A SURVEY OF DETERMINANTS OF THE INITIAL PUBLIC OFFERRINGS DECISION FOR COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

This project is my original work and has not been presented for a degree in any other University.

Signed--- **Date-----------------------------**

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

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DEDICATION

This work is dedicated to my family. They were the driving force behind the effort put in completing the work. To my dear wife Dorcas, for the constant encouragement throughout the journey, to my youngest daughter Natalie, for reminding me that the journey is not yet complete, to my daughter Sandra, for the constant reminder to live by example, to my daughter Nicole, for the light moments when the going got tougher and to my son Rodney, for encouragement to move forward.

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ABSTRACT

One of the most momentous events in the life of corporations is going public through the issue of shares in a Stock Exchange to the public. Being a very complex, costly and time-consuming process, a public offering requires, from a company that decided to list its shares, a thorough analysis and consideration of various aspects. The decision to list/ or not, cannot be generalized into one single determinant for all companies: different characteristics of firms and external environments play a vital role in identifying the most beneficial option. This paper examines the determinants influencing the IPO issue decision by enterprises under the conditions in force on the Nairobi Stock market. In the study, we asked CFOs of Kenyan enterprises, divided into two groups, to formulate their insights in the area of going public. The first group consisted of the entities that have previously executed an initial public offering, the second one included the entities that have not executed an IPO (but meet all the requirements of conducting an IPO.) This paper had a two-pronged focus; it explored the motives for Initial Public Offerings (IPOs) for companies listed at the NSE; then it catalogued the circumstances and conditions that discourage would be IPO candidates from completing an IPO issue in Kenya. To achieve the study objectives, an anonymous survey was conducted of a matched sample of ‘IPO companies’ listed on NSE and ‘non-IPO firms’, during the period 2000- 2014.The study revealed that the most common reason for conducting an IPO at NSE was to meet financing needs, followed by the push given by favourable market conditions, and lastly, as an exit strategy that enables founder entrepreneurs to encash their investments. The quest to reduce cost of capital received less weight as an IPO motivator. When the impediments to going public were evaluated, the desire to maintain decision making control was the most frequently cited justification. The second most common deterrence was prevailing bad market conditions. The need to avoid EPS dilution, and low price of stock were viewed as less critical deterrence.

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ABBREVIATIONS AND ACRONYMS

IPO	**Initial Public \offering**
VC	**Venture Capitalist**
NSE	**Nairobi Securities Exchange**
NYSE	**New York Stock Exchange**
AMEX	**American Exchange**
NASDAQ	**National Association of Securities Dealers Automated Quotation**
SPSS	**Statistical Package for Social Sciences**
CFO	**Chief Financial Officer**

CHAPTER ONE

INTRODUCTION

1.1 Background

Initial Public Offering (IPO) is the first sale of a corporation's common shares to investors on a public stock exchange (Greg, 2006). IPOs have been used by corporate entities to raise funds to finance their activities and for other non -financial reasons. This exercise has been used by companies all over the world at different economic periods, and at different stages in their lifecycles.

In this study we extend the IPO literature by analyzing data from surveys of chief financial officers (CFOs) to compare CFO perspectives to prevailing academic theory. Specifically, we examine two sides of the same coin of an IPO issue: WHY, and WHY NOT, companies conduct an IPO?

1.1.1 The Motivations for IPOs

Academic theory suggests four motivations for going public. First, the cost of capital literature (e.g., 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 misevaluation, 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 venture capitalists 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 et al. (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.

The fourth advantage of IPOs is that once a company is listed, it will be able to issue further shares via a rights issue, thereby again providing itself with capital for expansion without incurring any debt. This regular ability to raise large amounts of capital from the general public, rather than having to seek and negotiate with individual investors is a key incentive for many companies seeking to list.

Fifth, 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.

In sum, an IPO allows a company to tap a wide pool of stock market investors to it with large volumes of capital for future growth. The company is never required to repay the capital, but instead, the new shareholders have a right to future profits distributed by the company. The existing shareholders will hope that the capital investment out of the IPO proceeds will make their shareholdings more valuable in absolute terms.

1.1.2 Why companies stay private

Although there are many success stories of IPOs across the world, yet a significant number of companies have opted to remain private, which suggests that this option also has some benefits compared to going public.

Being listed on a stock exchange imposes heavy regulatory compliance and reporting requirements. Brau and Fawcett (2006) recorded this finding indicating that insiders at many private firms have a strong preference to remain private. Among other reasons, the following stood out as most compelling are: the desire to maintain decision making control: to avoid ownership dilution and, to avoid bad market/industry conditions.

Brav et al. (2006) name the following reasons for remaining private: first, the financial costs of public listing – both registration and ongoing administrative costs – are very high, thus, most companies cannot afford public listing until a certain stage of their lifecycle; secondly, the common fact of IPO underpricing prevents some companies from going public. Additionally, public companies face increased information disclosure requirements comparing to their privately-owned peers. Finally, loss of private benefits of control is among the costs of an IPO or reasons to remain private. Booth (2007) adds to the previous study by indicating indirect costs of an IPO, which include exposure to shareholder lawsuits and management distraction.

