the company. Shares of private companies can be traded only by informal searching for a counterpart at considerable cost for initiating party), monitoring, investor recognition, change of control and windows of opportunities (If there are periods in which stocks are mispriced as suggested by Ritter (1991), companies recognizing that other companies in their industry are over-valued have an incentive to go public, to the extent that entrepreneurs manage to exploit the overvaluation of their companies by investors).

There are also numerous costs of going public to the original owners which can be direct or indirect. Direct cost include: adverse selection, in general, investors are less informed than the issuers about the true value of the companies going public. This information asymmetry adversely affects the average quality of the companies seeking a new listing and thus the price at which their shares can be sold Leland and Pyle (1977) and also determines the magnitude of the underpricing needed to sell them (Rock 1986). More importantly there is also some administrative expenses and fees that are incurred on top of the initial expenses, there are some yearly layouts on auditing, certification and dissemination of accounting information, stock exchange

fees, etc. Finally loss of confidentiality where by the disclosure rules of stock exchanges force companies to unveil information whose secrecy may be crucial for their competitive advantage such as data about ongoing Research and Development projects or future marketing strategies

Financial performance is often assess firm's production and productivity performance, profitability performance, liquidity performance, working capital performance, fixed assets performance, fund flow performance and social performance.

Measures of central tendency are also known as statistical averages. It is the single value which represents the whole series and contains its measure characteristics. The main objective is to give a brief picture of a large group, which it represents, and to give a basis of comparison with 5 other groups. Arithmetic mean, median, mode, geometric mean and harmonic mean are the main measures of tendency. Mean, also known as arithmetic average, is the most common measure of central tendency. It is defined as the value which obtained by dividing the total of the values of various given items in a series by the total number of items. (Trivedi 2010)

Stein (1989), using a signal-jamming model, shows that, even in efficient capital markets, myopic behavior like window-dressing may persist since it is a Nash equilibrium. In the context of IPOs, his model implies that managers may attempt to manipulate investors' beliefs by pumping up pre-IPO earnings. In equilibrium, the market is not fooled by this behavior and correctly anticipates and accounts for it in its valuation of the firm. The more intuitive equilibrium in which managers avoid window-dressing and, therefore, investors do not need to account for it, cannot be sustained as a Nash equilibrium.

Stein's signal-jamming model can also be extended to show that, in equilibrium, managers may attempt to time issues and that rational investors anticipate and account for this behavior. If the market is able to account for such actions, the long-run investment performance of IPO firms should be normal. However, the longrun investment underperformance documented by Ritter (1991) and Loughran and Ritter (1995) suggests that the decline in operating performance is not anticipated and investors are constantly surprised by the poor performance of IPO firms. Previous studies have shown post-issue declines in the M/B ratio, P/E ratio, and EPS are consistent with this interpretation, suggesting that potential investors initially have high expectations of future earnings growth, which are not subsequently fulfilled.

1.1.5 Nairobi Securities Exchange

The NSE Handbook (2004) defines a stock exchange is an organized market where the trading of the securities are done, institutional and retail investors can buy and sell securities. It can also be defined as a market through which, companies, governments and local authorities can raise funds for expansion and development by issuing equity and debt securities to the public. Securities can be brought to listing through: Initial Public Offer (IPO) where the public at large is invited to subscribe to the securities being issued, introduction which provides a market for existing shareholders and private placements where shares are placed for sale to identified investors. (Jordan *et al*, 2001).

The Nairobi Securities Exchange was constituted as Nairobi Stock Exchange (NSE) in 1954 as a voluntary association of stockbrokers in the European community registered under the Societies Act. It is one of the most active capital markets in Africa. The listed companies were very few and in the recent past the NSE has

undergone major changes and transformations and the level of activity has tremendously increased.

The Nairobi Securities Exchange comprises approximately 61 listed companies with a daily trading volume of over USD 5 million and a total market capitalization of approximately USD 15 billion. Aside from equities, Government and corporate bonds are also traded on the Nairobi Securities Exchange. This offers an opportunity to study the relationship between IPO and performance of firms. The NSE has been selected as a focus of this study given the availability of secondary data for all the firms listed on the NSE hence it will be easier to collect the data and the data will also be very reliable.

The study endeavors to compare the financial performance of eight companies, before they are listed in the Nairobi Stock Exchange and after they are listed. It will make use financial ratios to carry out this analysis. The study will encompass various selected companies listed in the Nairobi Stock Exchange. The study generally will deal with all listed companies in the NSE from the years 1984 to 2000. It will consider all companies listed between 1984 and 2000 which are Jubilee Insurance, Barclays Bank, Kenya Commercial Bank, Nation Printers, Standard Chartered Bank, Crown Berger, Uchumi Supermarkets, National Bank Of Kenya, Housing Finance, Sameer Africa, NIC Bank, Kenya Airways, Rea Vipingo, TPS Serena and Athi river Mining as they meet the criterion that will be considered for the study. It will deal with comparing the financial performance of companies before and after listing in the Nairobi Stock Exchange

1.2 Problem Statement

The IPO performance of a company can be lower than, equal to or higher than the post-performance of a company's market price at the time of the IPO. Each one of these relationships is as likely as the other depending on the market conditions surrounding an initial public offer as well as the competence and experience of the underwriter. The main challenge in trying to determine the above relationship comes from trying to determine the market price of a company whose shares were offered to the public through an IPO. Several authors have shown conflicting results both in developed and developing economies. Jain & Kini (1994), Teoh et al. (1998), Wang (2005), Shiah-Hou (2005), Ahmad-Zaluki (2008) and Mittal & Mayur (2012) all showed a significant decline in operating performance after going public whereas Krishnan (2011), Chancharat (2012), Kinyua et al. (2013), Bessler (2012) and Jacquillat et al. (1978) showed an improvement of performance after going public.

Jain and Kini (1994) investigate the change in the performance of firms as they make the transition from private to public ownership through initial public offerings (IPOs). They found out that IPO firms exhibit a decline in post issue operating performance as measured by the operating return on assets and operating cash flows deflated by assets relative to their pre-IPO firms however comes with a caveat. These firms exhibit high growth in sales and capital expenditure relative to firms in the same industry in the post IPO period. Degeorge and Zeckhauser (1993), Jain and Kini (1994), Mikkelson, Partch and Shah (1995) established a reduction in profitability, investment and financial leverage following the IPOs. All these appear to persist beyond the first three years after the IPO.

There are a few studies that have been done on IPOs in Kenya. Kinyua et al. (2012), on the effects of initial public offer on performance of companies quoted at the NSE as measured by liquidity, leverage and profitability. Jumba, (2002) studied IPO performance in Kenya. Maina, 2006 did an analysis of IPO performance in Kenya while Karitie (2012), on the long- run performance of IPOs. Little research has been done in the area of performance of a company before and after IPOs in Kenya or as compared to other regions of the world. However, some research still exists. Ochenge (2011) sampled 15 Kenyan IPOs for the period 1990-2008 and found that the average initial market adjusted returns for the first three days of listing is about 64.3 percent indicating a significant level of underperformance.

The findings of this study will show the financial performance of companies before and after they are listed so as to analyze how listing affects a company's profitability, liquidity and leverage levels of companies since most of the studies previously carried out, specialized on IPO performance only. This study compares the pre-issue financial performance with the post issue financial performance of IPO firms in Kenya.

1.3 Objectives of the Study
1.3.1 General Objective
To establish whether there is significant difference in the overall financial performance on companies before and after going public quoted at Nairobi Stock Exchange.

1.3.2 Specific Objectives
i.   To analyze the effects of IPO on profitability of firms

ii.   To analyze the effects of IPO on liquidity levels of firms

iii. To analyze the effects of IPO on leverage levels of firms

1.4 Value of the Study

Compared to other research work done that mainly covers short and long run performance of companies and the comparison of the overall performance of companies, the study will compare the financial performance of companies covering periods before and after their listing. The findings of this research will be useful to academicians: It will add to their body of knowledge on how listing affects performance of companies. To Companies that seek listing: It will give insight to the management in carrying out a financial analysis.

To Investors: The study will be of importance to investors, as it will give insight on the profitable and liquid companies. It also will educate current and potential investors in the Nairobi Stock Exchange on how to evaluate the financial performance of companies so as to choose wisely where to invest their money. Researchers: In this case researchers include anyone researching work relevant to this topic be it students or financial institutions. The study will help them form a basis for further research work. And finally Financial Advisors: Evaluating performance is critical in order to understand investment strategies thus the study aims to investigate the performance of IPOs in Kenya relative to investor expectations. Financial advisors will be able to use this information to better advice clients on investments decisions

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Review of literature was undertaken to support the study carried out in this research project. This chapter gives an overview of theoretical and empirical literature surrounding performance of companies before and after issue of shares to the public. This literature review is based on: recent, original and authoritative sources such as books, the internet and journals.

