A SURVEY OF THE FACTORS THAT ACCOUNT FOR THE DISMAL LISTING AT THE NAIROBI STOCK EXCHANGE (KENYA)

By

REUBEN KIPROTICH CHEPNG'AR

D61/P/7468/2002

THIS MBA RESEARCH PROJECT WAS PRESENTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE MASTERS OF BUSINESS ADMINISTRATION (MBA) DEGREE OF THE UNIVERSITY OF NAIROBI

»

PRESENTED JULY 2006

DECLARATION

I, Chepng'ar Reuben Kiprotich, hereby declare that except where due acknowledgement has been made, this project work is mine alone and has not been previously submitted in whole or in part, to qualify for any academic award.

Signed ^ ^ t ST **Dated** - ^ t - i L :

Reuben Kiprotich Chepng'ar
(D61/P/7468/2002)

I, Mr. Otieno Luther Odhiambo, hereby declare that this project has been presented for examination with my approval as the University of Nairobi Supervisor.

Signed — **Dated** – a 4

Mr. Luther Odhiambo Otieno
Lecturer, Faculty of Commerce
Department of Finance and Accounting
University of Nairobi.

DEDICATION

To my dear Brother, Luka Kipkemoi Chepng'ar, to whom I owe most of the guidance and support which, saw me through my education.

ACKNOWLEDGEMENTS

I feel indebted to all those individuals and companies without whom this research project would never have seen the light of the day.

I salute my supervisor, Mr. Luther Otieno for his invaluable guidance, support and decisive input in all the stages of conceptualizing, developing, improving and finalizing of this research project.

To all respondents and in particular Mr. Dhruv Pandit of East Africa Building Society, Mr. John of Mashariki Motors, Mr. Abisaya Orwa, the Accounting Manager of Tetra Pack Kenya Limited, Ms Pamella Omondi of Marketing Department, Stanbic Bank Kenya Limited and the Finance Manager of Mastermind Tobacco Kenya Limited for their valuable responses.

To my employer. Capital Markets Authority, I remain grateful for the unwavering financial and material support, which was paramount in seeing me through my studies.

To my wife and Daughter for their understanding as I toiled over time to go through my studies. I cannot forget my entire family and relatives for their spiritual and moral support.

To my Lecturers, classmates and Friends, I say thumps up for providing a conducive academic environment that contributed towards the blossoming of my academic life.

Finally, to all those who in one way or another, contributed towards my academic and social life as an MBA student, either directly or indirectly, I will forever remain grateful to you all.

ABSTRACT

The objective of the research project was to establish the factors that account for the dismal number of additional listings at the Nairobi Stock Exchange (NSE) over the last fifty years of its existence. The number of listed companies at the NSE has oscillated around 50 since its establishment in 1954 despite the existence of profitable private companies whose sizes, growth rates and profitability may exceed those of the already listed companies and the potential benefits they are likely to recoup from being listed. The Government has undertaken several steps aimed at boosting the contribution of capital markets in the economic development of the country. These include the establishment of the Capital Markets Authority as the primary regulator over the activities in the sub-sector and provision of numerous fiscal and monetary incentives aimed at attracting the participation of the public in making use of the capital markets to ensure attainment of desired goals. In effect, the study was set to find out from a sample of non-listed companies whether they understand the existence of the capital markets, potential benefits and their real or perceived inhibitors to seeking listing at the NSE.

The study utilized primary data collected from a sample of 25 out of 60 targeted non-listed companies. The analysis procedure involves the tabulation of the responses such as the factors considered by the sampled companies to be impediments to list at the NSE as well as suggested solutions to this phenomenon. The respondents indicated that stringent and numerous entry requirements are the main obstacles for private companies not to seek listing at the NSE. The other obstacles include the profitable track record, stringent and numerous continuous listing requirements as well as the quantity and quality of disclosures. These findings agree with those of Mbui Wagacha (2001) wherein the regulatory framework was rated good by 44.4% of the respondents while a cumulative 56.6% regarded it as very poor to fair. Also Ngugi and Njiru (2005) noted that a good regulatory system creates an enabling environment for facilitate listing.

This means that efforts of boosting listings in the stock exchange should address these areas of concern as well as enhancing creation of public awareness and education as to the

existence and usefulness of the capital markets to the public and the economy as a whole. Ngugi and Njiru (2005) recommended that mass education on the stock market operations is important to the business community.