Consequently, all the above-mentioned factors confirm that before conducting an IPO companies must carry a thorough and time-consuming analysis weighting all the benefits and costs public listing may ensure for a specific company with its particular characteristics. Hence, investigation of the relationships between these characteristics and the decision to go public is of great importance.

1.2 Statement of Research Problem

A lot of research work on 'going public' has been done in the developed countries (See Pagano et al. 1998, Brau and Fawcett, 2006; and Ahmad –Zaluki, Campbell and Goodacre, 2007). These studies have provided vital information on understanding the thinking behind going public in these economic zones. Many companies have used this information to shape their funding decisions thereby accessing advantages provided by the pool of IPO funds. Perhaps the abundance of information regarding IPOs is contributory to the vibrancy of the IPO market in these developed markets.

The Nairobi Securities Exchange (NSE) was constituted in 1954 to help finance companies and provide a market for their securities. To date 65 companies in a wide range of industries have listed their shares. In addition, NSE lists also corporate and treasury bonds, preference shares and debentures. With a market capitalization of about Kshs 900 billion as at July 2015, it is one of the largest exchanges in East and Central Africa region, although it remains relatively small compared to developed market like New York Stock Exchange (NYSE) American Stock Exchange (AMEX), NASDAQ, and Tokyo Stock Exchange. The NSE has 65 quoted companies currently, 10 firms having been de-listed over time. In the recent past, a number of companies including Scangroup, Access Kenya, Kenya Reinsurance, KenGen Equity Bank, and Safaricom have been listed.

The state of the IPO market in emerging markets, especially Africa, is quite the opposite of what obtains in developed markets. Despite all the administrative, fiscal and tax incentives IPOs are few and far in between. In Kenya, the number of companies listed at the Nairobi Securities Exchange has more or less stagnated for the past two decades at no more than 65 companies. It is time that attention was directed to finding out the reasons for this gloomy situation despite a vibrant and growing economy.

Related local studies are few. Maina (2004) investigated the performance of IPOs in the after-market; Ndegwa (2006) has documented the factors affecting the development of the Nairobi Securities Exchange, While Ndatimana (2008) analyzed the IPO underpricing phenomenon at the NSE. This study intends to add to existing literature by adducing evidence from company CFOs as to the factors motivating the decision to go public (or remain private) for large corporate entities in Kenya.

1.3 Objectives of the Survey

The objectives of the survey were to identify:

1. The key factors motivating the decision to list for Kenyan companies.
2. The circumstances that discourage companies from going public

1.4 Significance of the Survey

This study benefits various groups of stakeholders with an interest in development of the equity market in Kenya. This includes the following;

a) Corporate executives

This study is significant to corporate executives since it makes them aware of the factors influencing listing of local companies on the stock exchange, highlight the benefits that accrue to their entities by listing and recommends various ways that serve as incentives for listing.

b) Investors

The study highlights the benefits to investors of investing in quoted stocks as a means of earning better returns in comparison to other investment avenues. As highlighted in various studies, IPOs offer some of the highest returns on investment in shortest investment period. With information highlighted in the study, investors (both current and prospective) are in a position to encourage entities in which they (intend to) hold a stake to go public in order to enjoy the inherent benefits.

c) Nairobi Stock Exchange (NSE) Management

The NSE management just like the Capital Markets Authority (regulator) plays a major role in shaping the operations of the players on the stock market. This study provides information helpful to the policy maker as well as the implementation teams (NSE).

d) The academic fraternity

This study is significant to the academic fraternity in that it contributes to the general body of knowledge/information on development of equity markets in Kenya. The study also suggests areas of further research that can be pursued by students of finance in enriching the available information on equity markets in Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews relevant literature on the influences of the decision of whether to go (or not go) public. The researcher looked at the literature on the rationale for listing, followed by the theories of listing. The researcher concludes by reviewing empirical literature on the listing decision.

2.2 Rationale for Listing

These are principles or reasons that explain a particular decision, course of action or belief in regard to listing, also known as “going public”. As indicated earlier in this study, in the last few years, a sizeable increase has been seen in the number of local companies that have listed on the Nairobi Stock Exchange indicating an increase in the level of awareness of the management of companies on the benefits of listing. As indicated in the statement of the problem, studies done on various aspects of listing prior to this study did not explore the rationale for listing among Kenyan firms. These studies were specific to other attributes of listing. Establishing the rationale for listing among firms in Kenya therefore still remains an important but unstudied issue and therefore constituted an information gap that this research addresses.