2.2 Review of Theories

This study reviewed on the theoretical studies and mainly concentrate on four theories which are; the window of opportunity hypothesis, signaling theory, agency theory and self-interest theory.

2.2.1 The Window of Opportunity Hypothesis

Ritter (1991) argued that, if there are periods when investors are especially optimistic about the growth potential of companies going public, the large cycles in volume may represent a response by firms attempting to "time" their IPOs to take advantage of these swings in investor sentiment.

He argued that the low returns on IPOs are consistent with issuers taking advantage of "window of opportunity" in which the market is willing to overpay for their equity. Myer (1994) viewed this framework as a dynamic financing hierarchy or window of opportunity model. External financing is sometimes the first choice for financing because sometimes firms can issue overvalued equity. The window of opportunity predicts that there will be low long – run returns of firms conducting IPOs than on firms conducting seasoned equity offerings.

2.2.2 Signaling Theory

Leland & Pyles (1977) model is one of the first signaling models which describe the issuer's function in the IPO process. Their model is a simple static equilibrium model where the ownership retention rate signals to investors the quality of the issuer. They argued that the level of retention of shares by original shareholders can be convincing signal of the firm value to the outsiders. This idea is very much tied to the principal – agent conflict which should be less of a problem when owners of a company retain large amount of shares after the IPO, thus these companies are regarded as high quality ones.

Investors are expected to make their IPO purchasing decisions based upon this crucial information. 11 Allen and Faulhaber (1989), Grinblatt and Hwang (1989), and Welch (1989) have suggested that issuers use underpricing as a mechanism to signal their quality to the market. These models posit that high-quality firms underprice their stock at the IPO and subsequently conduct a seasoned offering when market prices are established and there has been an opportunity for information revelation.

The cost of underpricing and a positive probability of their type being revealed between the two offerings prevent the low-quality firms from following suit. Thus, signaling models of underpricing predict that IPO firms that under price should exhibit superior operating performance in comparison to those that do not. The absence of a positive relation between the change in operating performance and underpricing is inconsistent with the signaling explanation for under pricing

2.2.3 Agency Theory

Agency theory, as initially conceptualized by Jensen and Meckling (1976) analyzes the relationship that develops in an economic exchange when an individual (the

principal) concedes authority to another (the agent) to act in his or her name, so that the wealth of the principal is benefited by the decisions adopted by the agent. According to the theory, separating ownership from control can result in costs for the principal, known as agency costs, thus requiring costly mechanisms for controlling these costs.

Agency costs arise because agents are argued to pursue interests that do not necessarily coincide with those of the principal. Because the use of incentives to create alignment of interests between principal and agency is a primary mechanism proposed by the theory to reduce agency costs, the theory is without doubt one of the main (if not the main) theoretical frameworks in the area of compensation management (particularly at the top management level) (Gomez-Mejia, Berrone, & Franco-Santos, 2010).

The roots of agency theory are linked to economic utilitarianism (Ross, 1973), which suggests that rational individuals will favor alternatives that enhance their own utility. It provides parsimonious predictions as to how rational individuals would behave in bilateral relations between self-interested individuals, where each individual is faced with information asymmetry about the other individual's effort and interests. In summary, agency theory focuses on identifying the most efficient contract for aligning the interests of an agent with those of the principal (Fama & Jensen, 1983).

2.2.4 Self Interest Theory

A possible reason for underpricing may be the self-interest of investment bankers (Baron and Holmstrom, 1980; Baron, 1982). According to Baron and Holmstrom (1980), most new security issues are managed and distributed by investment banking syndicates that perform three basic services for the issuers of the securities. First, they

offer advice and counsel regarding the type of security to be issued, coupon rates, maturity, offer price etc.

Secondly, they provide an underwriting function by bearing all the risks associated with the proceeds of the issue and thirdly, they provide a distribution function by selling the securities to investors. They identified an incentive problem that was mainly centered on the tradeoff between the offer price decision and the distribution effort made to place the issue. Distribution involves substantial costs and therefore a banker would be expected to limit those costs to the extent that is feasible. The most common way of limiting those costs is to underprice the new issue. This incentive problem was described by Van Horne (1977) in the following way, 'the underwriter wants a price that is high enough to satisfy the issuer but low enough to make the profitability of successful sale to investors reasonably high'. 16 Baron and Holmstrom further identified two principle forces that can work to mitigate the incentive to underprice.

The first is that the investment banking industry is to some extent competitive and a banker that continuously prices new issues lower than the industry norm will likely lose some market share. The second force is the sophistication of the issuer because if the issuer is financially sophisticated and makes comparisons with similar security issues, the investment banker is forced to price closer to market.

2.3 Review of Empirical Studies

Reflecting the importance of the going public decision, the academic literature on IPOs has been voluminous. Yet perhaps surprisingly, the vast majority of empirical literature has ignored the underlying reasons why firms go public. Instead, it focused

on the underpricing, the long-run performance, and the time clustering of IPOs (Jenkinson and Ljungavist, 2001).

Pagano, Panetta and Zingales (1998), which utilized a database containing information on 69 Italian firms that went public between 1982 and 1992, as well as a number of private Italian firms that did not go public but met the listing requirements of the public exchange during the same time period. These authors conclude that firms in their sample choose to go public not to finance future investment, and growth, but rather to rebalance their leverage and allow the managers to liquidate their positions. Although these findings may hold for the sample considered by Pagano, Panneta and Zingales (1998), it is not obvious that their results automatically extend to other countries and periods. Mikkelson et al (1997) documented that US IPOs are generally followed by a large growth in assets. This finding is at least suggestive of the view that firms go public so that they can raise public capital to finance growth.

Zingales (1995) argues that, it seems plausible that differences between primary and secondary offerings could reflect differences in the underlying motivation of the IPO. In particular, IPOs that involve secondary offerings are likely to be driven by desire for liquidity by the firm's executives, Chemmaur and Fulghieri (1999) assert that firms increasing investment most rapidly have the greatest demand for capital, and thus choose to issue primary shares when they go public. A desire to find investments in capital expenditure research and development, as well as elements of net property, plant and equipment could lead some firms going public.

Going public, in fact allows firms to access external financial resources. The resources can be used either to compensate for a lack of capital or high debt/equity levels, or as means to seize and finance growth opportunity (Harvey, Evans, 1995)

and (Maherault, 2000). According to Arkebauer (1991) the most important reason for going public is to infuse a significant amount of investment capital into the firms.

Roell (1996) documents that the real reasons why firms go public are: an informative stock price, a more liquid stock, and increased competition among providers of finance. Gaia and Davide (2001) combine evidence from a series of preliminary case studies, with the results of a survey of 74 Italian IPOs, to investigate important implications of going public like improved visibility and reputation that are usually neglected or presented as side benefits and glossed over. Evidence from their research indicates instead that an increasing number of companies see going public as a way to improve their reputation and social capital, with beneficial effects on their capacity to access external resources and opportunities for new entrepreneurial ventures. Their study reveals that besides the usual financial motives, the decision to public is increasingly stimulated by search for a higher visibility and is seen as an important step in the expansion and reinforcement of the network of relationship that sustains entrepreneurial activity.

Kurtaran & Er (2008) analyzed the post-issue operating performance of initial public offerings at the Istanbul Stock Exchange (ISE) as a developing market. They documented a general decline in operating performance subsequent to the IPO. They then explored the relationship between managerial ownership and the change in the post-issue operating performance. They found a positive relation between post-issue operating performance and underpricing level. Finally, they 13 examined post-issue market –to-book ratio and price earnings ratios to test the market expectations and their results inducted post-issue declines in both ratios.

According to Kikeri, Sunita and Shirley (1994) IPOs are mechanisms used by government that are pursuing privatization of previously public institutions. Public share offering is among the most popular methods of privatization because they allow more people to be shareholders of entities created by public resource. The method is highly attractive for it is relatively stronger egalitarian aspects. Kinyua et al. (2013), investigated on the effects of initial public offer on performance of companies quoted at the NSE where they measured performance of the companies using leverage and earnings per share between 2006 and 2011. The study concluded that earnings per share which comprised of sales, assets, profit after tax, ROA and ROE increased after the IPO.

Buigut, Soi, Koskei & Kibet (2013) on their study on the relationship between capital structure and share prices in NSE assessed the effect of debt, equity and gearing ratio on share price. Using panel data pertaining to the energy sector over the period 2006 to 2011 and employing multiple regression analysis, the results indicated that debt, equity and gearing ratio were significant determinants of share prices for the sector under consideration. Further, gearing ratio and debt were found to positively affect share prices while equity negatively affected share prices.