This research project has been organized into five chapters. Chapter one covers the introduction, which gives the background to the study while highlighting its objectives, statement of the problem and the importance of the study. Chapters two and three cover the literature review and research methodology respectively. The findings and their analysis are presented in chapters four and five.

TABLE OF CONTENTS

LIST OF ABBREVIATIONS

AIMS	Alternative Investment Market Segment
CMA	Capital Markets Authority
IPAR	Institute of Policy Analysis and Research
IPO	Initial Public Offering
Kshs	Kenya Shillings, the legal currency or tender of the Republic of Kenya
MIMS	Main Investment Market Segment
NSE	Nairobi Stock Exchange
OTC	Over the Counter
VAT	Value Added Tax
%age	Percentage

1.0. CHAPTER ONE: INTRODUCTION

1.1. Background of the Study

Capital markets are an essential part of the financial sectors of modern economies, which provide alternative savings tools to savers, and non-bank sources of financing for enterprises. They promote economic growth through improved efficiency in savings mobilization (Schimdt-Hebbal and Solimano, 1996). Aggarwal (2001) stated that Capital Markets allow for efficient capital raising and allocation of limited resources. Well-functioning primary and secondary capital markets provide issuers the ability to raise capital and investors the ability to invest in diverse financial instruments at low transaction costs. This helps to lower the cost of capital for issuers so that they can compete globally and it also helps increase savings that will be channeled into productive investments. Capital markets also play an essential role in improving corporate governance, disclosure standards, transparency in the market place, and accounting standards (Aggarwal, 2001).

Pagano et al (1998) stated that the decision to go public is one of the most important and least studied questions in corporate finance. Institutional aspects of going public are mostly described whereas the motivation to go public is briefly stated. The conventional wisdom is that going public is simply a stage in the growth of a company. Although, there is some truth in it, this "theory" alone cannot explain the observed pattern of listings in various countries. Even in developed capital markets like the United States, some large companies such as United Parcel Service or Bechtel- are not listed. Thus, according to Pagano et al (1998), going public is not a stage that all companies eventually reach but is a deliberate choice.

Publicly listed companies represent only a small subset of Kenya's enterprises. Kimura and Amoro (1999) indicated that it has been thought that the listed companies are the organized and perhaps better-performed group of enterprises, which chose to be listed in the Nairobi Stock Exchange (NSE). However there are several well-performing private companies which are even larger than those listed at the NSE.

Masinde and Kibua (2004) stated that the small number of listed companies on the stock market has resulted to low supply of securities, leading to an overvaluation of the shares traded and also unmet demand that has impacted negatively on the development of the stock market since investors have limited choice of companies listed.

Mbui Wagacha (2001) indicated that in an economy of many private enterprises, many firms list in the market while many that qualify to do so do not and that capital markets authorities may be unaware of plausible factors that induce firms to list in the market. Worse, they may be unaware of persisting negative factors that may inhibit qualified firms from listing in the stock exchange.

This study therefore surveys the reasons as to why the growth of the NSE in terms of the number of companies listed over its fifty years of existence has not been increasing despite the existence of profitable private companies whose sizes exceed those already listed and the potential benefits they are likely to recoup from being listed.

1.2. The Role of Financial Markets in an Economy

Individuals, corporations and governments frequently use financial markets to invest excess funds or to borrow funds. Financial markets are expected to offer a forum of investing or borrowing funds at the most economical and efficient manner possible. A financial market is a market in which financial assets (securities) such as shares and bonds can be purchased or sold. Thus, financial markets play a crucial role in helping individuals, corporations and government agencies in obtaining financing. Most of the large expenditures in an economy are financed with funds obtained in financial markets through the issue of various securities such as bonds (Treasury and corporate), bills (Treasury and commercial paper), common stock, and asset backed securities among others.

There are two fundamental types of financial markets: Money markets and Capital Markets. Money markets are financial markets that facilitate the flow of short-term funds, that is, those with maturities of less than one year. Instruments in this market are treasury bills, commercial paper, and overnight lending among others. Capital Markets on the other hand are financial markets that facilitate the flow of long-term funds. Under Capital Markets, are Primary and Secondary markets, and Organized and Over the Counter (OTC) markets.

Primary markets facilitate the issuance of new securities while secondary markets facilitate the trading of existing securities. Primary markets transactions provide funds to the initial issuer of securities, while secondary markets transactions facilitates trading in already issued securities hence boosting their liquidity and transferability.

