COMMERCIAL PAPER AS A SOURCE OF FINANCE FOR KENYAN COMPANIES

BY

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A management project research submitted in partial fulfillment of the requirements for the Master of Business Administration Degree at the University of Nairobi.

October, 1999

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DECLARATION

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

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The project has been submitted for examination with my approval as University Supervisor.

MR. LUTHER O. OTIENO

DEDICATION

This research project is dedicated to **my wife Elizabeth and my son Ian** for their love and patience.

In sincere and deep appreciation for the many sacrifices that they have made during my period of study.

ACKNOWLEDGEMENT

First and foremost I want to thank the project supervisor, Mr. Luther Otieno for availing himself and guiding me in this study project.

I want to thank the entire faculty of the Executive MBA program for the manner in which the program has been conducted, and for their assistance during the hectic period of working during the day and attending night school.

I want to acknowledge the student companionship of my long-term colleagues, Elizabeth Mugo and Mwangi Ndete for the support that they gave me during the time that we studied together. Special thanks go to Sammy Muvellah for the use of his computer resources and the incisive discussions that were of great assistance during the final stages of this project.

My deep gratitude also goes to the staff in respondent companies who gave me much of their time, and many times at a moment's notice.

Last but not least I want to thank my entire family for their concern, encouragement and moral support. I knew I could always count on their prayers and words of comfort.

I am grateful to God Almighty, who answers all prayers and is with us at all times.

ABSTRACT

Financial structure decisions are a central part of corporate theory. Corporate managers need to make decisions pertaining to the sourcing of funds, and how much of the firm's earnings will be distributed to shareholders as dividends. The dividend decision is important because of its implications on the capital structure decisions that managers need to make all the time.

The capital structure decision requires managers to choose between debt and equity as sources of financing investments of the business. The owners of the firm have certain expectations that they expect managers to fulfil. The main expectation is that managers will act in the interest of the shareholders at all times, with a core objective of maximizing the net worth of the shareholders and the market value of the firm as a consequence. Debt finance offers the advantage of a tax shield, which leads to the increase in the value of the leveraged firm. However, increased use of debt leads to financial distress, and this may offset the benefit accrued from the tax shield.

The pecking order theory advanced by Myers (1990) shows that managers have an order of preference that moves from internal to external sources. When debt is used in the capital structure, the managers prefer safer to riskier debt. The use of short-term debt is an attempt to use safer debt, especially in times when interest rates are high and when there exists high uncertainty about the magnitude and timing of expected future cash flows. Commercial paper is one form of short term borrowing, and its use can be attributed to the following of the pecking order theory by corporate managers in practice.

In light of the above background, this study explores the use of commercial paper as a source of finance for Kenyan companies, judging by its increased use by the corporate sector especially in 1999. The study attempts to find, *inter alia,* if there has emerged a pattern among the issuing companies that would show existence of any similarities as regards size, ownership and industrial class. It also seeks to find out the reasons that bring companies to source funds from the commercial paper market.

The number of companies that have borrowed funds using commercial paper is at present still relatively small. This can be partly attributed to policy and infrastructural limitations within the capital markets framework. More commercial paper issues are expected in the future after the resolution of these limitations by the Capital Markets Authority, expected to be accomplished within this year.

The study has determined that there has been a significant rise in the use of commercial paper as a source of finance in 1999. Use of funds sourced from commercial paper issuance has been mainly limited to the financing of working capital needs. This is within expectation considering that commercial paper is a short-term source of funds. The study has determined that there is a demand for a secondary market for commercial paper so as to offer flexibility to both the lenders and borrowers.

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CHAPTER ONE

INTRODUCTION

1.0 Background

The management of a company is faced with difficult decisions in the determination of the appropriate mix of sources of finance to use in financing its investments and business operations. The challenge facing management emanates from the expectations of shareholders that management will maximise their returns and increase the markert value of the firm over time without putting future operations into jeopardy. Though shareholders expect that the management, as their agents, will work in the shareholders best interests at all times, sometimes the management decides to pursue their own interests that are at variance with those of the shareholders. This gives rise to conflict of interest, whose solution lies in the implementation of agency arrangements designed to align the objectives of management to those of shareholders. In the agency theory developed by Jensen and Meckling[1], shareholders can ensure that managers make optimal decisions by giving them appropriate incentives and monitoring of their activities.

Commercial paper is a short term capital markets instrument that provides a cost effective and flexible source of funding. Like corporate bonds, commercial paper is an instruments issued for the purpose of raising funds direct from investors without intermediation by banks. Commercial paper is generally used to finance the working capital requirements of a company, the same way that a bank overdraft would do. This is in contrast to bonds that are used by companies to meet their long-term financing needs. The debt market is part of the wider financial market. A major role of the financial market is to increase the financial resources available to the players in an economy, and to

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[1] Jensen, Michael C and William H Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure", *Journal of Financial Economics* 3, October 1976 pp 305 - 360

promote the efficient use of such resources to forster economic growth. By allowing the development of commercial paper as a source of finance, the Capital Markets Authority (CMA) has facilitated the increase in the range of financial instruments available in the market, for the benefit of both the lenders and the borrowers. The effect of this is to increase competition in the financial system, leading to the chanelling of resources towards the highest return investments for a given degree of risk.

Commercial paper issuance in Kenya can be traced to1994 when the first issues were made in the corporate sector. In 1996 the CMA moved in to regulate the issuance of both corporate bonds and commercial paper, in a market that has been dominated by trade in equities.[2] This heralded the birth of a debt market that is important in providing an alternative source of funds for the corporate sector, as well as offering investors an alternative avenue for their savings. The issuance of commercial paper is a further step towards the deepening of the Kenyan capital market.

Since 1994, the number of companies that have borrowed funds from the market using commercial paper has risen to eleven as at April 1999 as shown in Appendix I[3]. The cost of borrowing has a significant impact on the profitability of companies, especially in the current challenging economic environment. Commercial paper has therefore come in handy by helping companies reduce their interest expense.

Commercial paper is a money market instrument that is dependent on interest rates. A regime of volatile interest rates is not conducive to issue of commercial paper, and the

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[2] The Capital Markets Authority Annual Report, 1996/97 p 47

[3] Dry Associates Ltd

volatility in Kenyan interest rates since their deregulation in 1993 is one reason cited by the CMA as contributing to the late emergence of commercial paper in Kenya[4]. The cost of commercial paper is determined to a large extent by the interest rates on the 91-day treasury bills and the commercial bank lending rates. The 91-day treasury bill has generally been used in the Kenyan money market as the benchmark against which other instruments are rated. The yields on the bills are the floor mark, and they represent the return that the lenders would get on their investment if they did not invest in any other short term financial instrument. The commercial banks lending rates on the other hand represent the ceiling mark, since they represent the cost that borrowers would pay if they sourced funds from the next alternative, the bank overdraft. By having a yield higher than the treasury bills, commercial paper is attractive to lenders; in the same manner, it is attractive to borrowers since the cost of borrowing is lower than that of bank overdraft.

1.1 The History of Commercial Paper

Commercial paper has its origin in the United States of America in the early 19th century.[5] There existed legal restrictions preventing banks from operating in more than one state, resulting in a scarcity of funds in some states, and surplus in others. Corporations that found themselves in "deficient" states could not borrow from commercial banks competitively, and they resorted to borrowing from the open market so as to meet their financing needs.

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[4] CMA, *op cit.*, p 14

[5] Wells, David H, "Commercial Paper" in "International Finance and Investment: Multinational Corporate Banking", edited by Brian J Terry, CIB London, 1994 pp 671-694

The initial issuers of commercial paper in the US were textiles, utilities and the railroads, which were the developing industries at the time. However, the advent of the automobile and other consumer goods like electronics introduced finance companies into the commercial paper market. These companies had the objective of helping consumers finance purchases of their products, whose prices were beyond what they could afford. Companies like General Motors Acceptances Corporation (GMAC), a subsidiary of General Motors, were formed to finance the buying of GM vehicles. Commercial paper was used to finance the hire purchase operations of these companies.

A 1997 survey in the US showed the distribution of commercial paper issuers as industrials at 42.0%, utilities at 21.9%, finance companies at 17.6%, and others at 18.5%.

Although non-financial issuers of commercial paper dominate the US market in terms of numbers, finance companies contribute the bulk of the outstanding paper in volume terms General Electric Credit Corporation (GECC), Ford Motor Credit Corporation (FMCC), and GMAC are the leading finance companies that at present form the nucleus of the commercial paper market.

Before the entry of GMAC and other finance companies into the commercial paper market, the paper was issued through dealers. GMAC became the first company to issue commercial paper directly to the investors. Due to the large volumes of paper issued, finance companies have found it much cheaper to sell their paper directly to the investors, thereby saving on the dealers' commissions. Industrial companies, utilities and smaller finance companies sell their paper through dealers since their issue volumes do not justify establishment of in-house paper selling departments.[6] There are about six major

[6] Van Horne, James C and John M Wachowicz, Jr., "Fundamentals of Financial Management", New Delhi, Prentice Hall, 1997 p 235

dealers who purchase the issued paper at a discount for subsequent selling to investors. On average, dealers get a commission of 0.125% on the placements they make.

While historically commercial paper was bought by commercial banks, the early 1950s saw other firms enter into the market as investors. These include insurance companies, non-financial business firms, pension funds, and university endowment funds.

The US commercial paper market is regulated by the Securities Act 1933. Whereas registration of the issue is a requirement, the Securities and Exchange Commission (SEC) can grant a company exemption if the paper has an original maturity of up to 270 days, and the proceeds of the issue are used to finance current transactions only. Most of the dealer placed paper has maturities of between 30 to 90 days, while that of directly placed paper ranges from 7 to 270 days. Issued paper is held to maturity, and there is no formal secondary market. The absence of an active secondary market and the ever-present risk of default have given commercial paper yields higher than treasury bills of similar maturity.

Even though commercial paper is usually issued to provide short term financing, cases of paper being issued to finance long-term needs like acquisitions and capital expenditure are on the increase. The finance companies use commercial paper as a permanent source of funds, unlike the industrial users. In the past companies used to issue paper on seasonal basis, but the trend has now changed towards ongoing or fairly permanent basis. However, the US commercial paper market generally supplies companies with working capital financing, unlike European commercial paper that has no restrictions at all on the purpose of borrowing.

The commercial paper market in the US grew exponentially in the 1960s, with the outstanding paper tripling between 1966 and 1968. Many companies were facing difficulties in accessing credit from commercial banks, thereby resulting to issuing commercial paper. The growth of this market in the US is not attributed to the borrowing companies alone. A series of bank failures and the Mexican debt crisis of 1982 shook the confidence of bank depositors, forcing them to find an alternative means through which to invest their funds.