Ochege (2011) carried out research into the issue of IPO underpricing at the Nairobi Securities Exchange because of its apparent contradiction to the efficient market hypothesis. After examining 15 Kenyan IPOs for the period 1990-2008, he found that the average initial market adjusted return for the first three days of listing is about 64.3%.

Ooko (2013) analyzed the effect of shares valuation method used by companies on the IPO outcome for a period 2006-2011. He studied 9 Kenyan companies and discovered that most companies used the discounted cash flow method and company comparable

multiple method to arrive at the offer price. He found that of the 9 companies studied 8 of them had a positive initial return and had underpriced their shares. He also found that the average initial return was 0.577 for the 9 companies which issued their shares during the period of study.

2.4 Determinants of Financial Performance

According to Emery (1998), the easiest way to determine the performance of a firm is to compare its recent ratios with past ratios. When financial ratios over a period are compared, it is known as the time series or trend analysis. It gives an indication of the direction of change and reflects whether the firms' financial performance has improved, deteriorated or remained constant over time.

2.4.1 Profitability

A firm, which generates a substantial amount of profits per given amount of sales, can comfortably meet its operating expenses and provide more returns to its shareholders. The relationship between profit and sales is measured by profitability ratios

2.4.2 Liquidity

Companies with more liquid assets are less likely to fail because they can realize cash even in very difficult situations. It is therefore expected that insurance companies with more liquid assets will outperform those with less liquid assets. Brown at al., (2001) In his study, firm performance was positively related liquidity band portfolio returns Maintaining high liquidity can reduce insurance companies' management's discipline as regards both underwriting and investment operations. Moreover, according to the theory of agency costs, high liquidity of assets could increase agency costs for owners because managers might take advantage of the benefits of liquid assets

2.4.3 Leverage

Leverage affects the level and variability of the firm's after tax earnings and hence, the firm's overall risk and return. Insurance companies collect premiums in advance and keep them in reserve accounts for future claim settlements. Pervan et al., (2014) investigated how insurance companies in Macedonia performed and according to the findings of panel analysis regarding the determinants of profitability, it was revealed that expense ratio, claim ratio, Size of the insurer, internal factors like leverage, staff and external factors like economic growth, and inflation have statistically significant influence on insurers' performance.

2.3.4 Company Size

It has been suggested that company size is positively related to financial performance. Brown at al., (2001) identified important economic and market factors and insurer specific characteristics related to the life insurer performance. In his paper, firm performance was positively related to the size and liquidity band portfolio returns whereas negatively related to anticipate inflation. Large insurance companies normally have greater capacity for dealing with adverse market fluctuations than small insurance companies. Additionally large insurance companies usually can relatively easily recruit able employees with professional knowledge compared with small insurance companies.

2.5 Summary of Literature Review

The above review has shown the theories that relate to issuance of IPO. The theories explain better why firms issue IPO and why there has been under performance of firms after IPO. The empirical review has shown the studies done in the area and mainly focused on the underpricing, the long-run performance, and the time clustering

of IPOs. No studies have been done to compare the financial performance of companies before and after they are listed. This study therefore seeks to compare the financial performance of companies after they are listed so as to analyze how listing affects a company's profitability, liquidity and gearing levels of the companies. The vacuum that exists on studies of pre and post IPOs performances of companies has necessitated my drive to carry out this study.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The study analyzed the financial performance of companies before and after they were listed in the NSE. The chapter dealt with the research methodology used by the researcher as the vehicle towards the attainment of the objective set out in chapter one. It specifically highlights the research methods that were used in carrying out the study in order to answer the research questions. In addition, various methodological issues such as population, sampling technique, sampling frame and size, data collection and analysis methods that were adopted in the conduct of the study will be discussed.

3.2 Research Design

A research design is a plan according to which one obtains research participants and collects information from them .This research adopted a descriptive research design. Descriptive research is defined as a process of data collection to test the hypothesis or answer questions concerning the current status of the study Mugenda and Mugenda (2003). Descriptive research is analytic and it focuses on the particular variables. It will give researchers the ability to look at what they are studying in various aspects and provides a bigger picture as opposed to other types of research design. Descriptive correlational research describes data and characteristics about the population or phenomenon being studied. This method was selected because it enabled the researcher to be able to attempt to describe the relationship that exists between IPOs and financial performance of companies listed at the NSE. A description of the overall financial performance of companies for the periods under study was done using different types of ratios.

3.3 Population

Population refers to an entire group of individuals, events or objects that have a common observable characteristic. Thus, a population is the entire group of interest that conforms to a given specification. A population is made up of elements, individuals or objects about which a researcher wishes to describe or draw conclusion (Cavusgil and Byington, 1997). The population of the study covered all companies which were quoted at the Nairobi Stock Exchange between 1984 and 2000. During this period, there were seventeen IPOs. A census survey will be conducted.

3.4 Sample

The sample size consisted of 14 companies which were quoted at the Nairobi Stock Exchange between 1984 and 2000. During this period, there were seventeen IPOs. However, three companies were omitted from the study since they are deregistered leaving a sample of fourteen companies.

3.5 Data Collection

This refers to the means by which measure and facts are obtained from selected elements in a study. The study made use of secondary data which was obtained from the NSE. The data of interest was from the companies which are quoted between 1984 and 2000. Data was extracted from the financial statements five years prior to and five years after listing. This was collected from the Nairobi Stock Exchange database, Capital Markets Authority, newspapers and the respective company premises inclusive of their website. The financial statements included: the Income statements and the Balance Sheets. The data was used to compute the accounting ratios, which forms the basis of the study. The ratios the research analyzed included: Liquidity, Profitability and Leverage. Liquidity ratio was used to measure the ability of the firms to meet their current obligations. This helped to establish the financial

position of firms. Current ratio (Total Current Assets/Total Current Liabilities) was used to measure liquidity. Profitability ratio was used to measure overall performance and effectiveness of firms. The ratio that was used was the Net profit margin (Net profit/Sales). Leverage ratio shows the proportionate contributions of owners and creditors. Debt ratio (total Liability/Total Assets) was also used.

3.6 Data Analysis and Presentation

According to Miles & Huberman (1994), data analysis consists of three concurrent flows of activity, namely data reduction, data display and conclusion drawing. The methods employed in data analysis mainly depend on the purpose of the study and the type of data collected (Cooper and Schindler, 2003). The data analysis involves comparing the performance of the selected firms before and after IPO. The research study will use MS excel statistical package for data analysis. It will be used for tabulation and obtaining averages of the various ratios and to derive the trend for the ratios over the period of the study. The package will also be used to come up with relevant tables and graphs that will be used to make interpretation of the data that will be collected.

This study was done to test the effect of initial public offering on the financial performance of firms. The study employed profitability, liquidity and leverage ratios as measures of financial performance. The first measure was the net profit margin which is a ratio of profitability calculated as net profits per unit sales. It measures how much out of every unit of sales a company actually keeps in earnings. Second measure was the current ratio. It signifies a company's ability to meet its short-term liabilities with its short-term assets. A current ratio greater than or equal to one indicates that current assets should be able to satisfy short -term obligations. It compares a firm's current assets to its current liabilities.

The last measure was the Debt Ratio. It is a financial ratio that indicates the percentage of a company's assets that are provided through debt. The study also used sample means which was computed on all the accounting ratios for the pre and post financial performance of companies listed. The t-test for the two sample means was used to test the hypothesis on whether there was any significant differences in the financial performance ratios of firms before and after going public

The research, study, further conducted a multiple regression analysis. This was done to test relationship among variables on the effects of initial public offer on performance of companies quoted at the Nairobi stock exchange. The statistical package for social sciences (SPSS) was applied to code, enter and compute the measurements of the multiple regressions for the study. The model was as below:

$(Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \dots b_n x_n + \varepsilon)$.

Where Y is (company performance),

  X1 - Profitability,

 X2 -   liquidity,

 X3-   Leverage

$\beta_0 \beta_3 \dots Bn$ - coefficients of variables in the regression model

ε = Error term normally distributed about the mean of zero

3.6.1 Test of Significance

Y was the dependant variable financial performance, β_0 was the regression. $\beta_1 \beta_3 \dots Bn$ was the coefficients of the variables in regression model. The model's validity was measured on how well the regression model fits the data. Goodness of fit statistics are available to test how well the sample regression function (SRF) fits the

data how or how close' the fitted regression line is to all of the data points taken together. The most common goodness of fit statistic is known as R2 (Brooks, 2008).