Various studies have been done in various countries regarding reasons why companies decide to go public. Modigliani and Miller (1963) argue that firms conduct a public offering when external equity will minimize their cost of capital thereby maximizing the value of the company. This reasoning suggests that at some point in a firm’s life, external equity financing could be needed to achieve an optimal capital structure. This position is also echoed by Myers (1984) that firms have a pecking order of financing: internal equity, debt financing and then external equity.
Zingales (1995) argues that an IPO allows insiders to cash out. In this way, insiders opportunistically sell shares in the IPO for personal gain. The insiders could be individuals or venture capital firms eying exit opportunities. IPOs may facilitate takeover activity. In the same

study, Zingales (1995) argues that an IPO can serve as a first step towards having a company taken over at an attractive price. Brau et al. (2003) reinforce this view and state 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.

IPOs also serve as strategic moves. According to Chemmanur and Fulghieri (1999), IPOs broaden the ownership base of the firm. Firms may conduct IPOs to capture a first- mover advantage. This can increase the publicity and reputation of the firm that is going public. In the same breadth, Bradley, Jordan, and Ritter (2003) show that analysts' recommendations are often biased upward after an IPO. Analyst coverage may thus motivate a firm to go public.

Despite all the advantages of going public, many firms still choose to remain private. Many reasons have been advanced by researchers to explain why the firms adopt this position. According to a survey of 336 chief financial officers (CFOs) conducted by James Brau and Stanley Fawcett (2006) and published in *The Journal Finance* , the aggregate results denote that maintaining decision-making control is the most important issue in deciding whether or not to stay private. Need to avoid ownership dilution came across as the other reason why many private entities shy away from 'Going-Public'. This aspect was strong among old companies and companies with conservative management.

Bad market and industry conditions also play a key role in making the decision to go public or remain private. The degree of perceived IPO benefits is considerably higher during bull periods, consistent with the study done by Lerner (1994) and Ritter and Welch (2002). Market and industry conditions largely determine the degree of success an IPO is likely to have. Hence if the fundamental market and industry conditions are not right, many CFOs will prefer to remain private.

Listing of companies comes with some level of disclosure requirements that they have to fulfill. Company information thus disclosed could be used by competition to the detriment of the entity going public. Reluctance to disclose vital company information also discourages companies from going public.

Need for capital for expansion drives companies towards going public. In cases where the corporate entity has strong capital base to support its expansion plans, the likelihood of it remaining private is high.

The costs of going public have also been noted to be a concern for CFOs. Specifically auditing and underwriting fees make up the most explicit costs of going public. Other incidental costs such as promotion add to the list of deterrents.

In a survey of why European firms go public, Bancel and Mittoo(2008) obtained contributions from 78 Chief Financial Officers (CFOs) from 12 countries across Europe about the determinants of going public and exchange listing decisions. The CFOs identified enhanced visibility and prestige, and financing growth as the most important benefits of an IPO. Their views on other motivations vary across firms and across countries. Large firms considered enhanced external monitoring as the most important benefit, while small firms go public primarily to raise capital for growth, and family controlled firms viewed IPOs as a vehicle to strengthen their bargaining power with creditors without relinquishing control. According to their survey, the English system firms considered the increased share liquidity and their ability to sell shares as the important benefits, whereas Italian firms identified reduction in cost of capital as the most valuable. Despite the divergent views, nearly all the CFOs agreed that benefits of going public significantly outweigh the related costs.

In another survey, Brau and Fawcett (2006) obtained contributions from 336 Chief Financial Officers (CFOs) of American firms to compare practice and theory in various areas of initial public offering including motivation, timing, underwriter selection, underpricing, signaling and the decision to remain private. In their study, the CFOs identified the creation of public shares for acquisitions as the most important motivation for going public. For these CFOs, traditional explanations such as lowering the cost of capital and the pecking order of financing were not among the most important reasons for conducting an IPO. In considering the variations among firms, they found out that high-tech firms view an IPO more as a strategic reputation-enhancing move than as a financing decision.

In 1998, Pagano, Panetta and Zingales conducted a study using a large data base (2,181 companies) of private firms in Italy to analyze the determinants of initial public offerings by comparing the ex ante and ex post characteristics of IPOs with those of private firms. In this study, they found out that companies appear to go public not to finance future investments and growth, but to rebalance their accounts after high investment and growth. In this regard, IPOs are followed by lower cost of credit and increased turnover in control. They contend that the reduced cost of credit may stem from the improved public information associated with stock exchange listing or from the stronger bargaining position vis banks determined by the availability of an outside source of funds.

In their paper titled "*Why do Firms go Public? Evidence from the Banking Industry*", Rosen, Smart and Zutter (2005), examine the reasons behind the decision by several private banks in the US to go public. In the study, they found out that banks that chose to go public faced a higher probability of being acquired in subsequent years than the banks that remained private. They also found out that the IPO banks put themselves in a better position to acquire other banks. One characteristic of these IPO banks that was common to a majority of them was that they experienced rapid growth and high profitability for several years preceding the IPO.