The spread of commercial paper to other parts of the world is comparatively recent. US companies went offshore in 1970 due to congressional restrictions on "capital exports", the funding of US offshore subsidiaries with dollars transferred from the parent company's domestic financing program. The subsidiaries had to tap dollar funding from the reserves held by non US investors, and this led to the issue of US$ denominated commercial paper in Europe. With time, large commercial paper borrowers like GMAC were able to source funds more cheaply in the Euromarket than in the US.

With the passing of enabling legislation, commercial paper was introduced in the UK and France in mid 1980s, and later to other European countries. The Euro market is now firmly established, with many borrowers, both US and foreign, having European and US commercial paper programs running alongside each other, thereby enabling them to take advantage of whichever offers the cheapest funds for the given risk. In India, commercial paper was introduced in 1989, and works much the same way as the US paper. The exception is that the use of the paper is restricted to short term financing, and the maturities range from 91 to 190 days.

1.2 The Kenyan Commercial Paper Market

Commercial paper in Kenya is very recent compared to elsewhere like the US and Europe. The first issues can be traced back to 1994, and these were placed by a commercial bank following guidelines issued by the Central Bank of Kenya. It was not until 1996 however that activity increased. In recognition that commercial paper was emerging as an important source of financing for the corporate sector, the CMA released operating rules and regulations to govern all aspects of commercial paper. The Capital Markets Disclosure and Standards Committee formulated the guidelines.[7]

The premier issues were not part of the capital markets framework, having been introduced as new financial products by the subsidiary of an international bank. The CMA intervened to regulate the issues, and a cardinal condition then was that an issuer needed to be listed on the Nairobi Stock Exchange in order to issue commercial paper. This saw the withdrawal from the market of outstanding commercial paper issued by unlisted companies. The CMA issued revised rules in April 1997, and these allowed a wider range of companies to issue paper irrespective of their listing status[8], subject of course to meeting the regulations laid out in the guidelines.

The Kenyan commercial paper programs have a combination of European and US features. For example, they are authorised by the CMA for working capital purposes, just like in the US. However, they are sold to the investors only through dealers who must be registered with the CMA as investment advisors. This is similar to the European issues, where companies do not issue their paper direct to the investors. This is to be expected

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[7] CMA, *op cit.*, p 14

[8] Capital Markets Authority: "Guidelines for the issue of Corporate Bonds and Commercial Paper", April 1997 pp 9 - 11

because the commercial paper market in Kenya is relatively new, and much is still unknown about it. Besides, the unsecured nature of the paper needs the intervention of the dealer to help in contacting investors and in placing of the paper.

Since the issuance of debt instruments by the corporate sector is traditionally a capital markets activity, the CMA regulates the Kenyan commercial paper market. The CMA gives the reason behind this as the need to ensure proper and appropriate disclosure of information for the benefit of investing companies[9]. At present there is no independent credit rating agency in the local money and capital market, unlike in the US where such agencies like Standard & Poor's and Moody's exist. This has been a serious impediment to the development of both the commercial paper and corporate bonds markets. Because commercial paper is unsecured credit, investors/lenders have been left to assess for themselves the risk and credit worthiness of the issuing companies. As a regulator, the CMA prescribes the minimum conditions that are considered protective to the investors in commercial paper.

Lack of independent credit rating agencies in the local market can be attributed to cost to a large extent. The cost to a company of obtaining a full rating in the US is approximately US$200,000.00. This hefty amount reflects the depth of analysis carried out by the rating agencies.[10] This is an enormous cost in relation to Kenyan companies, especially considering the fact that cost is one prime reason why the companies would want to issue commercial paper. This would explain why commercial paper has remained the preserve of big names in the local corporate sector. There is however the possibility of smaller companies and others that do not meet some of the issuing requirements to issue paper

[9] CMA issuance guidelines, *op. cit.*, p4
[10] A recent media article by the corporate banking director of a leading commercial bank provides the current figures for the US.

that is guaranteed by a commercial bank or any other company, provided that the guarantor meets those requirements.

In Kenya, issuers of commercial paper use dealers, who are called placement agents or arrangers. They provide to the issuing company a comprehensive service in two main ways. First is arranging, which includes the preparation of a prospectus and detailed financial analysis, seeking the approval of the CMA on behalf of the issuer, and explaining to prospective investors how the funds to be raised will be used, as well as providing background information on the issuing company. Second is placement, which is the actual sale of the paper to institutional investors for the agreed tenor and interest rate. In most of the cases, the issuing company chooses the offer cost based on the dealer's advice after considering the bids received from prospective investors. The investors quote their preferred interest rate based on the prevailing treasury bill rates and the number of days for which the amount quoted for is to be held.

As is the case in international commercial paper markets, the paper is normally issued on discounted basis. The investors buy the notes at less than their face value, with the difference representing the value of the effective interest. The investors receive the full face value amount on maturity.

Commercial paper issues in Kenya are usually of considerable interest to the investors. Most of the issues have coincided with periods when the yields on the 91-day treasury bills are falling faster than commercial banks lending rates. Investors therefore prefer commercial paper because it affords them a chance to earn higher returns than they would from the treasury bills. The treasury bill attracts a lot of liquidity from the market due to the consistently high yields it offers. For most of 1997 and 1998, the yields on the

91-day treasury bill ranged between 21.6% and 26.3%. Starting from the end of 1998, the yields fell progressively to 8.8% in March 1999. When these yields fall, investors who have been accustomed to the hitherto high returns look for alternatives, with commercial paper coming in as a good replacement.

The outstanding stocks of the 91-day treasury bill declined by 3.4% in the period June 1998 to February 1999[11]. While some of these funds found their way into the longer term floating rate treasury bonds, another part went into commercial paper as indicated by the increased activity in the first quarter of 1999. The excess liquidity in the market in the corresponding period is attributed to the reduction in the minimum cash ratio for commercial banks from 15% in June 1998 to 12% in December; the elimination from the market of the bearer certificates of deposit by the Central Bank; and the reduced demand for bank credit by the corporate sector due to depressed economic activity. This situation favours the issuing of commercial paper because there is a ready investor market. Liquidity therefore is an enabling factor for commercial paper issues.

By the same token, companies borrowing funds through issues of commercial paper benefit because it affords them an opportunity to borrow at interest rates that are below prevailing commercial bank lending rates. There is no secondary market for commercial paper in Kenya at present.

[11] Central Bank of Kenya: Monthly Economic Review, April 1999 pp24 - 38

1.3 Statement of the Problem

Commercial paper is an emerging source of finance for Kenyan companies. There was in excess of Ksh6.5b issued by the end of the first quarter of this year. This is a significant amount, considering that commercial bank lending to the private sector stood at Ksh243b in the year to February 1999.[12]

This study is an investigation of the reasons behind the increase in the number of companies raising funds by way of commercial paper, and to what uses the funds are being put to.

1.4 Objective of the Study

This study is focussed on companies that have issued commercial paper in Kenya. This is only one aspect of the commercial paper market, since there are other players like the investors/lenders, agents/dealers and the regulators.

The objective of the study is to seek answers to the following questions in regard to commercial paper issuance in Kenya:

(a) Are there any similarities amongst the issuing companies in regard to size, industry and ownership?

(b) How have the borrowing companies used funds borrowed through commercial paper?

(c) Is the present regulatory regime supportive or restrictive for companies issuing commercial paper?

[12] Central Bank of Kenya, *op. cit.*, p19

(d) Would the issuers of commercial paper prefer having the notes traded in a secondary market like the Nairobi Stock Exchange like other corporate debt instruments, and for what reasons?

1.5 Significance of the Study

This study is considered significant for several reasons:

(a) It is an exploratory study that will throw light on the reasons behind the increasing use of commercial paper by Kenyan companies to raise funds. The increase in use of the paper is perceived through the increase in both the number of borrowers and the amounts borrowed.

(b) It will help both the CMA and other regulators like the Central Bank of Kenya and the Commissioner of Insurance in the formulation and administration of regulations governing issue of commercial paper and guarantees.

(c) It will help potential and eligible investors/lenders to understand the reasons that bring the borrowers to the market, and whether the lenders have a choice of borrowers of particular characteristics as indicated by size, industry and ownership.

(d) It will help predict what type of companies will issue commercial paper.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

An integral part of each financial manager's responsibility is the financing decision. The financial manager must consider and evaluate the alternative sources of financing available, and their relative costs as well as their effect on the firm's financial risk. When evaluating the alternative sources of capital, the financial manager should remember that the firm is an economic unit whose objective is the maximisation of the net economic gain accruing to its owners.

The process begins with the making of a capital budgeting decision, which brings about the need to raise funds so as to finance positive net present value projects. Financing can come from the issue of common equity, use of retained earnings or external borrowing. External borrowing could either be on short or long term. This clearly then illustrates that a financing decision facing the financial manager is nothing more than a financial structure decision. The financing decision influences the shareholders' return and risk, with the market value of the shares being affected by the capital structure decision.[13]

The dividend decision goes hand in hand with the financing decision. Dividends represent that part of current earnings that is distributed to the shareholders. Whatever is retained in the business can be used to finance business investments. How much of earnings are available to finance investments therefore depends on the dividend policy decisions of a company.

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[13] Pandey, I M, "Financial Management", New Delhi, Vikas, 1992 p631

Use of commercial paper provides greater financial flexibility because it allows the issuer the latitude to select the timing and size of the issue, and it can also be used to refinance existing debt that is more expensive.

The ability to source funds at a reasonable cost and without increasing the risk of financial distress is important to a firm in that it sends signals to various parties. To the market, the signal is that the company is reputable and it represents a good investment. To the competitors, the signal is that the company is no walkover, and it is a formidable competitor that enjoys the goodwill of lenders. To the lenders, the signal is that the firm is stable and strong enough to qualify for lending at rates of interest lower than those charged to the ordinary borrower. This is important to the firm should it decide to borrow from commercial banks in the future, or even raise funds by equity issues.

Empirical observations show that the greater portion of the financial manager's time is devoted to the management of working capital. The importance of working capital to the firm is reinforced by the direct relationship between sales and working capital needs. As sales grow, firms invest more in stocks and receivables. The financial manager needs to watch the growth in these two and finance them expeditiously.

2.1 Decisions on Business Financing

Business firms use many types of financing for their operations and investment projects. Finance may be generated internally or externally, with residual profits after distribution of dividends to the owners constituting internal funds. External sources include debt and quasi-debt in its many forms, such as bonds, leases, debentures, preference shares and trade credit.