A correlation coefficient must lie between −1 and +1 by definition. Since R2 defined in this way is the square of a correlation coefficient, it must lie between 0 and 1. If this correlation is high, the model fits the data well, while if the correlation is low (close to zero), the model is not providing a good fit to the data. R2 is the square of the correlation coefficient between the values of the dependent variable and the corresponding fitted values from the model. ANOVA was used to establish the significance of the model and also to deduce the relationship between financial performances and interest rates. The tests were performed at 95% level of confidence to determine whether the model is a good predictor.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.1 Introduction

In this chapter, an analysis of the data is done and results presented. The analysis involves the use of the secondary data obtained from the financial statements. The analysis relied on the Microsoft (MS) Excel statistical package. The ratios analyzed were profitability, liquidity and leverage. The study aimed at establishing whether there is any difference in the financial performance of companies quoted at the Nairobi Stock Exchange before and after going public.

4.2 Descriptive Statistics

Secondary data collection method was used for the study. Data collected was used to calculate the variables used in the analysis. Table 4.1 gives the summary descriptive statistics of the dependent and independent variables of the sample for a period of 10 years. From the findings as indicated in table 4.1, Profitability had a mean of 0.2492 and standard deviation of .02295 with a minimum and maximum value of .21 and .29 respectively. Liquidity of the firms for 14 observations had a mean of .8568and standard deviation of .04924and a minimum and maximum value of .77and 0.94 respectively. Leverage had a mean value .8074and standard deviation of .01218and a minimum and maximum value of .79 and .83.

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Profitability	14	.21	.29	.2492	.02295
Leverage Ratios	14	.79	.83	.8074	.01218
Liquidity	14	.77	.94	.8568	.04924
Valid N (listwise)	14				

4.3 Summary and Interpretation of Findings

The financial performance ratios were analyzed and a trend determined thereof. The ratios analyzed included: profitability, liquidity and leverage. The figure 4.1, 4.2, 4.3 and 4.4 below show the trends in mean profitability, liquidity, leverage and the overall financial performance of the fourteen companies' studied.

4.3.1 Effects of IPO on Profitability

Below is a table showing profitability ratios of fourteen companies five years before and after initial public offer. Profitability ratio used was: Net Profit Margin= Net profit/ Sales

Table 4.2: Profitability Ratios

Pre Initial Public Offering   Pre Initial Public Offering

Company Years	1	2	3	4	5	1	2	3	4	5
Jubilee Insurance	0.19	0.265	0.17	0.365	0.198	0.216	0.215	0.256	0.259	0.123
Barclays Bank	0.24	0.365	0.28	0.254	0.365	0.359	0.136	0.174	0.157	0.254
Kenya Commercial	0.18	0.326	0.39	0.165	0.385	0.258	0.256	0.225	0.354	0.365
Nation Printers	0.29	0.183	0.19	0.249	0.285	0.148	0.237	0.236	0.374	0.256
Standard Chartered	0.26	0.254	0.21	0.265	0.165	0.197	0.159	0.136	0.458	0.145
Crown Berger	0.14	0.236	0.26	0.169	0.219	0.335	0.285	0.285	0.254	0.132
Uchumi Supermarkets	0.27	0.298	0.36	0.316	0.189	0.254	0.186	0.147	0.155	0.365
National Bank of Kenya	0.35	0.317	0.39	0.194	0.309	0.195	0.183	0.186	0.206	0.392
Housing Finance	0.27	0.217	0.28	0.305	0.142	0.051	0.262	0.268	0.308	0.261
Sameer Africa	0.33	0.256	0.17	0.394	0.122	0.152	0.142	0.217	0.111	0.150
NIC Bank	0.22	0.399	0.38	0.310	0.222	0.262	0.161	0.207	0.091	0.259
Kenya Airways	0.25	0.328	0.35	0.294	0.342	0.213	0.239	0.307	0.007	0.370
Rea Vipingo	0.37	0.346	0.30	0.390	0.288	0.075	0.113	0.157	0.211	0.383
TPS Serena	0.24	0.284	0.20	0.243	0.318	0.156	0.212	0.295	0.310	0.150
Total Profitability	3.66	4.083	4.00	3.921	3.558	2.878	2.793	3.105	3.266	3.613
Mean Profitability	0.26	0.29	0.28	0.280	0.2541	0.2056	0.1995	0.2218	0.2333	0.2580

The table above shows the performance of companies five years before they go public and five years after. The average profitability is high before the companies go public but continue decreasing from year three. After IPO there is a slight decline in the first and second year after going public before it starts rising slowly from the third year.

Trend of Profitability Ratios
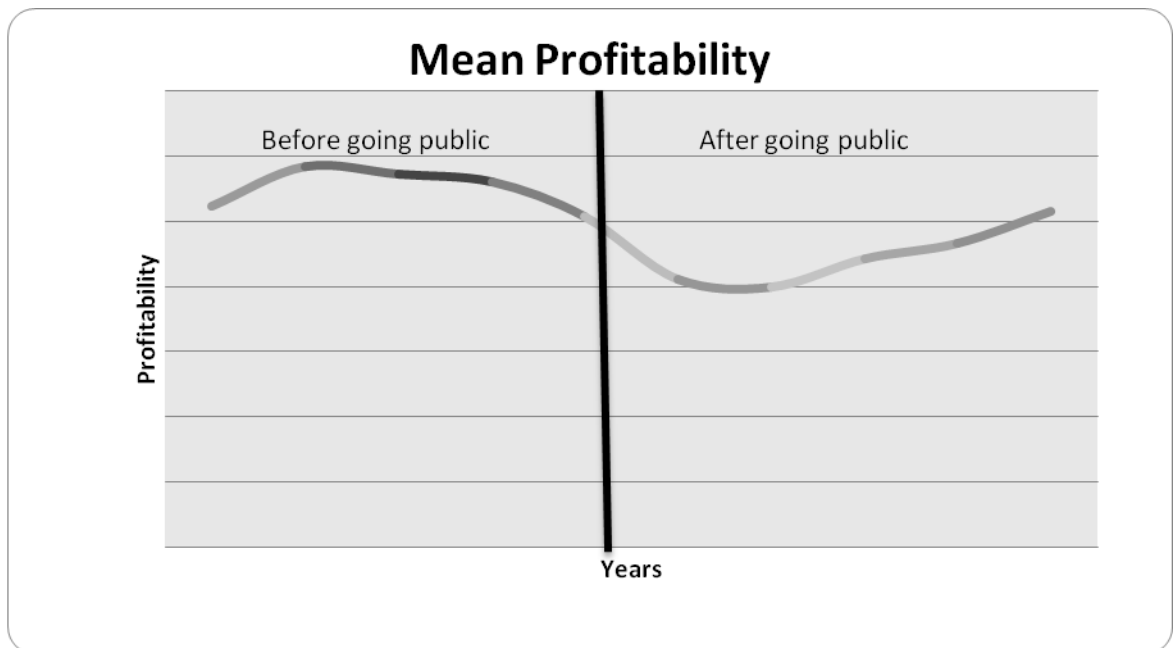
Figure 4.1: Trend of Mean Profitability ratio

The graph shows that the ratios are low before the companies go public but increases after the companies go public. It is evident from the analysis that profitability declines in the first and second year after going public before it starts rising steadily from the third year. Generally, the overall profitability increases after companies go public.

4.3.2 Effects of IPO on Liquidity

The table below shows liquidity ratios of fourteen companies five years before and after initial public offer. Liquidity ratio used was: Current ratio= Current Assets/Current liabilities.

Table 4.3: Liquidity

Pre Initial Public Offering   **Pre Initial Public Offering**

Company / Years	1	2	3	4	5	1	2	3	4	5
Jubilee Insurance	0.956	0.874	0.901	0.856	0.799	0.845	0.795	0.824	0.863	0.957
Barclays Bank	0.812	0.921	0.812	0.812	0.845	0.812	0.951	0.932	0.861	0.914
Kenya Commercial	0.845	1.002	0.799	0.753	0.914	0.954	0.8614	0.914	0.894	0.856
Nation Printers	1.569	1.012	0.923	0.833	0.823	0.873	0.892	0.799	0.814	0.847
Standard Chartered	0.987	0.911	0.857	0.742	0.782	0.789	0.762	0.826	0.825	0.798
Crown Berger	0.823	0.925	0.826	0.723	0.923	0.917	0.912	0.893	0.835	0.864
Uchumi Supermarkets	1.588	0.845	0.855	0.894	0.882	0.817	0.8459	0.914	0.894	0.886
National Bank of Kenya	0.902	0.932	0.799	0.7425	0.8818	0.837	0.886	0.844	0.816	0.816
Housing Finance	1.046	0.885	0.888	0.786	0.835	0.871	0.730	0.737	0.818	0.858
Sameer Africa	1.013	0.804	0.900	0.845	0.767	0.7286	0.820	0.754	0.784	0.917
NIC Bank	0.289	0.794	0.776	0.765	0.857	0.810	0.789	0.869	0.864	0.926
Kenya Airways	0.871	0.895	0.843	0.8563	0.899	0.8942	0.9196	0.8429	0.854	0.975
Rea Vipingo	1.036	0.881	0.874	0.8753	0.757	0.7655	0.7694	0.7758	0.844	0.908
TPS Serena	0.271	0.961	0.844	0.704	0.798	0.865	0.836	0.754	0.785	0.887
Total Liquidity	13.014	12.650	11.90	11.192	11.769	11.783	11.774	11.685	11.757	12.41
Mean Liquidity	0.929	0.903	0.850	0.799	0.840	0.841	0.841	0.834	0.839	0.886

The table above table shows the performance of companies five years before they go public and five years after on liquidity ratio. The average liquidity is high before the companies go public but continue decreasing from year three. After IPO in the first and second year it is constant then decreases in year three and increases in year four and five.