Kim and Weisbach (2005) considered whether raising capital was an important motive of going public. They used a sample of 16,958 initial public offerings from 38 countries between 1990 and 2003. They considered differences between firms that sold new shares, primary shares to the public and existing secondary shares that previously belonged to insiders. The study found a correlation between sale of primary shares with a number of factors associated with a firms demand for capital. In particular issuance of primary shares is correlated with higher increases of investments, higher repayment of debt and increase in cash and more subsequent capital raising through seasoned equity offers. From their sample, 79% of all capital raised through IPOs was from sale of primary shares, concluding that capital raising was an important motive of the going –public decision.

2.3 Theories behind Listing

Various theories have been advanced to explain the motives behind the listing decision among corporate firms. We revisit some of the theories that have a bearing to this study.

2.3.1 Cost of Capital Theory

This theory was reinforced by several scholars (e.g. Scott 1976, and Modigliani and Miller (1963)). The literature on this theory argues that firms conduct a public offering when external equity will minimize their cost of capital, thereby maximizing the value of the company. Other scholars have also argued in support of this theory. Myers and Majluf (1984) and Myers (1984) further argue that companies have a pecking order of financing starting with internal equity, debt financing, and then external equity.

2.3.2 Exit Strategy Theory

The proponents of this theory argue that firms go public with a motive of providing an avenue for existing shareholders to cash out. Zingales (1995) and Mello and Parsons (2000) argue that an IPO allows insiders to cash out. Similarly Ang and Brau (2003) demonstrate that insiders opportunistically sell shares in the IPO for personal gain. Black and Gilson (1998) support this theory arguing that IPOs give venture capitalists the opportunity to exit, providing an attractive harvest strategy.

2.3.3 Acquisition Theory

This theory postulates that IPOs facilitate takeovers and acquisition by companies going public. Zingales (1995) argues that an IPO can serve as the first step towards having a company taken over at an attractive price. In support of this theory, Brau et al. (2003) argue IPOs are important because they create public shares for a firm that may be used as “currency” in either acquiring other companies or in being acquired by other companies in a stock deal.

2.3.4 Strategic Move Theory

This theory argues that firms may go public as a strategy move to gain positive publicity that comes with an IPO. Maksimovic and Pichler (2001) assert that firms conduct IPOs to capture a first-mover advantage. They suggest that an IPO can increase the publicity or reputation of the firm going public. Bradley, Jordan and Ritter (2003) show that analyst recommendations are often biased upwards after an IPO. Similarly, Chemmanur and Fulghieri (1999) argue that IPOs broaden the ownership base of the firm. This in turn increases the firm's visibility in the public domain.

2.3.5 External Monitoring Theory

This theory suggests that firms may go public to increase the level of external monitoring. The firm's commitment to meet regulatory and disclosure requirements of the stock exchanges increases transparency, and lowers the agency costs between managers and majority shareholders. Jensen and Meckling (1976) argue that increased transparency and market scrutiny facilitates better corporate governance when there is separation between ownership and control. They argue that a publicly listed firm becomes subject to increased scrutiny by analysts and market participants that imposes discipline on managers for performance. It also facilitates better corporate governance by allowing firms to device incentives such as stock option plans to align managers' interests with those of shareholders.

2.3.6 Windows –Of- Opportunity Theory

This theory argues that managers use their superior information to select the timing of IPO and exchange listing, opportunistically to take advantage of temporary favourable market conditions and to capture attractive stock prices. Several studies (Ritter (2003), Ritter (1991)) have documented clustering of IPOs during strong industry and market conditions as well as long run underperformance following initial public offerings across both the US and other countries.

2.3.7 Funding For Growth Theory

This theory suggests that businesses will go public to raise new money to finance new growth opportunities in the environment. Ritter and Welch (2002) argue that most firms go public primarily to raise new capital for growth. Similarly other studies by various scholars have supported this notion. Kim and Weisbach (2005) provide evidence consistent with this theory in a study of a sample of IPOs conducted between 1990 and 2003 in 38 countries. They document that almost all firms raise substantial amount of new capital in the IPO, although European firms also sell a relatively large portion of their existing shares. They also report that new funds raised in the IPOs are used for a variety of purposes including financing growth and rebalancing leverage.

2.4 Empirical Literature

2.4.1 Factors that influence listing decisions

Following the foregoing review of literature on going public, several factors stand out as determinants of the going – public decision. These can be summarized as follows; Enhanced external monitoring, reduction of cost of capital, creation of public shares for acquisition purposes, raising of new capital to finance new growth opportunities, taking opportunity of favourable industry and market condition, enhanced reputation and publicity, and provide an exit avenue for existing shareholders.

From the foregoing, the rationale for listing possibly lies in several options listed above. The review of various studies highlighted in the literature review above has shown that the motives of going public will vary across firms and countries depending on various variables among them institutional and legal frameworks. The studies have shown that European companies CFOs considered enhanced visibility and prestige and financing growth as the most important determinants (Bancel and Mittoo, 2008), American company CFOs considered creation of public shares for acquisitions as key (Brau and Fawcett, 2006) while Italian firms considered rebalancing of accounts after high investment and growth as the key motivator (Pagano, Panetta and Zingales, 1998). This study seeks to establish which of the factors are ranked as most important determinants of the listing decision among Kenyan firms.