Due to the growth in the size of the firm, owners' equity and accumulated reserves become inadequate to finance operations. This is what gives rise to the need for external capital. Even though the firm has the option to go public to raise additional equity, the desire of the present owners to retain control of the company makes debt the only avenue left for extra financing. Use of debt is to be approached cautiously because debt agreements sometimes contain certain restrictive covenants that curtail the company's operating flexibility in the future. This interferes with the very right of control of the company that shareholders would wish to retain.

The business expectations about future cash flows are a key determinant of whether a firm should use debt or equity financing. Where there is expectation of high and relatively stable cash flows, a firm can be optimistic and take on debt, with the comfort that it can manage to service the principal and interest cost payments. This means that a firm is able to make decisions on its financing mix based on its expectations of future cash flows. During a regime of high interest rates in an economy, the risk of the firm facing difficulties in servicing debt payments is high enough to have owners choose equity financing instead of debt.

In determining what type of debt financing to use, the approach suggested by Morris[14] is to use short-term debt when there exists a positive covariance between the net operating income and the expected future interest rates. Use of short-term debt in such circumstances reduces the risk borne by shareholders, and increases the value of equity.

[14] Morris, J R, "Corporate Debt Maturity Policies", *Journal of Finance,* March 1976 pp 29 - 37

Another approach suggested by Myers[15] uses agency costs. Shareholders of a company that has positive net present value projects to invest in will not get the maximum benefit accruing from such investments if the company has used long-term debt in its capital structure. This is because part of the benefits accruing from the investments will pass on to the debt holders in form of reduced default risk, since the positive NPV projects are expected to increase profitability and improve cash flows. If such a firm had used short-term debt, the likelihood is that such debt will have fallen due and be repaid by the time the company receives the benefits of investing in the positive NPV projects, whose full benefit is now enjoyed by the shareholders.

2.2 The Alternative Views of Capital Structure

Before the trail blazing paper by Modigliani and Miller in 1958[16], finance theory was based on the traditional view that held that an optimal capital structure exists for a firm, and that the firm's cost of capital is dependent on its capital structure. Such an optimal structure can be achieved by the careful use of debt and equity, with the value of the firm being maximised as the cost of capital gets minimised. The cost of capital declines with leverage because cost of debt is lower than that of equity for a given range of debt. There comes a point where the firm's weighted average cost of capital is at its lowest, and the

[15] Myers, S C, "Determinants of Corporate Borrowing", *Journal of Financial Economics,* November 1977, pp 147 - 176

[16] Modigliani, H and Merton H Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment", *American Economic Review,* 48, June 1958, pp 261 - 267

total value of the firm is at its highest. Use of debt beyond this point leads to the increase in the cost of equity, which more than offsets the cost of debt used in the capital structure, leading to the rise of the overall cost of capital.

Modigliani and Miller subjected the traditional view to serious analysis. The thrust of their argument is that total risk for all the security holders of a firm is not altered by changes in its capital structure. The total value of the firm remains the same irrespective of the financing mix used in the firm's capital structure. Assumptions of perfect capital markets, existence of homogeneous risk classes, absence of corporate taxes and the ability to borrow at the risk free rate were made in arriving at their proposition I. The total market value is arrived at by capitalising the expected net operating income by the capitalisation rate applicable to the firm's risk class. Where two firms are identical in all respects except for their capital structures, they cannot have different market values or different cost of capital. If they were to have different market values, shareholders can benefit by selling shares of the lower value company so as to invest in an equivalent proportion of the one with higher value. Besides, shareholders in the firm that uses debt in its capital structure are better off divesting from the firm and by use of personal leverage, borrow in their own right and invest in the unlevered firm. This creates arbitrage opportunities.

The sole determinant of a firm's weighted average cost of capital is the investments the firm makes, with the source of financing for these investments being of no effect on their value.

In his writings on optimality and capital structure, Myers[17] notes that there has been a proliferation of the use of debt in take-overs, restructurings and leveraged buyouts. The use of junk bonds has gone up as well. These are indications that firms have become substantially levered. Myers advances three important theories of capital structure, two of which are important in understanding the reasons behind increased leverage that he alludes to earlier. The static trade off theory brings out the issue of the tax shield created by the use of debt, since interest on debt is taxable. By increasing debt in its capital structure, the firm gains a higher tax shield, which leads to the rise in the firm's market value. Use of more debt however brings with it other costs such as the agency costs of debt and the likelihood of financial distress. These costs eat into the benefits accrued from the tax shield, eventually leading to reduced market value of the firm.

The pecking order theory brings out the preference by firms for internal financing in favour of external financing. In the event that the positive net present value investments of a firm require funds to be sourced externally, the safest sources are preferred. The order starts from safer debt, riskier debt and finally to equity. There is no predefined debt ratio since use of debt is consequent upon the inadequacy of internal financing. The availability of investment opportunities spurs firms into using increasing amounts of debt without the risk of financial distress being a primary consideration. The pecking order theory has a linkage to the challenges posed by asymmetric information. The theory explains that if the firm acts in the interest of its existing shareholders, as indeed the shareholders expect management to, the announcement of a new equity issue is negative news that leads to the fall in share prices. This is in contrast to a repurchase of equity to issue debt. Since

[17] Myers, SC, "Still searching for an Optimal Capital Structure", *Are the Distinctions Between Debt and Equity Disappearing?* Ed by Richard W Kopcke and Eric R Rosengren, Boston: Federal Reserve Bank of Boston, 1990, Conference Series No 33, pp 80 - 95

the market believes that management has superior information, this decision is considered a signal for optimistic future prospects, and the share prices rise.

2.3 Financial Structure Decisions and Financial Leverage

The financial structure of a firm refers to the manner in which assets of the firm are financed[18]. It represents the entire capital and liabilities side of the balance sheet. The financial structure decision is about the financing mix, with the financial manager combining various sources of financing so as to maximise the market value of shares[19]. Capital structure decisions on the other hand focus on the mix of long-term sources of finance, and this means that capital structure is part of the wider financial structure. In many cases however, the terms are often used interchangeably.

Decisions about the long-term mix of assets cannot be made independent of decisions about short-term sources such as trade credit, bank overdraft and commercial paper. In practice there are many cases where short-term debts like bank overdrafts are used as substitutes for long-term debts to finance long-term activities. In such cases, the short-term debts provide leverage benefits to the equity holders of the company. Samuels[20] argues that the legal form of bank overdrafts, that allows lenders to recall their funds at short notice, should not be enough justification for treating overdrafts as short-term finance.

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18 Pandey, *op. cit.*
19 Kaen, Fred R, "Corporate Finance: Concepts and Policies", Cambridge, Blackwell, 1995
20 Samuels, J S and F M Wilkes, "Management of Company Finance", Surrey, Thomas Nelson, 1980, p157

Even long term borrowing agreements also contain clauses that give the lender the right to recall the loaned funds at any time. If a firm makes use of bank overdrafts regularly and the borrowed amount remains fairly constant across periods, then such borrowing can be treated as long term from a practical perspective.

The presence of debt, both short and long-term, in the financial structure of a firm creates a commitment to pay interest. This causes the return on equity to be more variable than would be the case if no debt were used. By the same token, the use of debt increases the probability of insolvency, which is the financial risk of a firm. Financial risk due to the use of debt occurs because of, one, the increase in the variability of the shareholder's return, and, two, the probability of insolvency due to the failure to meet repayments of the principal and interest.

A firm that has only equity in its financial structure will have neither the benefits of leverage nor financial risk. It follows therefore that the concept of financial leverage has significant bearing on a firm's decision regarding the composition of its sources of finance.

2.4 Financial Structure and Financial Distress

The advantages of debt financing lie in two areas. First, the interest tax shield arising from the fact that the interest costs are tax allowable deduction, and second, the control of the company remains in the hands of the existing shareholders. In spite of these advantages of using debt financing, companies in the real world do not use 100% debt in their financial structure. Financial distress is the term that accurately describes the disadvantage of using debt, and it occurs when the borrowing companies face difficulty in meeting their contractual obligations on debt. In the extreme, financial distress leads to insolvency. Heavy use of debt introduces inflexibility in raising of more funds in that the firm is unable to source funds on favourable terms, and this could adversely affect the firms operations and performance.[21] The present value of financial distress reduces the value of the levered firm. For low to moderate amounts of debt, the present value of the interest tax shield is higher than that of financial distress, resulting in the increase of the value of the firm. When debt is used heavily, the costs of financial distress increase in excess of the value of the interest tax shield. This is clearly seen in Myers' static trade off theory that has been discussed earlier.

Use of debt financing should therefore be limited to the ability of the borrower to service the principal and interest payments so as to avoid increasing the likelihood of the firm encountering financial distress. In a situation of financial distress, conflicts of interest arise between the shareholders and the creditors, the effect of which is to increase agency costs as the debt ratio increases.

Creditors find mature, well-established firms appealing. For example, firms in the manufacturing sector tend to have substantial investments in fixed assets. Such assets can be used as collateral for debt. In many cases, such established firms tend to earn average, and occasionally above average, returns on their operations. However in periods that earnings fall and the firms make losses, the value of their equity is reduced. If the reduction on reserves is substantial and sustained, the firms now find that their debt ratios become unfavourably high. These higher than planned debt ratios lead such firms into financial distress.

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[21] Pandey, *op. cit.*, p705 to 707

This affects the market's perception of the company unfavourably. The likely consequence of financial distress on companies is the loss of turnover and key personnel due to the uncertainty about the future of the company. This erodes the competitive edge that such companies enjoy in the market, resulting in reduction in profitability.

2.5 Financial Structure Issues in Kenya

Most of the studies done in the area of business financing are confined to long term financing decisions. However, short-term debt can have risk implications for a firm if it is significant.

Mbogo (1983) found out that Kenyan public companies were barely managing to meet their obligations as indicated by their current ratios. The study covers the period 1971 to 1982, and it is described as a difficult period economically. This is similar to the economic situation currently prevailing, and what has also been the case for many companies for most of the 1990s due to the effects of the Gulf War and the liberalisation of trade and the financial sector in Kenya. An interesting finding of the study is the proliferation of short-term debt as represented by the bank overdraft, and the perpetuity of its use through annual renewals. For many of the companies in the study, bank overdraft should be treated as a long-term source of finance.