Trend of Liquidity Ratios
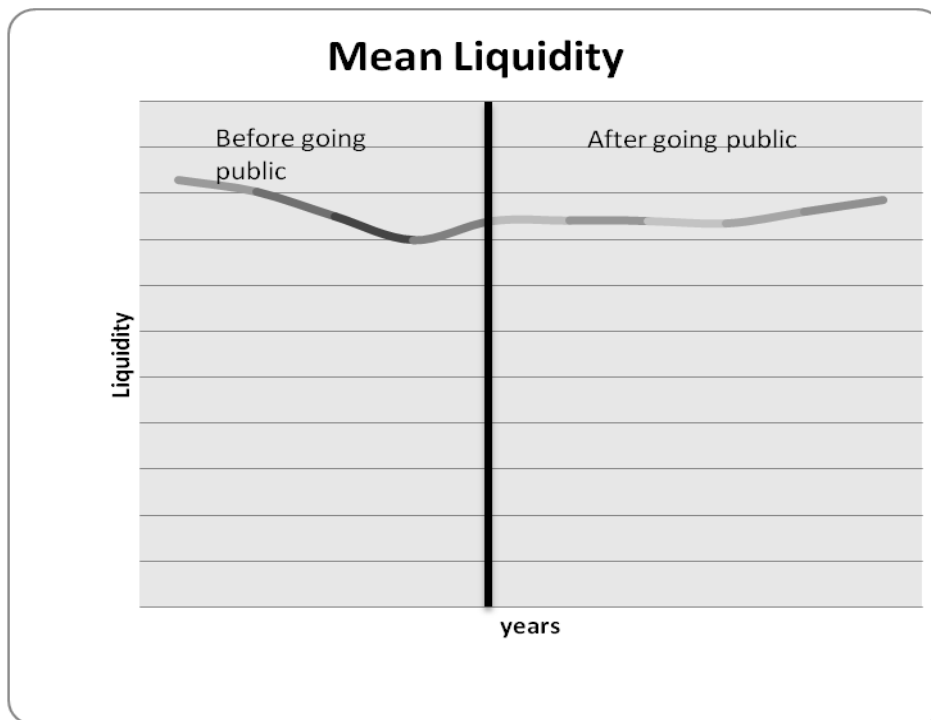
Figure 4.2: Trend of liquidity ratio

The above figure shows the liquidity of the companies remains at a fairly constant rate until the third year after IPO where it starts increasing gradually. This shows that the companies' improves their ability to meet shorter obligations out of their liquid assets

4.3.3 Effects of IPO on Leverage

The table below show leverage ratios of fourteen companies five years before and after initial public offer. Leverage ratio used was: Debt ratio = Total assets/ Total liabilities

Table 4.4: Leverage Ratios

Pre Initial Public Offering   **Pre Initial Public Offering**

Company Years	1	2	3	4	5	1	2	3	4	5
Jubilee Insurance	0.94	0.854	0.83	0.769	0.824	0.785	0.712	0.685	0.865	0.823
Barclays Bank	0.91	0.897	0.88	0.798	0.796	0.802	0.739	0.698	0.825	0.854
Kenya Commercial	0.84	0.914	0.81	0.854	0.856	0.779	0.812	0.786	0.756	0.798
Nation Printers	0.81	0.798	0.78	0.816	0.769	0.723	0.795	0.756	0.786	0.887
Standard Chartered	0.86	0.847	0.85	0.789	0.897	0.854	0.836	0.699	0.814	0.786
Crown Berger	0.79	0.814	0.91	0.838	0.759	0.834	0.769	0.732	0.778	0.835
Uchumi Supermarkets	0.87	0.835	0.82	0.759	0.819	0.795	0.726	0.726	0.792	0.847
National Bank of Kenya	0.77	0.842	0.84	0.825	0.805	0.792	0.821	0.763	0.732	0.842
Housing Finance	0.80	0.799	0.79	0.796	0.833	0.776	0.795	0.750	0.772	0.811
Sameer Africa	0.87	0.782	0.86	0.740	0.773	0.798	0.722	0.662	0.840	0.868
NIC Bank	0.90	0.898	0.89	0.778	0.860	0.855	0.739	0.692	0.811	0.779
Kenya Airways	0.85	0.849	0.82	0.805	0.732	0.723	0.698	0.749	0.783	0.88
Rea Vipingo	0.92	0.882	0.76	0.756	0.870	0.743	0.765	0.716	0.819	0.831
TPS Serena	0.84	0.861	0.85	0.835	0.810	0.783	0.808	0.722	0.805	0.818
Total Leverage	12.0	11.88	11.7	11.16	11.41	11.05	10.74	10.14	11.18	11.66
Mean Leverage	0.86	0.848	0.8388	0.797	0.815	0.7893	0.7674	0.7245	0.7989	0.8332

The table above table shows the performance of companies five years before they go public and five years after on leverage ratio. The average leverage is high before the companies go public but continue decreasing from year three. After IPO in the first, second and third year it is decreasing then increases in year four and five.

Trend of Leverage Ratios

The graph below shows the proportion of debt and equity in the firm's assets. Generally, companies have a higher ratio before going public than after going public. A low debt-equity ratio shows that companies replace debt with equity immediately after they go public. But in the fourth year the debt to equity ratio raises back to the level before the companies go public hence generally the long run solvency of the companies, increases later after the companies went public.
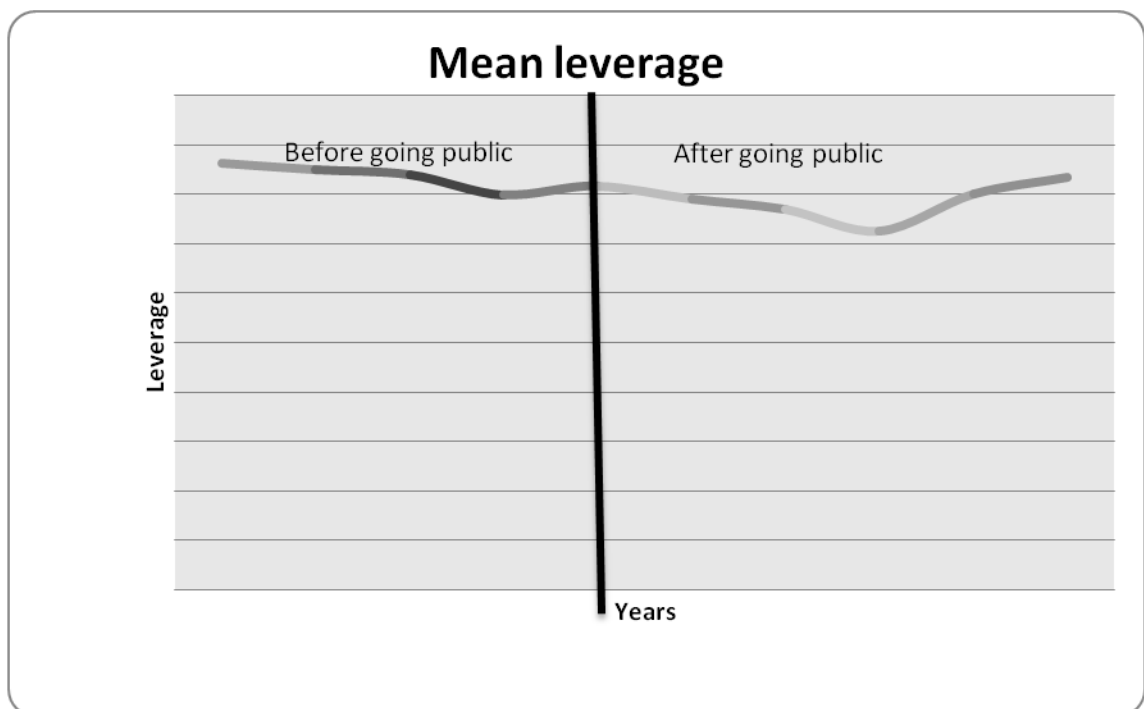
Figure 4.3: Trend of leverage ratio

4.3.4 Overall Financial Performance

The table below shows the overall financial performance of fourteen companies five years before and after initial public offer.