2.4.2 Factors that inhibit listing decisions

Despite the availability of literature on going public, many companies have decided to remain private. In a bid to understand the factors that have reinforced this position, I reviewed various studies done elsewhere to develop the possible reasons that inform the local situation.

In their study of CFO perceptions on going public, Brau and Fawcett (2006) asked the respondents to rank several factors that have influenced their decision to remain private. According to their findings, maintaining decision-making control was the most important factor. Other factors that appeared to influence this decision included avoiding ownership dilution and bad market and industry conditions. Other factors considered in this survey included disclosure of company information to competitors, reporting requirements by regulatory authorities, capital adequacy, the costs associated with an IPO, desire to be acquired, and dilution of earnings.

Similarly, Aslam and Kumar (2007) highlight firm specific attributes that will influence the management decision to remain private. They argue that firms with relatively high information production costs such as young or smaller companies will prefer to remain private. Jensen (1986, 1993) argues that low financial visibility is correlated with lower liquidity, reinforcing the view that such firms are likely to remain private. He also argues that low growth firms with large cash position relative to market capitalization are likely to remain private. This stems from the view that they can support any new growth opportunities as and when they arise.

The study by Pagano, Panetta and Zingales (1998) also sheds light to several institutional and regulatory factors that will hinder companies from going public. Citing experiences in Italy, they indicate that only companies that complied with the listing requirements could go public. Many family-owned and small companies have been found to be deficient in meeting regulatory authority requirements. They also argue that comparably Italian companies need higher reputational capital to go public because of lack of enforcement of minority property rights, making the magnitude of potential agency problem much bigger.

From the foregoing, it was discernible to highlight the outstanding factors that have informed the decision not to go public by company executives. These were; maintaining decision-making control, avoiding ownership dilution, bad market and industry conditions, avoiding disclosure, of company information to competition, stringent reporting requirements by regulatory authorities, capital adequacy, dilution of earnings to shareholders, stringent listing requirements, reputational and public image problems. This study sought to highlight which of the above factors had a bearing on the decision not to go public for Kenyan companies.

2.5 Summary

We reviewed literature on the influences on the listing decisions of corporations. Both viewpoints of listed and unlisted firms were reviewed. The main reasons that favored the listing decision were enhanced external monitoring, reduction of cost of capital, creation of public shares for acquisition purposes, raising of new capital to finance new growth opportunities, taking opportunity of favourable industry and market condition, enhanced reputation and publicity, and providing an exit avenue for existing shareholders. The grounds that mitigated against listing were maintaining decision-making control, avoiding ownership dilution, bad market and industry conditions, avoiding disclosure, of company information to competition, stringent reporting requirements by regulatory authorities, capital adequacy, dilution of earnings to shareholders, stringent listing requirements, reputational and public image problems.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the blueprint of how the research was executed. It describes the research design, population, the sample and sampling procedure, data collection methods and how data was collected and analyzed.

3.2 Research Design

The research design for this study was survey. This is a social science study, and as stated by Mugenda and Mugenda, the most appropriate design is survey. It seeks to collect data from Chief Financial Officers (CFOs) of the listed companies on the Nairobi Stock Exchange and of private Kenyan companies. The researcher targeted respondents who have gone through the listing process thereby aiming for factual information based on their listing experience. Similarly the respondents from unquoted companies provided factual information informing their decision to remain private. This design has been successfully used by Bancel and Mittoo (2008), and Okumu (2004), for similar studies.

3.3 Population

The population of the study was 61 companies listed on the Nairobi Stock Exchange and 50 private owned companies. The population contains companies operating in various sectors of the economy. This includes Agriculture, Automobile, Banking, Commercial Services, Construction, Energy and Petroleum, Insurance, Investment, Manufacturing and Telecommunication and Technology. The choice of private companies was done across the sectors to maintain objectivity.

3.4 Sample and Sampling procedure

The researcher used probability sampling since this is a quantitative research. As stated by Orodho (2005), it employs random selection and the results can be generalized to the population.

The researcher first stratified the companies into listed and those not listed. This was to ensure adequate representation of both groups. After stratifying, he used simple random sampling to pick the sample from each strata. Simple random sampling was used to ensure that companies in each strata have an equal and independent chance of being chosen.

The researcher selected 15 percent of the target population as sample size. Using the sampling procedure indicated above, the researcher allocated numbers to the companies in the population and selected every seventh company. This gave him a total of 16 companies. The researcher then wrote to the CFOs of the 16 companies in the sample and did a follow up for responses in two weeks. Any failed responses within the sample was replaced by a member from the same sector in the population.

3.5 Data collection methods

The study used primary data collected using a questionnaire with a 5- point Likert scale. The respondents were required to rate the factors motivating the listing decision on a 5- point Likert scale. The factors were rated ranging from “Not Important (1) to Very Important (5)”.