Kamere (1987) notes that the practice amongst Kenyan companies is to classify bank overdraft as a current liability to reflect its legal form as payable to the lender on demand, and within one year. The reality is as per Mbogo's study, and further that short-term borrowing has been used to finance both working capital and fixed assets. Kamere also identified excess borrowing as a significant contributor to business failure.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This study is exploratory, surveying the characteristics of Kenyan companies that have issued commercial paper, and the factors that have influenced them towards use of commercial paper as opposed to other forms of short-term borrowing. Primary data was collected from the companies that have issued commercial paper by way of a questionnaire.

3.1 Data Sources

The data used in this study was obtained directly from the issuing companies by way of a questionnaire that was designed in line with the objectives of the study (see Appendix II). Except for two respondents who asked that the questionnaires be dropped and picked later, the rest granted face to face interviews. In a few of the cases, part of the data relating to the statistics on turnover and total assets was obtained from the published annual reports of the companies. While commercial paper has been in issue in Kenya since 1994, the study was focussed on the companies that have issued the paper irrespective of the period in which the paper was issued. Out of the 11 companies that have issued commercial paper since 1994 up to April 1999, 7 responded to the survey, a response rate of 63.6%.

The questionnaire responses have been coded to enable performance of statistical analysis. The computer statistical software SPSS was used to perform the necessary analysis.

3.2 Population Frame

Since the number of companies that have issued commercial paper in Kenya is small, the entire population was used in the study. The population frame was obtained from the leading arranger and placement agent of commercial paper in the market, and confirmed with the registered issues at the CMA.

As at April 1999, the companies that have issued paper totalled 11. The names of these companies are listed in Appendix I.

CHAPTER FOUR

ANALYSIS AND PRESENTATION OF RESULTS

4.0 Introduction

In this chapter, a discussion of the results is presented. The data collected for the study was largely descriptive in nature. This requires that descriptive statistics be used in the analysis of the data. The descriptive statistics employed in this study include: percentages, means and frequency tables. Correlation has been done for applicable variables such as age of company, value of total assets and the size of commercial paper issue. Correlation is important in this study because it brings out the direction and the strength of the relationship between variables such as the age of the company, the value of total assets and the size of commercial paper issue.

4.1 Company Characteristics

The number of employees, annual turnover and total assets have been used in this study as indicators of the size of companies issuing commercial paper. A study by Ferri and Jones[22] used total assets and turnover as measures of size in determining whether there is a relationship between use of debt and the size of the firm. Aosa (1992) uses sales turnover, number of employees and capital employed as measures of corporate size. The results of this study show that all the companies issuing commercial paper are relatively large when measured in these three dimensions. This can be interpreted to mean that due to their size, such companies always have large requirements for financing, and

[22] Ferri, MG and WH Jones, "Determinants of Financial Structures: A New Methodological Approach", *Journal of Finance*, June 1977, p350

commercial paper is one way they use to meet their needs. The investors consider companies with such characteristics relatively safe due to their massive resources.

The study has established existence of a positive correlation between age of the company and the size of the issue (see Appendix VII), meaning that an established company is more likely to issue commercial paper than a relatively new one. A similar correlation exists between the value of total assets and the issue size. This clearly brings out the fact that investors are comfortable lending their money to companies that have significant total assets that can be utilised in the event of default.

4.1.1 Age of Company

Table 1: Statistical Measures of Age of Respondent Companies

Statistical Measure	Value
Maximum	92.00
Minimum	22.00
Range	70.00
Median	40.00
Mean	45.14
Standard Deviation	23.30

The survey shows that issuing companies have ages ranging from 22 to 92 years, an indication that they are well established and largely mature. This is consistent with the nature of commercial paper where the reputation of the issuing company is important due to the unsecured nature of the borrowing. By being in existence for a long period, as indicated by the mean age of 45 years, companies have been able to establish themselves and they have a track record of performance that lenders and the investors in commercial paper can use as an indication of what to expect in the future.

4.1.2 Nature of Business

Table 2: Distribution of Respondents by Nature of Business

Nature of Business	Frequency	Percentage
Manufacturing	2	28.6
Commercial	1	14.3
Motor	3	42.9
Oil	1	14.3
Total	7	100.0

Motor industry companies lead at 42.9%, closely followed by 28.6% of companies in manufacturing. This is an indication that motor industry and manufacturing firms, by the nature of their operations, are capital intensive and their large operations require heavy investment in working capital. Motor vehicles are high value items, and the ability to meet actual and forecast demand requires a major investment in inventories. For such companies therefore, financing of these large requirements by issue of commercial paper is of economic necessity considering the higher cost of financing using short-term bank borrowing. Companies in the manufacturing sector tend to have heavy investments in fixed assets, and this is of comfort to the investors in commercial paper that there is something to fall back on in the event of default by the company. This would of course be subject to the statutory ranking of creditors in the event of the company being liquidated.

4.1.3 Number of Employees

All the respondent companies have a staff establishment of over 100 employees. The number of employees is a good indication of the level of overheads in a firm since employee costs account for a significant amount of total business costs.

4.1.4 Annual Turnover

Companies with an annual turnover of above Ksh 1 billion, as per their last annual report, represented 85.7% of the respondents (see Appendix VI). Turnover is a good indication of the working capital requirements of a firm, and a high turnover means the requirements of working capital are high. To support growth in turnover, a firm needs to increase its investments in inventories. In a challenging economic environment such as that confronting business firms in Kenya at present, receivables rise due to poor collections and default by debtors. Many companies in reaction tend to stretch their payables.

4.1.5 Total Assets

Table 3: Statistical Measures of Respondents by Value of Total Assets

Statistical Measure	Value
Maximum	6.50
Minimum	1.18
Range	5.32
Median	2.20
Mean	3.16
Standard Deviation	2.28

In terms of total assets, the companies ranged from Ksh 1.178 to 6.50 billion, with a mean of 3.16 billion. The interpretation is that the total assets are an indication to the investors in commercial paper of the assets they can fall back to in the event of default by the issuing company. This also indicates that companies that are likely to meet the CMA issuance regulations tend to be large.

4.1.6 Ownership of Company

Table 4: Distribution of Respondents by Ownership

Ownership of Company	Frequency	Percentage
100% Local Shareholding	1	14.3
Majority Local Shareholding	2	28.6
Majority Foreign Shareholding	3	42.9
100% Foreign Shareholding	1	14.3
Total	7	100.0

A total of 42.9% of the companies surveyed had a majority foreign shareholding, with a further 14.3% being 100% foreign owned. This adds up to 57.2% for companies with majority foreign shareholding. The significance of this in terms of commercial paper issue is the influence of the parent companies, which are mainly from Europe and the US. These two regions have the largest commercial paper markets in the world. It would appear therefore that these companies attempt to derive the benefits of issuing commercial paper locally just as in their home countries. It also indicates a preference in the market by investors of commercial paper to lend to companies that are part of a global group. This gives the investors an assurance that the local company is backed by the parent company, and that the parent can come to its rescue in the event of difficulties in redeeming maturing paper. Such a group is also able to easily meet the local CMA issuance conditions such as the level of capital and reserves, and can arrange for guarantees in favour of its local subsidiary if required.

4.2 Size and Frequency of Issue

Table 5: Statistical Measures of Issue Size

Statistical Measure	Value
Maximum	1,500.00
Minimum	100.00
Range	1,400.00
Median	500.00
Mean	642.86
Standard Deviation	464.07

Issuance of commercial paper is for face values ranging from Ksh 100million to 1.5billion, with a mean of Ksh 642million. This is consistent with the company characteristics noted in 4.1 above. This should however be seen in light of the CMA regulations on debt ratios that determine how much a company can be allowed to issue, its size and financing needs notwithstanding. The regulations set a total debt ratio of 4:1, and this should include the new issue of commercial paper.[23]

Table 6: Commercial Paper Issues by Year

Year of Issue	Frequency	Percentage
1996	1	14.3
1997	1	14.3
1998	1	14.3
1999	4	57.1
Total	7	100.0

There is an upsurge in issues noted in 1999, with the year accounting for 57.1% of the issues. This can be explained by the sharp fall in the 91-day treasury bill yields from 26.3% in May 1998 to 8.8% in March 1999. Comparative commercial banks lending rates moved from 30.54% in May 1998 to 22.9% in February 1999[24]. An opportunity therefore arose at the beginning of this year for qualifying companies to source funds at much cheaper rates by issuing commercial paper than they had been able to previously.

In terms of the frequency of issue, 85.8% of the companies issue paper on ongoing and continuous basis, with rollover of the outstanding paper being negotiated on maturity (see Appendix VI). This indicates that companies prefer to rollover maturing paper so long as the interest rate regime in the market is in favour of commercial paper as opposed to commercial bank lending rates, and so long as the need for the funds exists. Of course in

[23] CMA: "Guidelines for the issue of Corporate Bonds and Commercial Paper", April 1997
[24] This has been extracted from the Central Bank of Kenya's Statistical Bulletins for 1998 and 1999, as well as the Bank's Monthly Economic Reviews for January to June 1999.

the process of rolling over the paper, the companies need to keep within the CMA conditions that need continuous adherence over the currency of each issue. The rates of interest required by the investors at each rollover are dynamic in the sense that they take into consideration the prevailing yields on the 91-day treasury bills and their anticipated movement in the immediate future.

4.3 Factors Influencing the Size of the Issue

Table 7: Distribution of Factors Influencing the Size of the Issue

Factors Influencing Issue Size	Frequency	Percentage
CMA Issuance Regulations	1	14.3
Working capital needs	2	28.6
Firm's borrowing requirements	2	28.6
Parent Company Management	1	14.3
No response	1	14.3
Total	7	100.0

From the responses obtained, 14.3% chose the size of their issue based on what the CMA regulations allowed them to. Another 14.3% chose as per the decision of the corporate headquarters management, even where they had the capacity to borrow more. This applies to companies that have majority foreign shareholding. 28.6% chose as dictated by their working capital needs, with a further 28.6% of the respondents issuing paper to liquidate their current borrowings in form of short-term loans and bank overdraft, which underscores the cost and flexibility advantages of commercial paper.

4.4 Average Costs and Tenors

4.4.1 Average Tenors

The preference by the Kenyan market for the lower end of short-term instruments has been indicated in the responses obtained. From the general market and economy perspective, investors prefer the 91-day to the 182-day treasury bill, due to the uncertainty revolving around interest rates. The nature of commercial paper as unsecured borrowing is a strong determining factor of the tenor and cost of an issue. Although so far no Kenyan company has defaulted on its commercial paper obligations, investors realise that the possibility of default is always there should the company be unable to meet its cash flow projections. The risk is even more enhanced for companies that do not have back up credit lines with commercial banks that they can use to redeem maturing paper.