Table 4.5: Overall Financial Performances

Years	Mean Profitability	Mean liquidity	Mean Leverage	Overall Financial performance
1	0.262091311	0.929558	0.860668	0.887329328
2	0.291657754	0.903583	0.848678	0.951025189
3	0.285891203	0.850274	0.838838	0.925588801
4	0.280096918	0.799496	0.797586	0.91687823
5	0.25415055	0.8407	0.815116	1.018901388
6	0.205638924	0.841671	0.78935	0.936010981
7	0.199521077	0.841005	0.767426	0.936922019
8	0.221812684	0.834693	0.724576	0.958731171
9	0.233317505	0.839784	0.79895	1.048839376
10	0.258080634	0.886812	0.833268	1.042827409

Trends in Overall Financial Performance

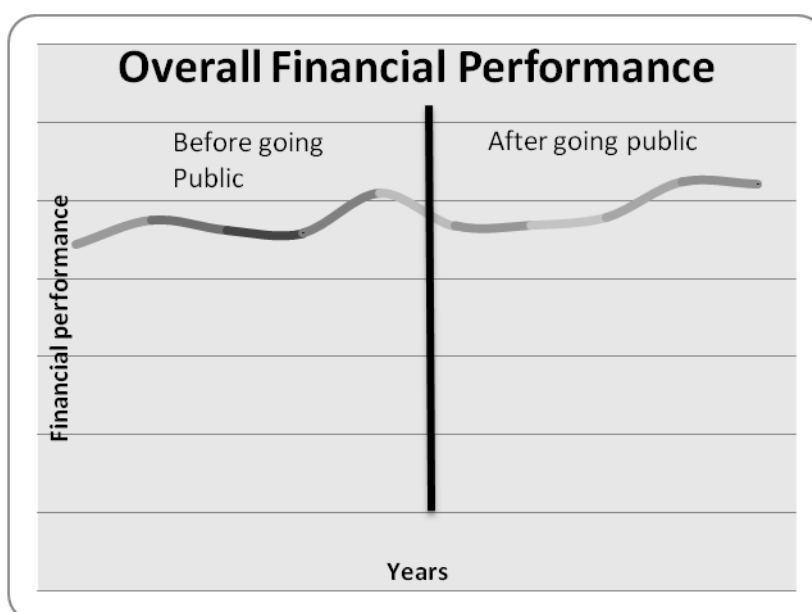**Figure 4.4: Trend of overall financial performance**

From the above graph, the overall financial performance of companies fairly improves after they go public. However, their financial performance drops immediately after companies go public but starts increasing after the second year of going public. This shows that the companies studied had a better overall financial performance after IPO.

4.4 Tests of Significance

Hypothesis testing on whether there is a significance difference between the financial performance of companies before and after going public was done using MS Excel t test two sample means with unequal variances for each category and yielded the following results.

The tests were done at a 95% level of significance using the two tail test.

H_o: There is no significant difference between the financial performance of companies before and after going public quoted at Nairobi Stock Exchange.

H_A: There is a significant difference between the financial performance of companies before and after going public quoted at Nairobi Stock Exchange.

4.4.1 Profitability Test Statistic

Table 4.6: t-Test: Two-Sample Assuming Unequal Variances

	Year 1-5	Year 5-10
Mean	0.274777547	0.223674165
Variance	0.000255791	0.000547226
Observations	5	5
Hypothesized Mean Difference	0	
df	7	
t Stat	4.032479368	
P(T<=t) one-tail	0.002490057	
t Critical one-tail	1.894578604	
P(T<=t) two-tail	0.004980114	
t Critical two-tail	2.364624251	

The profitability test statistic computed was 4.0325 and fell in the critical region, implying that we reject the null hypothesis that there is no significant difference in profitability before and after companies go public and accept the alternative hypothesis that there is a significant difference in profitability before and after companies go public.

Table 4.7: Liquidity Test Statistic

t-Test: Two-Sample Assuming Unequal Variances

	Year 1-5	Year 5-10
Mean	0.8647222	0.848793
Variance	0.002688529	0.000459198
Observations	5	5
Hypothesized Mean Difference	0	
df	5	
t Stat	0.634863596	
P(T<=t) one-tail	0.2767141	
t Critical one-tail	2.015048372	
P(T<=t) two-tail	0.5534282	
t Critical two-tail	2.570581835	

The computed Liquidity test statistic was 0.6349 and fell in the acceptance region defined by − 2.5706 and 2.5706. Thus accept the null hypothesis that there is no significant difference in Liquidity before and after companies go public.

4.4.2 Model Summary[b]-Liquidity

From the findings liquidity variable 54.3%   proportion of the performance as represented by the R^2.This therefore means that there are other factors not studied in this research that majorly contributes to the firms' performance.

Table 4.8: Model Summary[b]-Liquidity

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.737[a]	.543	.505	.43301

        a.   **Predictors: (Constant), Liquidity**

4.4.3 ANOVA-Liquidity

The F critical at 5% level of significance was 14.286. Since F calculated is less than the F critical (value = 4.84), this shows that the model was insignificant as shown by significance level of 0.185.

Table 4.9: ANOVA-Liquidity

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	2.679	1	2.679	14.286	.003[b]
Residual	2.250	12	.188		
Total	4.929	13			

a. Dependent Variable: Performance (Profitability)
b. Predictors: (Constant), Liquidity

Simple regression-Liquidity

The findings indicated that the relationship between the two variables is positive. A unit increase in the liquidity leads to1.875 increase in the performance of the firm. The t value = 3.78 at 5% level of significance implying insignificance. The study findings are in line with Brown at al., (2001) In his study, who found out that firm performance was positively related liquidity band portfolio returns Maintaining high liquidity can reduce insurance companies' management's discipline as regards both underwriting and investment operations. Moreover, according to the theory of agency costs, high liquidity of assets could increase agency costs for owners because managers might take advantage of the benefits of liquid assets

Table 4.10: Simple Regression-Liquidity
Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.875	.302		6.212	.000
VAR00006	.125	.033	.737	3.780	.003

a. Dependent Variable: Performance (Profitability)

Table 4.11: Leverage Test Statistic

t-Test: Two-Sample Assuming Unequal Variances

	Year 1-5	Year 5-10
Mean	0.832177	0.782714
Variance	0.000654	0.001619275
Observations	5	5
Hypothesized Mean Difference	0	
df	7	
t Stat	2.31975	
P(T<=t) one-tail	0.026707	
t Critical one-tail	1.894579	
P(T<=t) two-tail	0.053414	
t Critical two-tail	2.364624	

The computed Leverage test statistic was 2.3198 and fell in the acceptance region defined by − 2.3646 and 2.3646. Thus accept the null hypothesis that there is no significant difference in leverage before and after companies go public.

4.4.4 Model Summary-Leverage

From the findings Leverage variable explain only 79.6% of the performance as represented by the R^2. This therefore means that there are other factors not studied in this research that majorly contributes to the firms' performance.

Table 4.12: Model Summary-Leverage

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.796[a]	.634	.604	.38762
a. Predictors: (Constant), Leverage				

4.4.5 ANOVA-Leverage

The F critical at 5% level of significance was 20.8. Since F calculated is greater than the F critical (value = 4.84), this shows that the model was significant.

Table 4.13: ANOVA-Leverage

Model		Sum of Squares	d.f	Mean Square	F	Sig.
1	Regression	3.126	1	3.126	20.802	.001[b]
	Residual	1.803	12	.150		
	Total	4.929	13			

a. Dependent Variable: Performance (Profitability)

b. Predictors: (Constant), Leverage

4.4.6 Simple Regression-Leverage

The result indicates that Leverage has a negative insignificant association with profitability .This implies that any increase in leverage will significantly decrease profitability, which means that reducing debt level will leads to significant increase in firm's performance.

A simple regression model

$$Y = \beta_0 + \beta_1 X_1$$

Where X_1 is the working capital can be written as

$$Y = 10.561 - 0.576 X_1$$

Implying that a unit increase in leverage will lead to 0.576 decreases in the dependent variable that is profitability. The study findings are in line with H.M Alarm in his study "The impact of working capital management on profitability and market valuation of Pakistani firms" whom in his study found a negative association between ROA and leverage. Further the study conquers with Abdul (2012) findings who in his study concluded that financial leverage has a significant negative relationship with the firm performance as measured by return on assets (ROA).