The questionnaires was administered by way drop and pick method. The respondents were CFOs of all the firms in the sample. A follow up was done after two weeks and a second pick and drop was done on the third week to the failed responses with possible substitution on some of the failed responses.

3.6 Data analysis Method

After data collection, editing and coding of the instruments was done, the obtained data was analyzed by use of descriptive statistical tools of analysis. These include frequencies tables, mean scores, and percentages. Data was presented by use of tables. Data from the questionnaires was analyzed to establish the overall mean, followed by the percentage of respondents that view the motivation as important. The statistical package Statistical Predictive Software Solutions (SPSS) was employed to predict outcomes.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Introduction

In this Chapter the survey data obtained from the sampled companies are analyzed and the results presented with a view to arriving at study conclusions. We present and discuss our findings as to which factors motivate companies to conduct Initial Public Offerings. We also present findings on the circumstances that discourage companies going public at the Nairobi Securities Exchange.

4.2 Motivations for Going Public

The survey method allowed us to directly ask CFOs why they go public and compare their responses to existing theories. Managers were asked to rank the following motives that potentially had influenced their decision to go public:

(i)Enhanced external monitoring

(ii)Reduction of cost of capital

(iii)Reduction of cost of capital

(iv)Creation of public shares for acquisition purposes

(v)Raising of new capital to finance new growth opportunities

(vi)Taking opportunity of favourable industry and market condition

(vii)Enhanced reputation and publicity

(viii)Provide an exit avenue for existing shareholders

The results of the survey presented in **Tables 1 and 2** indicate that the most important driver for the decision to go public was the need for capital. This factor was ranked number one by nearly 33 percent of responding managers and also enjoyed the highest average rank. This finding is in line with the classical approach to finance, and should not come as a surprise.

Generally, companies issue equity and go public when their financing needs exceed their internal financing means and debt-capacity levels. More surprising is that financing need was the least important consideration for more than 21 percent of the firms in the sample.

The second most important factor by average rank was the desire to take advantage of favourable industry and market condition and firms past performance. It was the most important reason for 25 percent of firms going public. Managers tend to time a public offer to coincide with the moment when they can demonstrate very good financial results, in the hope that analysts and investors will extrapolate a favorable past into a rosy future, which would raise the IPO valuation.

The evidence on extrapolation bias among market participants suggests that this approach does increase IPO valuations because investors are likely to be misled by a firm’s good historical performance [Szyszka, 2013, pp.61–62].

Table.1. Rank distribution among items and rank parameters

Question: The decision to go public resulted from:

	Percentage of answers indicating rank value						Rank statistics	
Items	1	2	3	4	5	N	mean	Standard deviation
(i)Enhanced external monitoring	35.2	23.1	14.1	14.3	13.3	33	1.6	1.223
(ii)Reduction of cost of capital	32.2	28.1	12.1	14.4	13.2	33	1.9	1.215
(iii)Creation of public shares for acquisition purposes	36.0	23.8	14.2	15.5	10.5	33	1.2	1.412
(vi)Raising of new capital to finance new growth opportunities	21.1	11.4	18.4	16.7	32.5	32	3.28	1.356
(v)Taking advantage of favourable industry and market condition and firm history	14.7	25.0	14.7	20.7	25.0	33	3.16	1.667
vi)Enhanced reputation and publicity (PR and marketing effect)	29.6	26.1	8.7	20.9	14.8	32	2.65	1.542
(vii)Provide an exit avenue for existing shareholders	14.8	21.7	29.6	22.6	11.3	33	2.94	1.231

Note: Respondents were required to order all the above mentioned items. The highest rank was assigned the value 5 and the lowest was assigned the value 1. No ties were accepted. Cases with missing values were excluded.

Source: Researcher’s own elaboration.

Table.2. Results of Friedman and Wilcoxon test

Question: The decision to go public resulted from:

Friedman Test statistic value: 3.1449

p-value:0.01446

Wilcoxon post-hoc paired test

		Item						
		1	2	3	4	5	6	7
	1	x						
	2		x					
	3			x				
	4				X ***		*	
	5					x		
	6			**			x	
	7							x

Note: The null hypothesis for the Friedman test stated that the difference between the mean rank profile and the global mean rank (equal to 3) is zero. The null hypothesis for the Wilcoxon post-hoc test stated that the mean difference between a given pair is zero. Item numbers correspond to the numbers in parenthesis in the previous table. Table 2 above presents relationships between all pairs of items in terms of statistical significance in mean rank difference: ***, ** and * indicate significance at the level of 0.01, 0.05 and 0.1, respectively. Empty cells indicate no significant difference.

S o u r c e : Researcher’s own elaboration.

Corporate timing and market timing seem to be viewed similarly, as a favorable stock market situation and the desire to capitalize the firm’s good historical financial results are not statistically different at 90 percent confidence level. Similar to surveys by Graham and Harvey [2001] and Brau and Fawcett [2006], our managers identified positive general market conditions, portending a higher possible valuation, as an important choice determinant in the timing of their equity offering.