The responses show that the tenors of the issued paper range from 30 to 105 days (see Appendix VI). Most of the respondents had paper in issue across all the tenors, with most of them going up to 90 days with the exception of one company that reported a tenor of 105 days. Besides being a reflection of the unsecured nature of commercial paper, short tenors underline the influence of interest rates volatility in the local market in money market decisions by investors. From past experience, most investors know that the rates can swing to the opposite direction any time. They are therefore not willing to commit their money in a particular instrument like commercial paper for an extended period if they expect rapid upward movement of treasury bills yields in the immediate future.

4.4.2 Average Commercial Paper Costs

An analysis of the yields on the 91-day treasury bill and those of commercial paper of similar maturity in the period between November 1998 and May shows that investors in commercial paper received on average an extra return of between 6.17 and 2.02 percentage points through investment in commercial paper1999 (see Appendices III and IV). In the earlier periods of December to March, the differentials were much higher at between 6.17 and 3.58 percentage points. They are much lower for the period between April and May, ranging between 2.02 and 2.75 percentage points. This indicates two things; first is that in the earlier periods most of the investment funds of institutional investors were still held in treasury bills, with the little available for investment in commercial paper attracting higher spreads. The second indication is that most of the funds earlier held in treasury bills had matured and were now being invested in commercial paper instead. This influx of investors into the commercial paper market led to the reduced spreads. If more companies were to enter the commercial paper market, spreads are likely to go down further, say to a marginal 1% above the treasury bill rates.

In the period between December 1998 and May 1999, the average commercial bank overdraft rates moved from 28.8% to 20.5%. During the same period, the base lending rates as reported by the leading commercial banks ranged between 19% and 22%.

For smaller banks the base rates are higher. The usual practice is for companies to borrow at base plus a spread that is dependent on the risk assessment by the lending bank. Issuing of commercial paper has therefore enabled companies to borrow up to 9 percentage points lower than the bank overdraft rates[25].

4.4.3 Dealership Costs

The dealers' commissions paid by the issuing companies ranged from 0.6% to 2.0% of the amount placed by the dealer. For 85.8% of the companies, a dealership commission of up to 1.5% was levied on the placed paper (see Appendix VI). These commissions are negotiated before hand, and are loaded on to the interest cost discount workings so as to give the issuer an "all inclusive" interest cost. The companies that have a more favourable perception in the market were able to negotiate lower dealer commissions, this being the recognition of the ease of placing their paper with investors in comparison to less favoured issuers.

At the end of the day, placement of the paper is what matters to the issuing company. Companies desire to have the entire authorised amount placed, and it is important that the company gets a dealer who is aggressive in contacting investors and convincing them to buy the paper at rates that provide reasonable cost saving to the issuer. The commissions charged by the dealer indicate that the dealer takes the ease of placement into account, and this really depends on the reputation of the company and the investor perception of the inherent risk in individual issuing companies.

[25] The information used to make computations in this section is obtained from the weekly Commercial Paper and Treasury Bills Comparison Tables published by Dry Associates Ltd in the *Daily Nation BusinessWeek,* and The Central Bank of Kenya *Statistical Bulletin* for 1998 and 1999. A summarised version is given in Appendix III. The indicative base rates used are those published in the media by Barclays Bank and Standard Chartered Bank in the same period.

4.5 Application of Commercial Paper Funds

Table 8: Uses of Commercial Paper Funds

Use of Commercial Paper Funds	Frequency	Percentage
Finance working capital	5	71.4
Finance trading and expansion	1	14.3
Retiring existing borrowing	1	14.3
Total	7	100.0

The Kenyan commercial paper is generally authorised for financing working capital requirements of the issuing companies, and the fact of this is also apparent in its nature as a form of borrowing as indicated by the reported short tenors. While 71.4% confirmed usage for financing working capital, 14.3% of the respondents reported having used the funds to finance part of their expansion programs, which are basically of a capital nature. This is not totally unexpected in our kind of market that lacks a well-developed long-term capital market, especially for corporate bonds. This has to a large extent led to the proliferation of the bank overdraft as a "perpetual" source of financing that is used to finance company operations, including those of capital nature[26].

[26] The 1983 study by Mbogo details the perpetuity of use of the bank overdraft by most of the Kenyan public companies.

Since most companies have issued commercial paper with an intention of reducing bank borrowing, it is to be expected that part of these funds will be applied to purposes other than working capital. Another 14.3% used the funds to retire existing debt, and this underscores the cost advantage sought in use of commercial paper.

Table 9: Preference of Commercial Paper over Similar Alternatives

Reason for preference	Frequency	Percentage
Short term unsecured borrowing	1	14.3
Cheaper than similar alternatives	5	71.4
Easier to manage and fewer conditions	1	14.3
Total	7	100.0

A total of 71.4% of the companies preferred commercial paper to similar short-term sources of finance because it is cheaper, as discussed in 4.4.2 above. This is an expected response because each financial manager seeks to raise funds in the most cost-effective way possible, and the rational choice is that of the lower cost alternative, *ceteris paribus*.

A further 28.6% preferred it because to them it is an easier way to manage movement of funds, and because its unsecured nature leaves out technicalities and costs of registering charges on collateral. Stamp duty and legal fees are extra costs of secured borrowing, and these costs can be substantial depending on the amount being borrowed. Borrowing through issue of commercial paper eases the management of funds because all proceeds of the placed paper are held in one account with the receiving bank, and the same account is used to pay off matured paper.

4.6 Selection of Dealers

Table 10: Reasons for Selection of Dealers

Reasons for Selection of Dealers	Frequency	Percentage
Experience and reputation	1	14.3
Presentation skills and personalities	2	28.6
Existing relationship	1	14.3
Cheaper cost	2	28.6
No response	1	14.3
Total	7	100.0

The reasons given for the choice of the dealers included reputation, experience in managing paper issues, cost of placement commissions, existing relationships in provision of other services, presentation skills and the personality of the dealer's staff. Even though commission cost was taken into consideration by most of the respondents as evidenced by 28.6%, 42.9% indicated that the presentation skills and personalities of dealership staff, the reputation of the dealer and his experience in arranging and placing paper was the overriding selection criterion.

The selection of a dealer in the issue and trading of commercial paper is of paramount importance to the issuing companies for two main reasons. Firstly, commercial paper is relatively new in the local environment, and not many people are well versed about it. Companies intending to issue paper therefore need to have a dealer who is able to demystify the subject and tell them exactly what they need to do to issue, and how to go about it. The same applies to investors, who need to be shown the benefits of investing in the paper alongside other competing investments. Secondly, due to the nature of commercial paper as unsecured borrowing, prospective investors need to be convinced about the credit worthiness and reputation of the issuer based on the investors' knowledge of the company and the representations made by the dealer. Having a dealer who is reputable in the market in his own right is therefore important in ensuring successful placement of the authorised amount.

4.7 Effect of CMA Rules on Commercial Paper Issuance

Table 11: Effect of CMA Rules on Commercial Paper Issuance

Effect of CMA Rules	Frequency	Percentage
Constraining	3	42.9
Not constraining	4	57.1
Total	**7**	**100.0**
Reason for "Constraining" Answer		
Mandatory compliance	2	66.7
Restriction on issue size	1	33.3
Total	**3**	**100.0**
Reason for "Not Constraining" Answer		
Firm is used to disclosure requirements	1	25.0
Rules are not very stringent for large firms	1	25.0
Rules are accommodating	1	25.0
No reason	1	25.0
Total	**4**	**100.0**

As the regulator in the capital markets, CMA sets rules and conditions that need to be met before a company obtains authority to issue paper. The rules ensure fair play and a standard by which the commercial paper market can be evaluated. Majority of the companies that have issued commercial paper are public companies that are used to disclosure requirements as required by the CMA and the NSE. Listed companies are required to publish half-yearly and audited annual accounts in the print media each year, and this presented no challenge or apprehension when it came to doing the same for commercial paper purposes. This is evident in that 57.1% felt that the CMA rules were not a constraining factor.

For the 42.9% that felt that the rules were constraining, the reasons given revolved around the mandatory compliance sought by the rules, and the limitation of the size of the issue based on debt ratios. Since most of the companies are fully or largely foreign owned, the feeling was that parent companies could give repayment guarantees and thereby allow their local subsidiaries greater access to cheaper funds. 57.1% of the issuing companies had high equity in their capital structure before the issue of commercial paper. This is to be interpreted as compliance to the CMA rules that do not encourage issue of paper by highly indebted companies due the inherent default risk. It also indicates the existence of a debt capacity that can be utilised to raise funds when required.

The role of any regulator is generally to facilitate rather than to curtail. It is therefore important that the CMA avails a forum in which issues pertaining to commercial paper issuance can be discussed with the current and potential issuers so as to develop this sector of the capital market.

4.8 Development of a Secondary Commercial Paper Market

Table 12: The Need for a Secondary Commercial Paper Market

Need for Secondary CP Market	Frequency	Percentage
Yes	5	71.4
No	2	28.6
Total	**7**	**100.0**
Reason for "YES" Answer		
Greater access and flexibility by investors	2	40.0
Possibility of longer tenors	1	20.0
Save on rollover and issuance costs	2	40.0
Total	**5**	**100.0**
Reason for "NO" Answer		
Current NSE trading environment not conducive	1	50.0
Insecurity due to threat of theft and fraud	1	50.0
Total	**2**	**100.0**

A significant 71.4% of respondents were in favour of the establishment of a secondary paper market, even though for different reasons. Majority of those in favour felt that establishment of such a market would allow greater access to funds and flexibility to both the issuing companies and the investors. This works to the advantage of the investor who can trade the paper before maturity if the need for funds arises. By the same token, it would also be advantageous to the issuer in that the market can be pushed to higher tenors, say between 180 and 360 days. This removes the need for frequent rollovers and the associated administrative costs. Establishment of a market will also enable individuals to participate in the market, enabling them to earn higher returns than those from bank savings deposits and treasury bills. This would be a departure from the present regulations that restrict investment in commercial paper to institutional investors. This has the effect of deepening the financial markets further.

For the respondents who were not in favour, the issues raised pertained to their desire to know the particular investors who hold their paper. This comes out of the fear that the notes can be stolen or forged by unscrupulous people to fraudulently seek redemption from the issuer. Another reason given is that the trading environment at the NSE is not conducive to trade in commercial paper, considering the depressed market activity and the sustained fall of the market index from 2,583.73 in November 1998 to 2,493.50 in August 1999[27].