Table 4.14: Simple Regression-Leverage Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	10.561	2.959		3.569	.004
Leverage	-.576	.126	.796	4.561	.001
a. Dependent Variable: Leverage					

Table 4.15: Overall Financial Performance Test Statistic

t-Test: Two-Sample Assuming Unequal Variances

	Year 1-5	Year 5-10
Mean	0.939944587	0.984666191
Variance	0.002465867	0.003205096
Observations	5	5
Hypothesized Mean Difference	0	
df	8	
t Stat	-1.327926278	
P(T<=t) one-tail	0.110419532	
t Critical one-tail	1.859548033	
P(T<=t) two-tail	0.220839064	
t Critical two-tail	2.306004133	

The overall financial performance test statistic -1.3279 lies in the acceptance region

defined by -2.306 and 2.306.   Thus accept the null hypothesis that there is no

significant difference in the overall financial performance before and after companies

go public.

Table 4.16: Multiple Regression Analysis

Model Summary				
Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.958[a]	.918	.903	.19161
a. Predictors: (Constant), Liquidity , Leverage				

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Performance) that is explained by the independent variable working Capital.

Liquidity, Leverage variables explain only 91.8% of the performance as represented by the R^2. This therefore means that other factors not studied in this research contribute 8.2% of the firms' performance

4.4.9.1 ANOVA[a]

H_o: Liquidity and Leverage do not affect financial performance of companies before and after going public quoted at Nairobi Stock Exchange.

H_A: Liquidity and Leverage affects financial performance of companies before and after going public quoted at Nairobi Stock Exchange.

Table 4.17:   ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	4.525	2	2.262	61.622	.000[b]
Residual	.404	11	.037		
Total	4.929	13			

a. Dependent Variable: Performance (Profitability)
b. Predictors: (Constant), Liquidity , Leverage

The F critical at 5% level of significance was 61.622. Since F calculated is greater than the F critical (value = 4.84), this shows that the overall model was significant. The significance is less than 0.05, thus indicating that the predictor variable working capital, explain the variation in the dependent variable which is Performance of listed non-financial firms in Kenya. If the significance value of F was larger than 0.05 then the independent variables would not explain the variation in the dependent variable.

Since the overall model is significant and F calculated is greater than the F criticalH$_o$and the study concludes that Liquidity and Leverage affects financial performance of companies before and after going public quoted at Nairobi Stock Exchange.

Table 4.18: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	8.679	1.494		5.808	.000
Liquidity	.462	.065	.638	7.091	.000
Leverage	-.094	.015	.556	6.173	.000

a. Dependent Variable: Performance(Profitability)

The study used the model:

$$Y = a + \beta_0 + \beta_1X_1 + \beta_2X_2 + \varepsilon \qquad\qquad \text{equation (i)}$$

Where:

Y = is the value of the dependent variable, Performance of listed non -financial firms.

a = is the intercept of the regression line on the Y axis when X= 0

β = is the slope of the regression line

X_1 = Liquidity

X_2 = Leverage

Which when substituted gives:

$$Y=8.679 + 0.462X_1 - .094X_2$$

Where Y is the dependent variable (performance), X_1 is the Liquidity, X_2 is Leverage.

According to the regression equation established, taking all factors into account (X_1 = Liquidity and X_2) to be constant at zero, Firms' performance will be 8.679.The data

findings analyzed also show that taking all other independent variables at zero, a unit improvement in Liquidity will lead to a 0.0462 increase in Firms' performance; a unit increase in Leverage will lead to a 0.094decrease in Firms' performance.

Liquidity and Leverage are significantly positive and negatively respectively related to firm's performance as shown by beta coefficients and 0.00 significance which is less than 0.05. According to Pervan et al., (2014), Leverage affects the level and variability of the firm's after tax earnings and hence, the firm's overall risk and return. Pervan et al., (2014) investigated how insurance companies in Macedonia performed and according to the findings of panel analysis regarding the determinants of profitability, it was revealed that expense ratio, claim ratio, Size of the insurer, internal factors like leverage, staff and external factors like economic growth, and inflation have statistically significant influence on insurers' performance.

4.4.9.2 Correlation Analysis

The table shows the correlation among the 3 variables that were studied. Coefficient correlation lies between -1 and +1.The more positive the coefficient is the more the variables are positively correlated. The more negative the coefficient is the more negative the variables arenegatively correlated to each other. Pearson correlation (2-tail) was used to draw the correlation matrix. The study reveals that all the 2 variables were significantly (0.000) correlated with liquidity being positively correlated (.796) with Performance and Leverage being negatively correlated with performance with a Pearson coefficient .737.

Table 4.19: Pearson Correlations

		Performance	Liquidity	Leverage
Performance	Pearson Correlation	1	.796[**]	-.737[**]
	Sig. (2-tailed)		.001	.003
	N	14	14	14
Liquidity	Pearson Correlation	.796[**]	1	.284
	Sig. (2-tailed)	.001		.325
	N	14	14	14
Leverage	Pearson Correlation	-.737[**]	.284	1
	Sig. (2-tailed)	.003	.325	
	N	14	14	14
**. Correlation is significant at the 0.01 level (2-tailed).				

4.4.9.2 How findings compare with previous findings

These results are both in line and also in contrast to the results of other studies that have been carried out both in the international and local studies. Studies such as Kinyua (2013), shows evidence of increasing on performance after an IPO using leverage and earnings per share as measures of financial performance.

There are studies however that are consistence to this study, Mulu (2006), shows that the performance of the companies declines immediately after an IPO. The studies that have been done outside Kenya are consistent to this study even when using different methodology. Other studies used management earnings, market to book ratio, price earnings ratio which still shows a decline on the financial performance of the companies after going public.

There have however been studies where there have shown increase on the performance of companies. The reasons for this divergence among studies are probably the difference in the methodology that has been adopted in computing the

financial performance of these companies during their IPOs. The other reason for divergence among studies is in companies which have gone public and the owners still maintain the management rights of the company thus the performance increases. There are companies which also increase their financial performance after an IPO due to investing on the cash received from selling the company's shares.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of the Findings

On the basis of the aims and objectives of this project is to analyze the effect of initial public offer on the financial performance of companies at the Nairobi stock exchange. The study had three objectives namely: establishing if there is any effect of IPO on profitability, establishing if there is any effect of IPO on liquidity and finally establishing if there is any effect of IPO on activity of a firm.

The objectives mentioned above were achieved by analyzing financial ratios and the ratios that were used were profitability, liquidity and leverage. In addition the researcher went ahead to determine the tests of significance on all the three variables and the overall financial performance using 2 tailed t test with 95% level of significance. In doing so the researcher was trying to determine that, if any, the effect of IPO on profitability, liquidity, leverage and the overall financial performance was significant.

The analysis shows that the profitability ratios are low before the companies go public but increases after the companies go public. It is evident from the analysis that profitability declines in the first and second year after going public before it starts rising steadily from the third year. In addition the tests of hypothesis have shown significant difference in the profitability before and after going public i.e. the increase in profitability it's quite significant.

The analysis also shows the liquidity of the companies remains at a fairly constant rate until the third year after IPO where it increases slightly. The test of hypothesis showed that the increase was though not significant.

Leverage ratio indicate that, companies have a higher ratio before going public than after going public, but in the fourth year the debt to equity ratio raises back to the level before the companies go public hence, generally the long run solvency of the companies, increases later after the companies went public. Although the hypothesis test showed that there was no significant difference of leverage levels of companies before and after going public.

Finally the analysis showed that the overall financial performance of companies fairly improves after they go public. However, their financial performance drops immediately after companies go public but starts increasing after the second year of going public. In addition to this, tests of hypothesis showed that there is no significant difference of overall financial performance of companies before and after going public.

5.2 Conclusions

5.2.1 Effect of IPO on Profitability

The analysis of the financial performance ratios indicates that profitability ratio increased significantly in the post IPO era, meaning that increase in profitability is a good motivator to companies to go public. In addition to this the analysis also showed that the profitability decrease in the initial years after IPO thus it should be viewed as a long term strategy not a short term one. This leads to the conclusion that IPO has effect on a firm's profitability.

5.2.2 Effect of IPO on Liquidity

Liquidity ratio results showed that after companies go public, their ability to fulfill their short term obligations out of their liquid assets improved but not significantly,

therefore concluding that after company goes public the liquidity of the firm is not affected.