The willingness to divest stock by current shareholders was third in the ranking of factors influencing the IPO decision. It was neither the top priority (11 percent of responses), nor the least import one (15 percent). It is worth noting that pre‐IPO owners often cannot immediately capitalize on the favorable market valuation due to selling restrictions (lock‐up periods declared when going public), or because information about a major shareholder disposing of stock just after the firm went public could harm stock valuation.

Least weighty among managers were Creation of public shares for acquisition purposes, Enhanced external monitoring, and Reduction of cost of capital as IPO drivers. These factors had the worst average rank, were below all other averages, and significantly below item (iv) and (v). Over 31 percent of managers identified them as the least important, and just over 10 percent as most important.

The Friedman test documents p-value of 0.01446 which is significant and allows further multiple comparisons testing. However, the Wilcoxon shows the significant difference only in two cases: between questions (1) and (7) and between questions (iv) and (v). Therefore, the results of the survey in the respect to differences in ranks should be treated with some statistical caution. Overall, the survey documents that the most vital reason to go public is financing need.

4.3 Why Firms Do Not Go Public

In spite of the motivations for going public, many firms however, including a large portion of our sample, choose to remain private. Therefore, in this section, we explore the rationale behind the decision not to go public. We derive most of the survey questions from conjectures in the popular press. For brevity we will not motivate each question here, but proceed immediately to the interpretation of the survey results.

In our mailing to the not-tried CFOs, a unique question was asked: "How seriously has your firm considered an IPO?" The five-point scale ranged from 1 = no interest to 5 = serious interest. The majority of the CFOs (57.6%) replied that their firm has no interest in an IPO. Another 22.4% indicated that their firm has little interest in an IPO. Only about 20% of the not-tried firms indicated that they had interest in an IPO (10% marked 3, 5.7% marked 4 and 4.8% marked 5). This finding indicates that insiders at many private firms have a strong preference to remain private.

To better understand the reasons companies choose to remain private, we asked the CFOs to answer a variant of the following question: "To what extent have the following influenced your decision *NOT* to conduct an IPO?" Specifically, the not-tried CFOs were asked about their decision not to conduct an IPO, the withdrawn CFOs were asked about their decision to withdraw their IPO, and the successful CFOs were asked how much each of the factors concerned them in the IPO process. A 5-point scale (1 = no influence, 5 = great influence) was used. The CFO responses are reported in **Table 3.**

Table.3: Survey Responses to the Question: How Important Were/Are the Following in Your Decision Not to Conduct the IPO?

Means are based on a 5-point Likert scale with anchors of 1 = not important to 5 = very important. The sample consists of 33 completed surveys out of a population of non-IPO firms.

	Mean	**% 4-5**
(i)Maintaining decision-making control	3.48	55.56
(ii)Avoiding ownership dilution	3.19	47.02
(iii)Bad market and industry conditions	3.13	48.24
(iv)Avoiding disclosure of company information to competition	3.06	32.81
(v)Stringent reporting requirements by regulatory authorities	2.71	31.56
vi)Capital adequacy	2.65	29.87
(vii)Dilution of earnings to shareholders	2.64	27.12
(viii)Stringent listing requirements	2.31	19.3 1
(ix)Reputational and public image problems	1.90	9.42

The aggregate results denote that maintaining decision-making control is the most important (mean = 3.48, % agreeing = 56) issue in deciding whether or not to stay private. Three other issues received mean scores above 3.0 (but less than 50% agreement): to avoid ownership dilution, bad market/industry conditions, and avoiding disclosure of company information to competition. While the first two reasons deal with insiders' control/ownership, the third deals with an exogenous factor, indicating that insiders are most concerned with issues they can affect.

The relatively low aggregate scores for the 9 factors result largely from disagreement among the respondent CFOs. CFOs possess very strong feelings regarding only a few factors. For example, some CFOs are determined to maintain decision-making control (mean = 4.00), while others want to avoid ownership dilution (3.75). Any potential benefit from an IPO is outweighed by the risk of a loss of control through an IPO. No overriding issue exists that would lead these decision makers to seriously consider going public. For now, they are satisfied that they have enough capital to finance operations and growth (mean = 2.65) and perceive little value in going public. The withdrawn CFOs place little emphasis on control and ownership dilution.

When CFOs are partitioned, the successful CFOs acknowledge the importance of market/industry conditions, ranking it as their most important concern (mean = 3.17), though the degree of this concern is at a much lower level than that of the withdrawn CFOs. Successful CFOs also concur that the desire to maintain decision-making control was seriously considered before moving forward with the IPO (3.20).

The only other factor to receive a score greater than 3 was concern with disclosing information to competitors (3.06). The overall response profile from the successful CFOs indicates that their companies took a measured approach to going public.