4.9 Chapter Summary

Commercial paper issuing companies are relatively large as measured by the value of total assets, turnover and staff establishment. This is an indication that investors in commercial paper seek safety in the resources of the borrowing companies.

The companies that are likely to issue commercial paper are in capital-intensive industrial sectors, such as manufacturing and motor industry firms. There have been no issues of commercial paper in the Kenyan market by finance sector companies, and this can be attributed to the largely long-term nature of their operations such as the financing of mortgages.

[27] The index numbers published by the Nairobi Stock Exchange for the end of each month.

Issuing of commercial paper is large borrowing, as indicated by the mean of Ksh 642million for the paper issued to date in Kenya. This ties in with the "large firm" characteristics identified as common to all commercial paper issuers.

The average tenor for commercial paper issues is 90 days, clearly indicating that investors are sensitive to the risk inherent in unsecured lending, as well as to the volatility of interest rates in the local economy.

The cost advantage that is offered by commercial paper over other alternatives such as the bank overdraft is a major reason why eligible companies choose commercial paper over similar alternatives.

The choice of a dealer to place the issued commercial paper is important to the issuing company because it has a major influence in the successful placement of the entire issue of commercial paper, or the portion of the authorised amount that the company desires to place.

CHAPTER FIVE

SUMMARY AND CONCLUSIONS

5.0 Summary and Conclusions

The results to be drawn from the study are many and help in the understanding of the commercial paper market in Kenya.

The study has determined that issuance of commercial paper has increased, with 57.1% of the issues reported in 1999. This is largely due to the cost advantage offered by commercial paper over short term borrowing like the bank overdraft. This has been confirmed by 71.4% of the respondents who preferred commercial paper due to cost considerations.

There have been no issues of commercial paper by both the finance companies and utilities. Most of the non-bank finance companies in Kenya are in the housing development business, whose nature of business is long term lending. It would therefore not be reasonable for such companies to borrow short term through commercial paper to finance long-term business like mortgages. For utilities, this is a surprising reality because most of the utilities infrastructure in the country is in bad shape, and there is every possibility that such companies would benefit by issue of commercial paper. However, most of the utility companies are linked to the parastatal and municipal authorities arms of the government, whose history of performance does not inspire the confidence of investors.

Company characteristics are an important determinant of the type of company that will go to seek funds in the commercial paper market. The company will be well established, having been known in the market for quite sometime. The company will be large, as measured by total assets and turnover. These characteristics are important to the investors in that they provide the assurance of stability and security since commercial paper is unsecured, and they minimise the investors' exposure to risk.

Manufacturing and motor industry firms take the lead in commercial paper issues in Kenya. The nature and size of the operations of these firms tent to be relative large scale, and this imposes high financing requirements.

Tenors for the issued paper tend to be for short tenors averaging 90 days. This is a reflection of the investors' regard of the risk of default by the issuing companies, as well as the interest rate regime in the economy.

The majority of companies sourcing funds through issue of commercial paper are foreign owned and controlled. Besides the positive influence of the parent companies, this indicates investor confidence with foreign controlled companies due to their performance record, and the assurance of rescue by the parent company if the local affiliate runs into cash flow difficulties in redeeming matured paper.

The study shows that commercial paper borrowing is still predominantly used to finance working capital needs of the business. It is not surprising that 14.3% reported having used commercial paper to finance capital projects, taking into account the non-existence of corporate bonds in the market. This proportion could rise in the near term if no steps are taken towards the development of corporate bonds and a vibrant market for them similar to the one that exist for equities through the NSE.

Commercial paper is a relative new source of funds for Kenyan companies and a new money market instrument for the investors. Due to this emergence characteristic, the lack of credit rating service in Kenya and its unsecured nature, the placement of commercial paper with investors is a challenge that faces the issuing companies. It is therefore important for the companies to have a dealer who has good experience and reputation to ensure success in placing of the paper. These are the important characteristics that companies issuing commercial paper consider in their choice of a dealer.

The regulatory role of the CMA has a significant effect on the borrowing companies in that it can restrict the amount of funds the company can access due to the application of rules such as the 4:1 gearing ratio. The study has determined that a majority of companies that have used commercial paper is comfortable with the current regulatory regime. There should however be dynamism in the regulatory structure to recognise the changing variables in the economy such as inflation, as well as the business fundamentals of the issuing companies. The calibre of management is an important fundamental that investors should take into consideration. Companies with well-qualified management that has a history of profitable operations should access funds from the market more easily and cheaper than those without these attributes. This should be reflected in the rules set by the regulators.

The study establishes the desire of a secondary market for commercial paper, even if on over-the-counter basis. This is because of the flexibility this affords to both the issuers and the investors, arising from the fact that such a market is on willing seller-willing buyer consensus. Pricing will be fair and competitive due to the diversity of the investors. This is a clear departure from the present set up where most of the issued paper in the market is invested in by the same circle of investors such as commercial banks and insurance companies. This leads to the situation where the issuing companies are price takers most of the times. The establishment of a secondary market is also important because it subjects managers of the issuing companies to the scrutiny of the market. The performance of the managers in achieving profitability and cash flow targets will be taken into consideration by potential investors in deciding which commercial paper issues to invest in.

The desire for a secondary commercial paper market also indicates the need for a corporate bond market. While the government and the quasi-government East Africa Development Bank are able to raise funds through the floating rate treasury bonds and the EADB bonds respectively, the corporate sector does not yet have this opportunity. Policy issues revolving around this are discussed in section 5.1 below.

5.1 Policy Issues

Commercial paper is part of the capital markets. The statutory body charged with the development and regulation of the capital markets is the CMA, which was established in 1989 through an Act of Parliament.[28] Section 11(1) of the Act clearly brings out two of the roles of the CMA:

[28] Capital Markets Authority Act, Chapter 485A, Laws of Kenya, *The Government Printer*, 1989

- "The development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and the creation of incentives for the longer tem investments in productive enterprise"
- "The creation, maintenance and regulation, through implementation of the system in which the market participants are self-regulatory to the maximum practicable extent, of a market in which securities can be issued and traded in an orderly, fair and efficient manner"

The Kenyan capital market has for years been skewed in favour of equities. It was not until 1996 that the CMA issued guidelines to guide potential issuers of corporate bonds and commercial paper. The first issues of commercial paper were made in 1994, and these were made on "the basis of initial guidelines issued by the Central Bank of Kenya."[29] The initiative in this important business finance sourcing came from the CBK rather than from the CMA. The CMA should actually have been the one to spearhead this in line with its statutory objectives, rather than reacting to the situation after its occurrence. In a market like ours where the economy is still in the developing stage, it is important that bodies like the CMA act as the stimulant to the corporate and other sectors in putting in place all infrastructures that supports faster and more efficient achievement of the objectives of business firms, in the process supporting economic development.

Lack of an independent credit rating mechanism is another impediment to the development of a credible debt market in Kenya. Nearly all of the borrowings before the introduction of commercial paper were sourced from the banking system. This need not be the case because companies can source funds from bonds and directly from investors. In the absence of a credit rating agency, this is not possible because such a

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[29] CMA Annual Report 1996/97, p 14

market thrives on continuous rating of the companies issuing bonds and commercial paper.

The CMA needs to quicken the process of facilitating the technical and operational mechanism that was started in 1996. It is noteworthy that the CMA has rededicated itself towards the accomplishment of this during 1999[30]. The government has taken steps to encourage the formation of such agencies by making the cost of credit rating a tax-deductible expense, which encourages companies to seek credit rating.

For a credit rating agency to be useful in the market, detailed analysis of the company being rated is conducted. Variables like levels and trends in ratios of liquidity, debt and profitability; the historical and expected business risk of the firm; present and future capital requirements; and the ability to generate cash flows are considered in the analysis[31]. The present CMA commercial paper issuance guidelines cover most of these variables, and several companies have the capability of presenting information on the variables. The success of this depends on full disclosure across a wide spectrum of business activities, and most of the companies who are not listed on the NSE will initially find this uncomfortable.

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[30] CMA Annual Report 1997/98, p32

[31] Van Horne, *op. cit.*, p 456

5.2 Limitations of the Study

The failure of 4 of the targeted respondents to provide completed questionnaires is a limitation because the population frame itself is small. This however does not considerably affect the study conclusions if one takes into account the known characteristics of these companies, such as the industry class and the size of commercial paper issued.

The population frame of commercial paper issuers is still small, and the expectation is that the number will rise in future, especially after the putting in place of the enabling environment discussed in 5.1 above. With increased numbers, a more representative industry class is ensured.

The inability to obtain average commercial paper rates for the period 1996 to 1998 is a limitation in that a longer duration would have enabled a richer analysis of the spreads between commercial paper, 91-day treasury bills and the average bank overdraft rates.

Due to time constraints, it was not possible to have an all-inclusive study where investors, dealers and the regulators are surveyed to give a complete picture of the market as a whole.

5.3 Suggestions for Further Research

A further study can investigate the effect of the volatility of interest rates on the development of commercial paper, which has been cited by the CMA as hindering the deepening of this part of the capital market. The local interest rates have remained relatively high since the deregulation of the financial sector in 1993. It would therefore be important to test what effect if any this has had in the introduction of commercial paper in Kenya, and in its progress to date.

Further research can be done to study the commercial paper market in its entirety, and the interface between the market players: issuing companies (borrowers), investors (lenders), regulators and the dealers. It would be important to come up with a classification on of Kenyan investors in commercial paper, and what specific considerations influence their decisions to invest in commercial paper as opposed to alternative investments. The knowledge of the factors the investors consider in deciding which companies' paper to invest in will be useful to the managers of present and prospective issuing companies, as well as to the dealers. An all-inclusive study is also important because it provides information to the corporate sector about the specific considerations of dealers in deciding which commercial paper issues to place.

Further study can test whether it is easier and cheaper to place guaranteed paper or one that is not guaranteed. This significance of this is to determine the importance the market attaches to the reputation of a company issuing commercial paper.