5.2.3 Effect of IPO on Leverage

The analysis indicated that the ability to meet long term and short term liabilities increased after IPO but not significantly hence concluding that IPO does not have any effect on the leverage level of a company.

5.2.4 Effect of IPO on Overall Financial Performance

The analysis showed that, the overall financial performance of companies fairly improves after they go public. However, their financial performance drops immediately after companies go public but starts increasing after the second year of going public. But the hypothesis test showed that there was no significant difference of the overall financial performance before and after going public. In conclusion thus there is no effect of IPO on overall financial performance.

5.3 Recommendations to policy and practice

The study recommends that investors should also be careful when investing in IPOs because companies time their issues to coincide with periods of unusually good performance levels, which they know cannot be sustained in the future. Thus investors should be keen on the performance trends of the companies that they wish to invest in.

The government and regulatory bodies to thoroughly audit companies that wish to be listed especially the five years financials before going public in order to discourage the management from "window dressing" of their financial statements in order to avoid miss - informing the public on the true financial position of the company been listed.

Investor protection agencies such as the Capital Market Authority should be more vigilant in protecting would be investors who may wish to take up company shares in an IPO. While they cannot directly affect the actions of the issuing company and the underwriters when it comes to price setting they may be able to sensitize them on the importance to put investor interest at the centre of their decision making processes and to avoid miss informing them on the financial performance of the company. They should also sensitize investors on prevailing valuation trends so as to equip them with all the information necessary for them to make informed investment decisions

Underwriters, valuers and transaction advisors should refine or completely reexamine their IPO valuation techniques and methods in order to prevent the gross overvaluation of IPOs. This is because over valuing IPOs may adversely affect investors once these IPO enter the market. They can accomplish this primarily through better forecasting techniques that take into account the strengths, weaknesses, opportunities and threats faced by the companies as well as their particular industry and the economy in general.

The study has shown that the overall financial performance in pre and post IPO era is not significantly different. This should however not put to a halt the process of going public. There is the need to look at other motivators. Some of the motivators include; raising public capital to finance growth; allowing firms to have access to external financial sources; improved visibility and reputation i.e. the social capital to help the company to venture into new entrepreneurial opportunities.

5.4 Limitations of the study

The researcher was comparing financial performance of companies from different industries and that is bound to give misleading results. This is because the study was

not able to get listed companies in Kenya from the same industry that were listed within the same period of time to be able to compare their financial performance by use of ratios.

Use of financial ratios on the financial statements of the sampled companies was also a limitation. Any weaknesses of the financial statements such as "window dressing" of accounts are also captured in the financial ratios.

There was a limitation on the number of financial years that the study was carried out. The study compared data for five financial years before and after an IPO, this period could have been longer in order to give a better position of the sampled companies. This was not possible as some of the companies had not been listed for more than five years and thus their post issue financial data is non − existence. On the other hand, some of the companies that have been listed for more than five years, their IPO prospectus were not available with CMA and NSE to enable the researcher compare their pre- IPO financial performance. Companies which formed sample of this study did not go public at the same time.

The cost of doing the entire research was also a challenge. Completing the entire research incurred a lot of cost from printing and binding charges, transport fees to various companies to gather data, internet cost among others. Future researchers will need to prepare financially in order to complete the research studies.

5.5 Suggestions for Further Research

More research needs to be done on whether the industry that a company belongs to be it finance and Investment, commercial and services, industrial and allied and agriculture affects the performance of the organization after going public. This will be able to show if there are major performance differences in post IPO period between

different sectors. This study examined financial performance after IPO of various companies regardless of their various sectors.

From earlier analysis it has been observed that overall financial performance of companies increase but not significantly. With the current trend of organization going public, there has to be other factors other than the slight increase in financial performance that has motivated firms to go public. Therefore further studies need to be done to establish the factors that lead companies to go public. Lastly, there is also a need to look in to factors which lead to improved profitability after companies get listed at The Nairobi Stock Exchange.

Most studies on the IPO have concentrated on the share price after an IPO and very few studies especially in Kenya have been done on the performance of the company after a companies at is clear from this study that there exist a relationship between an IPO and the performance of the company. Other avenues of the study therefore need to be done in order to enhance knowledge on how companies perform after an IPO and also how they affect the development of the capital market in Kenya

The study only compared five years prior to listing with five years after listing, a further research which covers a longer period could be done to establish the financial performance trend over a longer period

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APPENDICES
APPENDIX I: LISTED FIRMS ON THE NSE

AGRICULTURAL

1. Eaagads Ltd Ord 1.25

2. Kapchorua Tea Co. Ltd OrdOrd 5.00

3. Kakuzi Ord.5.00

4. Limuru Tea Co. Ltd Ord 20.00

5. Rea Vipingo Plantations Ltd Ord 5.00

6. Sasini Ltd Ord 1.00

7. Williamson Tea Kenya Ltd Ord 5.00

COMMERCIAL AND SERVICES

8. Express Ltd Ord 5.00

9. Kenya Airways Ltd Ord 5.00

10. Nation Media Group Ord. 2.50

11. Standard Group Ltd Ord 5.00

12. TPS Eastern Africa (Serena) Ltd Ord 1.00

13. Scangroup Ltd Ord 1.00

14. Uchumi Supermarket Ltd Ord 5.00

15. Hutchings Biemer Ltd Ord 5.00

16. Longhorn Kenya Ltd TELECOMMUNICATION AND TECHNOLOGY

17. Safaricom Ltd Ord 0.05 AUTOMOBILES AND ACCESSORIES

18. Car and General (K) Ltd Ord 5.00

19. CMC Holdings Ltd Ord 0.50

20. Sameer Africa Ltd Ord 5.00

21. Marshalls (E.A.) Ltd Ord 5.00

BANKING

22. Barclays Bank Ltd Ord 0.50

23. CFC Stanbic Holdings Ltd ord.5.00

24. I&M Holdings Ltd Ord 1.00

25. Diamond Trust Bank Kenya Ltd Ord 4.00

26. Housing Finance Co Ltd Ord 5.00

27. Kenya Commercial Bank Ltd Ord 1.00

28. National Bank of Kenya Ltd Ord 5.00

29. NIC Bank Ltd 0rd 5.00

30. Standard Chartered Bank Ltd Ord 5.00

1. Equity Bank Ltd Ord 0.50 37

32. The Co-operative Bank of Kenya Ltd Ord 1.00 INSURANCE

33. Jubilee Holdings Ltd Ord 5.00

34. Pan Africa Insurance Holdings Ltd 0rd 5.00

35. Kenya Re-Insurance Corporation Ltd Ord 2.50

36. Liberty Kenya Holdings Ltd

37. British-American Investments Company (Kenya) Ltd Ord 0.10

38. CIC Insurance Group Ltd Ord 1.00

INVESTMENT

39. Olympia Capital Holdings ltd Ord 5.00

40. Centum Investment Co Ltd Ord 0.50

41. Trans-Century Ltd

MANUFACTURING AND ALLIED

42. B.O.C Kenya Ltd Ord 5.00

43. British American Tobacco Kenya Ltd Ord 10.00

44. Carbacid Investments Ltd Ord 5.00

45. East African Breweries Ltd Ord 2.00

46. Mumias Sugar Co. Ltd Ord 2.00

47. Unga Group Ltd Ord 5.00

48. Eveready East Africa Ltd Ord.1.00

49. Kenya Orchards Ltd Ord 5.00

50. A.Baumann CO Ltd Ord 5.00

CONSTRUCTION AND ALLIED

51. Athi River Mining Ord 5.00

52. Bamburi Cement Ltd Ord 5.00

53. Crown Berger Ltd 0rd 5.00

54. E.A.Cables Ltd Ord 0.50

55. E.A.Portland Cement Ltd Ord 5.00

ENERGY AND PETROLEUM

56. KenolKobil Ltd Ord 0.05

57. Total Kenya Ltd Ord 5.00

58. KenGen Ltd Ord. 2.50

59. Kenya Power & Lighting Co Ltd

60. Umeme Ltd Ord 0.50

GROWTH ENTERPRISE MARKET SEGMENT

61. Home Afrika Ltd Ord 1.00

APPENDIX II: SAMPLE TO BE

1984   Jubilee Insurance

1985   Barclays Bank

1988   Kenya Commercial Bank

1988   Nation Printers

1989   Standard Chartered Bank

1991   Kenya Finance Corporation

1992   Crown Berger

1992   Uchumi Supermarkets

1994   National Bank of Kenya

1994   Housing Finance

1994   Sameer Africa

1995   NIC Bank

1996   Kenya Airways

1997   Rea Vipingo

1997   Athi river Mining

1998   TPS Serena

2000   African Lakes Corporation