It is also evident that based upon the other conditioning variables, desire to maintain decision-making control is most influential among firms that are larger, older, and outside the high-tech environment—firms predisposed to entrenched management. Older companies also place greater emphasis on avoiding ownership dilution. Clearly, some companies perceive themselves as poorly positioned and less inclined to take advantage of an IPO. Further, some firms that are desirous to go public are deterred by poor market conditions and other factors that increase the cost of an IPO. For example, firms with low demand (as measured by an offer price less than the original mid-filing price) and cold IPOs (as measured by initial returns) were more concerned with bad market/industry conditions and CMA reporting requirements.

CHAPTER FIVE
SUMMARY CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This Chapter presents the summary of findings from the previous chapter, conclusions drawn, recommendation for further research and study limitations.

5.2 Summary of Findings and Conclusions

CFO survey responses indicate that academic theory regarding the IPO process is generally well-grounded. However, the CFO perspectives suggest a need to revisit and refine several ideas that are commonly held in the IPO literature.

The summarized key conclusions of our research are:

• The most important motivation for going public is raising of new capital to finance new growth opportunities. Minimizing the cost of capital is not among the three most important motivations for going public.

• Companies remain private to preserve decision-making control and ownership. However, IPO status (i.e., successful IPO, withdrawn IPO, or not-tried IPO) strongly influences CFO perceptions regarding the risks and difficulties encountered in going public. The experience itself appears to affect managerial perspectives regarding the IPO process.

5.3 Implications of the Study

A number of decisions surrounding the IPO process have serious business repercussions and occur within a dynamic environment. The success of an IPO depends upon the manager's ability to make timely and accurate decisions, while ensuring that the competitive edge of the firm is maintained.

Further, the findings of the survey underscore the need for a market that is operationally efficient, is supported by appropriate relevant laws and charter and is technologically advanced.

The regulatory authorities need to expedite legislation that will help streamline IPO process and create value for stakeholders. Modern state of the art technology should make the market less prone to insider dealings, while facilitating the price discovery function.

5.4 Recommendations for Further Research

In making its contribution to the existing literature on public offerings, this study raises a number of issues that must be investigated further.

First, the analysis does not provide definite evidence on the relationship between riskiness and the probability to go public. Thus, further research is required in order to understand whether diversification hypothesis of going public holds at NSE.

Further research is needed to investigate the influence of other factors such as political events like elections, government's privatization programs, global economic crises and the flow of foreign direct investment.

Additionally, There are many other IPO related issues that could be investigated and contribute the holistic understanding of the subject. These include:

- IPO timing
- Underwriter selection
- IPO under-pricing
- Signals conveyed by decision to issue
- Relative importance of various IPO process issues

5.5 Limitations of the Study

The results provide a number of valuable insights on the issue of listing for companies at the NSE. However, it should be noted that there are some factors which could influence these results:

First, merging data from different sources leads to a trade-off between the size of a sample and the level of accuracy. As discussed in the paper, the researcher took a number of measures to mitigate the possible bias; however, it is possible that this did not eliminate it entirely.

Another qualifying limitation of the study was the size of sample used and the criteria used to match the samples in the two strata of IPO firms vs. non-IPO firms. It can be argued that the study could have benefitted with a larger sample size and that a better basis for matching could be employed.

Finally, out of necessity, the analysis was performed on the basis of a number of simplifications; thus, it is to be borne in mind that the results provide only informed suggestions regarding listing, and the results should not be treated as definitive and irrevocable; every company has its own distinctive features that must be taken into account on an individual basis.

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APPENDIX I: SAMPLE QUESTIONNAIRE TO CFOs OF QUOTED COMPANIES						
SURVEY ON THE FACTORS THAT DETERMINE THE LISTING DECISIONS IN KENYAN COMPANIES Thank you for taking time off your busy work schedule to complete this survey questionnaire. We promise strict confidentiality concerning your responses. Please answer each of the questions to the best of your ability. Your support is highly appreciated.						
		Not important				**Very important**
Scores		**1**	**2**	**3**	**4**	**5**
1. How important were the following *motivations* for conducting the IPO/Listing?						
(i)Enhanced external monitoring						
(ii)Reduction of cost of capital						
(iii)Reduction of cost of capital						
(iv)Creation of public shares for acquisition purposes						
(v)Raising of new capital to finance new growth opportunities						
(vi)Taking opportunity of favourable industry and market condition						
(vii)Enhanced reputation and publicity						

(viii)Provide an exit avenue for existing shareholders					

APPENDIX II: SAMPLE QUESTIONNAIRE TO CFOs OF COMPANIES NOT QUOTED

How important were the following *motivations* for NOT conducting an IPO/Listing?

	Not important				**Very important**
Scores	1	2	3	4	5
(i)Maintaining decision-making control					
(ii)Avoiding ownership dilution					
(iii)Bad market and industry conditions					
(iv)Avoiding disclosure of company information to competition					
(v)Stringent reporting requirements by regulatory authorities					
(vi)Capital adequacy					
(vii)Dilution of earnings to shareholders					
(viii)Stringent listing requirements					
(ix)Reputational and public image problems					