APPENDIX I

COMMERCIAL PAPER ISSUES AS AT 25TH APRIL 1999

ISSUING COMPANY	DEALER / AGENT	AMOUNT IN KSH MILLION
ATHI RIVER MINING	DRY ASSOCIATES	100
BRITISH AMERICAN TOBACCO	CITIBANK	550
BROOKE BOND	CITIBANK	1,000
CMC HOLDINGS	DRY ASSOCIATES	250
EAST AFRICA INDUSTRIES	CITIBANK & ABN-AMRO	500
GENERAL MOTORS KENYA	CITIBANK	500
IPS	DRY ASSOCIATES	100
LONRHO MOTORS	DRY ASSOCIATES	1,500
MABATI ROLLING MILLS	BARCLAYS MERCHANT	500
KENYA SHELL	CITIBANK	1,000
NATION MEDIA GROUP	BARCLAYS MERCHANT	500

SOURCE: DRY ASSOCIATES LTD

APPENDIX II

RESEARCH QUESTIONNAIRE FOR
"COMMERCIAL PAPER AS A SOURCE OF FINANCE FOR KENYAN COMPANIES"

1 Name of company ______________________________

____

2 Date of incorporation ______________________________

3 Nature of business

☐ Manufacturing

☐ Agricultural

☐ Commercial

☐ Services

☐ Others – Specify ______________________________

4 Turnover per last annual report

☐ Below 500 million

☐ 500 million to 1 billion

☐ Above 1 billion

5 Total Assets per last annual report ______________________________

6 Number of employees

- [ ] Below 50
- [ ] 50 to 100
- [ ] Above 100

7 What is the ownership of your company?

- [ ] 100% local shareholding
- [ ] Majority local shareholding
- [ ] Majority foreign shareholding
- [ ] 100% foreign shareholding
- [ ] Others – Specify ____________________

8 When did the company first issue commercial paper? ____________________

9 What is the frequency of issue since the first issue?

____

____

____

10 How much was the issue? ____________________

11 What factors determined the size of the issue?

12 For the issued paper:

What was the tenor?

What was the average effective interest cost?

How much were the facilitating costs?

13 Please specify how the funds raised by commercial paper were used

14 For what reasons was commercial paper chosen in preference to other similar short-term sources of finance?

15 For what reasons were the dealer selected?

16 What was your capital structure before the issue of commercial paper? ____________

17 What proportion of your total borrowing is represented by commercial paper?____________

18 How was your decision to issue commercial paper affected by the Capital Markets Authority rules on commercial paper issues? Please explain

____

____

____

____

19 Would your company recommend a secondary commercial paper Market traded on the Nairobi Stock Exchange?

Yes ☐ No ☐

Please explain your response

____

____

____

END.

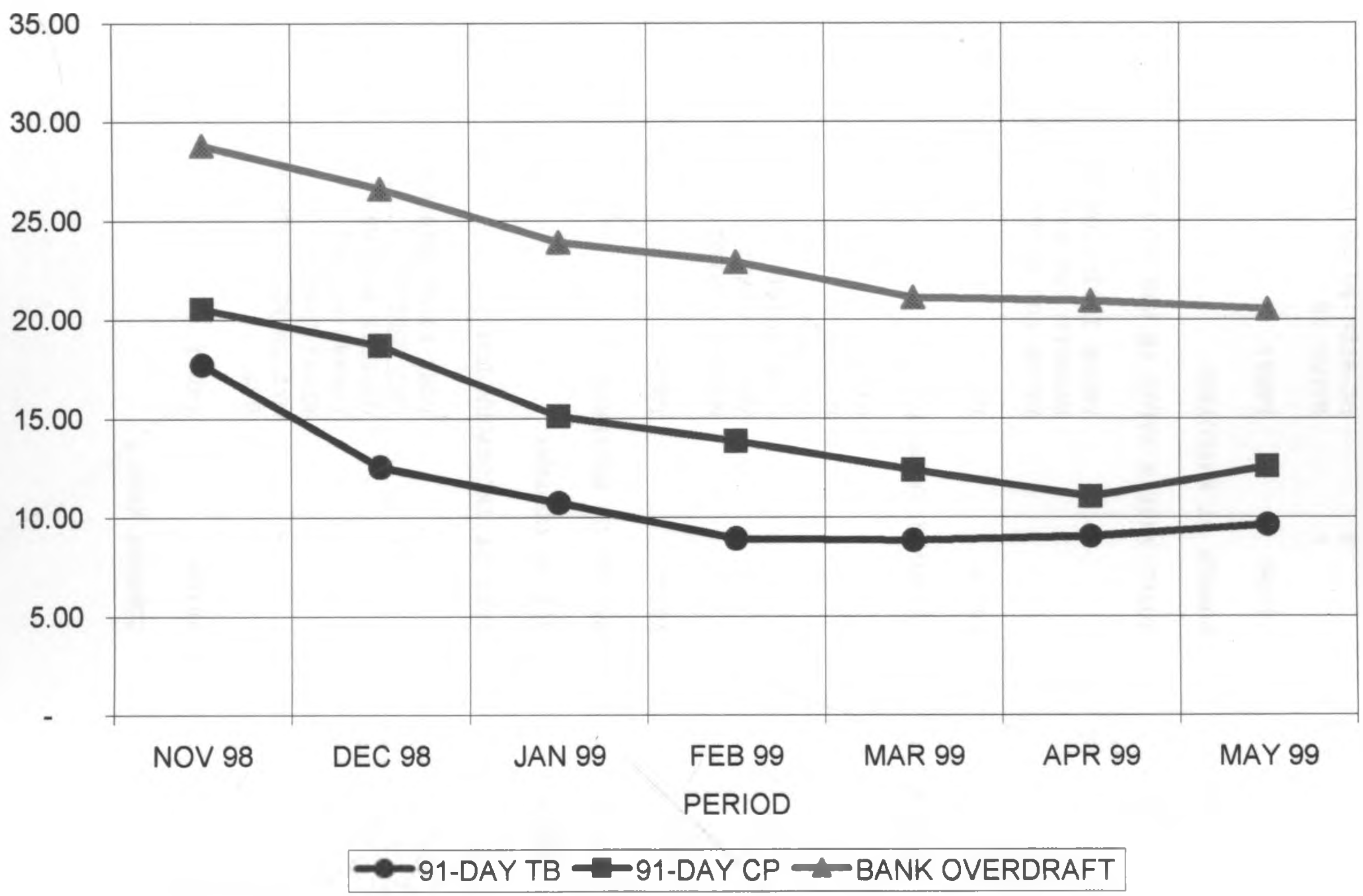
APPENDIX III

COMPARISON OF THE 91-DAY TREASURY BILL YIELDS, 91-DAY COMMERCIAL PAPER YIELDS, AND THE AVERAGE COMMERCIAL BANK OVERDRAFT RATES FOR THE PERIOD NOVEMBER 1998 TO MAY1999

PERIOD	91-DAY BILLS YIELDS	91-DAYCOMMERCIAL PAPER YIELDS	COMMERCIAL BANK OVERDRAFT RATES
NOVEMBER 1998	17.70	20.54	28.80
DECEMBER 1998	12.50	18.67	26.60
JANUARY 1999	10.70	15.08	23.90
FEBRUARY 1999	8.90	13.83	22.90
MARCH 1999	8.80	12.38	21.10
APRIL 1999	9.00	11.02	20.90
MAY 1999	9.60	12.35	20.50

APPENDIX IV

COMPARATIVE RATES FOR THE 91-DAY TREASURY BILL, 91-DAY COMMERCIAL PAPER AND THE AVERAGE COMMERCIAL BANK OVERDRAFT RATES



APPENDIX V

List of variables on the working file

QUENO1	COMPANY NAME		
	Value	Label	
	1	BAT	
	2	NATION MEDIA GROUP	
	3	KENYA SHELL	
	4	LONRHO MOTORS	
	5	GENERAL MOTORS	
	6	CMC HOLDINGS	
	7	ATHI RIVER MINING	
QUENO2	DATE OF INCORPORATION		
AGE2A	AGE OF COMPANY		
QUENO3	NATURE OF BUSINESS		
	Value	Label	
	1	MANUFACTURING	
	2	AGRICULTURAL	
	3	COMMERCIAL	
	4	SERVICES	
	5	MOTOR	
	6	OIL	
QUENO4	TURNOVER CATEGORY		
	Value	Label	
	1	BELOW 500 MILLION KSH	
	2	BETWEEN 500 MILLION TO 1 BILLION KSH	
	3	ABOVE 1 BILLION KSH	
QUENO5	TOTAL ASSETS VALUE IN KSH BILLION		
QUENO6	NUMBER OF EMPLOYEES		
	Value	Label	
	1	BELOW 50	
	2	BETWEEN 50 TO 100	
	3	ABOVE 100	

QUENO7	OWNERSHIP OF COMPANY	
	Value	Label
	1	100% LOCAL SHAREHOLDING
	2	MAJORITY LOCAL SHAREHOLDING
	3	MAJORITY FOREIGN SHAREHOLDING
	4	100% FOREIGN SHAREHOLDING
QUENO8	YEAR CP ISSUED	
YEAR8A	YEARS CP HAS BEEN IN USE	
QUENO9	FREQUENCY OF CP ISSUE	
	Value	Label
	1	ONGOING
	2	CONTINOUS
	3	MONTHLY
QUENO10	FACE VALUE OF CP KSH MILLION	
QUENO11	DETERMINANTS OF CP SIZE	
	Value	Label
	1	CMA REGULATIONS
	2	WORKING CAPITAL NEEDS
	3	BORROWING REQUIREMENTS
	4	PARENT COMPANY MANAGEMENT
	5	NO RESPONSE
QUENO12	TENOR OF CP IN DAYS	
	Value	Label
	1	30 DAYS
	2	60 DAYS
	3	90 DAYS
	4	30,60, & 90 DAYS
	5	30,60,90, & 105 DAYS
QUENO12A	INTEREST COST OF CP P.A.	
	Value	Label
	1	ABOVE 25%
	2	20 TO 25%
	3	15 TO 20%
	4	10 TO 15%
	5	05 TO 10%

QUENO12B	FACILITATING FEES IN % P.A.	
	Value	Label
	1	ABOVE 2.0%
	2	1.5 TO 2.0%
	3	1.0 TO 1.5%
	4	BELOW 1.0%
QUENO13	USE OF CP FUNDS	
	Value	Label
	1	FINANCE TRADING (WORKING CAPITAL)
	2	FINANCE TRADING AND EXPANSION
	3	RETIRING EXISTING BORROWING
QUENO14	WHY CP WAS PREFERRED TO OTHER SOURCES	
	Value	Label
	1	UNSECURED BORROWING & SHORT TERM
	2	CHEAPER THAN ALTERNATIVES
	3	EASIER TO MANAGE & FEWER CONDITIONS
QUENO15	REASONS FOR SELECTING CP DEALER	
	Value	Label
	1	EXPERIENCE AND REPUTATION
	2	PRESENTATION & PERSONALITIES
	3	EXISTING RELATIONSHIP
	4	CHEAPER COST
	5	NO RESPONSE
QUENO16	CAPITAL STRUCTURE	
	Value	Label
	1	HIGH EQUITY
	2	HIGH DEBT
	3	BALANCED
QUENO17	CP AS % OF TOTAL DEBT	
	Value	Label
	1	BELOW 20%
	2	20 TO 40%
	3	41 TO 60%
	4	61 TO 80%
	5	ABOVE 80%

QUENO18	EFFECT OF CMA REGULATIONS	
	Value	Label
	1	CONSTRAINING
	2	NOT CONSTRAINING
CMA18A	REASONS FOR "CONSTRAINING" ANSWER ABOVE	
	Value	Label
	1	MANDATORY COMPLIANCE
	2	RESTRICTION ON ISSUE SIZE
CMA18B	REASONS FOR "NOT CONSTRAINING" ANSWER ABOVE	
	Value	Label
	1	USED TO DISCLOSURE REQUIREMENTS
	2	RULES NOT VERY STRINGENT FOR LARGE FIRMS
	3	CMA RULES ARE ACCOMMODATING
	4	NO REASON
QUENO19	NEED FOR SECONDARY CP MARKET	
	Value	Label
	1	YES
	2	NO
QUENO19A	REASONS FOR "YES" ANSWER ABOVE	
	Value	Label
	1	GREATER ACCESS & FLEXIBILITY BY INVESTORS
	2	POSSIBILITY OF LONGER TENORS
	3	SAVE ON ROLLOVER/ISSUE COSTS
QUENO19B	REASONS FOR "NO" ANSWER ABOVE	
	Value	Label
	1	CURRENT NSE ENVIRONMENT NOT CONDUCIVE
	2	INSECURITY DUE TO THREAT OF THEFT AND FRAUD

APPENDIX VI

Analysis of Variables

AGE2A AGE OF COMPANY

Value	Label	Value	Frequency	Percent
		92.00	1	14.3%
		40.00	1	14.3%
		36.00	1	14.3%
		49.00	1	14.3%
		22.00	1	14.3%
		51.00	1	14.3%
		26.00	1	14.3%
		Total	7	100.0%

Mean	45.14	Median	40.00
Range	70.00	Std Dev	23.30
Sum	316.00	Variance	542.81
Maximum	92.00	Minimum	22.00

QUENO3 NATURE OF BUSINESS

Value	Label	Value	Frequency	Percent
1	MANUFACTURING	1	2	28.6%
3	COMMERCIAL	3	1	14.3%
5	MOTOR	5	3	42.9%
6	OIL	6	1	14.3%
		Total	7	100.0%

QUENO4 TURNOVER CATEGORY

Value	Label	Value	Frequency	Percent
2	BETWEEN 500M TO 1B KSH	2	1	14.3%
3	ABOVE 1 BILLION KSH	3	6	85.7%
		Total	7	100.0%

QUENO5 TOTAL ASSETS VALUE IN KSH BILLION

Value	Label	Value	Frequency	Percent
		6.40	1	14.3%
		2.20	1	14.3%
		6.50	1	14.3%
		2.40	1	14.3%
		2.00	1	14.3%
		1.46	1	14.3%
		1.18	1	14.3%
		Total	7	100.0%

Mean	3.16	Median	2.20
Range	5.32	Std Dev	2.28
Sum	22.14	Variance	[illegible]
Maximum	6.50	Minimum	1.18

QUENO6 NUMBER OF EMPLOYEES

Value	Label	Value	Frequency	Percent
3	ABOVE 100	3	7	100.0%
		Total	7	100.0%

QUENO7 OWNERSHIP OF COMPANY

Value	Label	Value	Frequency	Percent
1	100% LOCAL SHAREHOLDING	1	1	14.3%
2	MAJORITY LOCAL SHAREHOLDING	2	2	28.6%
3	MAJORITY FOREIGN SHAREHOLDING	3	3	42.9%
4	100% FOREIGN SHAREHOLDING	4	1	14.3%
		Total	7	100.0%

QUENO8 YEAR CP ISSUED

Value	Label	Value	Frequency	Percent
		1996	1	14.3%
		1997	1	14.3%
		1998	1	14.3%
		1999	4	57.1%
		Total	7	100.0%

QUENO9 FREQUENCY OF CP ISSUE

Value	Label	Value	Frequency	Percent
1	ONGOING	1	3	42.9%
2	CONTINOUS	2	3	42.9%
3	MONTHLY	3	1	14.3%
		Total	7	100.0%

QUENO10 FACE VALUE OF CP KSH MILLION

Value	Label	Value	Frequency	Percent
		550.0	1	14.3%
		500.0	1	14.3%
		1,000.0	1	14.3%
		1,500.0	1	14.3%
		500.00	1	14.3%
		350.00	1	14.3%
		100.00	1	14.3%
		Total	7	100.0%

Mean	642.86	Median	500.00
Range	1,400.00	Std Dev	464.07
Sum	4,500.00	Variance	215,357.14
Maximum	1,500.00	Minimum	100.00

QUENO11 DETERMINANTS OF CP SIZE

Value	Label	Value	Frequency	Percent
1	CMA REGULATIONS	1	1	14.3%
2	WORKING CAPITAL NEEDS	2	2	28.6%
3	BORROWING REQUIREMENTS	3	2	28.6%
4	PARENT COMPANY MANAGEMENT	4	1	14.3%
5	NO RESPONSE	5	1	14.3%
		Total	7	100.0%

QUENO12 TENOR OF CP IN DAYS

Value	Label	Value	Frequency	Percent
3	90 DAYS	3	3	42.9%
4	30,60, & 90 DAYS	4	3	42.9%
5	30,60,90, & 105 DAYS	5	1	14.3%
		Total	7	100.0%

QUENO12A INTEREST COST OF CP P.A.

Value	Label	Value	Frequency	Percent
2	20 TO 25%	2	1	14.3%
3	15 TO 20%	3	5	71.4%
5	05 TO 10%	5	1	14.3%
		Total	7	100.0%

QUENO12B FACILITATING FEES IN % P.A.

Value	Label	Value	Frequency	Percent
2	1.5 TO 2.0%	2	1	14.3%
3	1.0 TO 1.5%	3	3	42.9%
4	BELOW 1.0%	4	3	42.9%
		Total	7	100.0%

QUENO13 USE OF CP FUNDS

Value	Label	Value	Frequency	Percent
1	FINANCE TRADING (WORKING CAPITAL)	1	5	71.4%
2	FINANCE TRADING AND EXPANSION	2	1	14.3%
3	RETIRING EXISTING BORROWING	3	1	14.3%
		Total	7	100.0%

QUENO14 WHY CP WAS PREFERRED TO OTHER SOURCES

Value	Label	Value	Frequency	Percent
1	UNSECURED BORROWING & SHORT TERM	1	1	14.3%
2	CHEAPER THAN ALTERNATIVES	2	5	71.4%
3	EASIER TO MANAGE & FEWER CONDITIONS	3	1	14.3%
		Total	7	100.0%

QUENO15 REASONS FOR SELECTING CP DEALER

Value	Label	Value	Frequency	Percent
1	EXPERIENCE AND REPUTATION	1	1	14.3%
2	PRESENTATION & PERSONALITIES	2	2	28.6%
3	EXISTING RELATIONSHIP	3	1	14.3%
4	CHEAPER COST	4	2	28.6%
5	NO RESPONSE	5	1	14.3%
		Total	7	100.0%

QUENO16 CAPITAL STRUCTURE

Value	Label	Value	Frequency	Percent
1	HIGH EQUITY	1	4	57.1%
2	HIGH DEBT	2	2	28.6%
3	BALANCED	3	1	14.3%
		Total	7	100.0%

QUENO17 CP AS % OF TOTAL DEBT

Value	Label	Value	Frequency	Percent
1	BELOW 20%	1	1	14.3%
2	20 TO 40%	2	1	14.3%
4	61 TO 80%	4	1	14.3%
5	ABOVE 80%	5	1	14.3%
6	NO RESPONSE	6	3	42.9%
		Total	7	100.0%

QUENO18 EFFECT OF CMA REGULATIONS

Value	Label	Value	Frequency	Percent
1	CONSTRAINING	1	3	42.9%
2	NOT CONSTRAINING	2	4	57.1%
		Total	7	100.0%

CMA18A REASONS FOR "CONSTRAINING" ANSWER ABOVE

Value	Label	Value	Frequency	Percent
1	MANDATORY COMPLIANCE	1	2	66.7%
2	RESTRICTION ON ISSUE SIZE	2	1	33.3%
		Total	3	100.0%

CMA18B REASONS FOR "NOT CONSTRAINING" ANSWER ABOVE

Value	Label	Value	Frequency	Percent
1	USED TO DISCLOSURE REQUIREMENTS	1	1	25.0%
2	RULES NOT VERY STRINGENT FOR LARGE FIRMS	2	1	25.0%
3	CMA RULES ARE ACCOMMODATING	3	1	25.0%
4	NO REASON	4	1	25.0%
		Total	4	100.0%

QUENO19 NEED FOR SECONDARY CP MARKET

Value	Label	Value	Frequency	Percent
1	YES	1	5	71.4%
2	NO	2	2	28.6%
		Total	7	100.0%

QUENO19A REASONS FOR "YES" ANSWER ABOVE

Value	Label	Value	Frequency	Percent
1	GREATER ACESS & FLEXIBILITY BY INVESTORS	1	2	40.0%
2	POSSIBILITY OF LONGER TENORS	2	1	20.0%
3	SAVE ON ROLLOVER/ISSUE COSTS	3	2	40.0%
		Total	5	100.0%

QUENO19B REASONS FOR "NO" ANSWER ABOVE

Value	Label	Value	Frequency	Percent
1	CURRENT NSE ENVIRONMENT NOT CONDUCIVE	1	1	50.0%
2	INSECURITY DUE THREAT OF THEFT AND FRAUD	2	1	50.0%
		Total	2	100.0%

APPENDIX VII

Correlation of Variables

AGE OF COMPANY	ISSUE SIZE
92.00	550.00
40.00	500.00
36.00	1,000.00
49.00	1,500.00
22.00	500.00
51.00	350.00
26.00	100.00

0.12960

AGE OF COMPANY	TOTAL ASSETS
92.00	6.40
40.00	2.20
36.00	6.50
49.00	2.40
22.00	2.00
51.00	1.46
26.00	1.18

0.557624

ISSUE SIZE	TOTAL ASSETS
550.00	6.40
500.00	2.20
1,000.00	6.50
1,500.00	2.40
500.00	2.00
350.00	1.46
100.00	1.18

0.332890

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