Some secondary stock market transactions occur at an organized exchange, which is a visible place for secondary market transactions such as New York Stock Exchange, Uganda Stock exchange and Nairobi Stock Exchange. Other financial market transactions occur in the OTC market, which is a telecommunications network among several market players.

Capital Markets mostly deal with securities of listed companies though sometimes, unlisted shares are traded at the OTC market. Shares represent a significant proportion of wealth for many institutional and individual investors. Common stock is a certificate representing partial ownership in a company. Like debt securities, firms issue shares to obtain funds. However, the purchaser of shares becomes part owner rather than creditor. Although the issuing company is not obligated to purchase this stock at any time in the future, shareholders can sell it to other investors within the secondary market.

Companies who need long-term funds issue securities. Individuals and institutions that wish to invest long-term funds and obtain partial ownership or claim in companies purchase these securities. Thus, stock markets facilitate the transfer of funds in exchange for securities. Primary markets enable companies to issue new securities to investors, while secondary markets enable investors to sell securities that they had previously purchased to other investors. Thus, the primary market facilitates new financing for companies, while secondary markets create liquidity for investors who have already invested in securities.

1.3. Rationale for the Existence of Stock Exchanges

A stock exchange is an elaborate market system that enables investors to acquire or dispose of securities at prices that are "fair and equitable" (Kimura and Amoro, 1999). Such a market system is convenient to both buyers and sellers of financial securities since it performs the important function of financial intermediation in society. Stock exchanges facilitate the trade of financial securities specifically equities, debt instruments and mixtures or hybrids of both.

As earlier stated, company's financial securities can be traded on the stock exchange either in the secondary or primary markets. **Secondary market** is where securities are bought and sold by those who acquired them during the primary issue or from others and those who might want to acquire the shares of the company subsequent to their first issuance to the public. Trade is fuelled by demand and supply forces in the market. Whereas a **primary market** is used to raise funds for the company, the secondary market trade benefits the individual buyers and sellers.

Kimura and Amoro (1999) stated that the promotion, establishment and successful operation of an organized market for securities require certain conditions to exist, namely: there must be a considerable volume of securities whose ownership is widely distributed which implies that there has to be some degree of industrialisation or commercialisation and the presence of fairly large firms; there must be a sufficient number of well-endowed people or institutions wishing to hold their savings in form of financial assets rather than in business or real property; there has to be a reasonably functioning tax system; there has to be a significant degree of long-term political and economic stability; and the development of the market will also be greatly assisted if the law provides for an effective system of property rights that recognizes procedures for the transfer of title.

1.4. Benefits of Being Listed

Holmes and Dixon (1992), argued that the presence of a well developed securities markets lead to efficient allocation of available funds in an economy. This is because investors will only invest their money where the resultant risk matches the returns. They further argued that when ordinary shares are used to raise funds these do not have to be compensated immediately as dividend payout is not strictly required. Thus, stock exchanges provide vehicles for raising relatively cheap funds for long-term investments.

Kimura and Amoro (1999) stated that to be listed entails a certain level of expenditure in terms of time, money and effort on the part of the company. Companies are willing to incur this expenditure for a number of reasons, which include:

Firstly is to raise funds especially for long-term investments. The stock exchange provides a cheap source of long-term funds for long-term investments. Equity funds are not refundable except on liquidation of the company when the stockholders would share out what is left after all liabilities have been settled. Dividends may not be paid annually if the company is experiencing financial difficulties. This is a good alternative to bank loans whose repayment including the return are paid even if the company is not earning positive returns from its investments.

Secondly is to allow the citizens of a country to participate in the ownership of companies operating in their countries. Governments use the stock markets when privatising public corporations so as to spread their ownership among the citizenry.

Thirdly is to enhance a company's prestige and public image. A widely held company may appear less foreign to the public. Its products may become more acceptable as 'our own.'

Pagano et al (1998) found out that companies derive several benefits from going public. These are enumerated hereunder.

Companies overcome borrowing constraints through listing. Listing in the capital markets allows companies' to access alternative source of finance to bank loans. This is more appealing to companies, which are highly geared who manage to reduce their gearing levels easily.

Listing affords greater companies bargaining power with banks - Capital markets offers/presents competition to lenders of funds to companies. Information about listed companies is widely disseminated hence lower financing costs due to explicit competition among the lenders and capital markets. Rajan (1992) highlighted that by gaining access to the capital markets and disseminating information to the generality of investors, a company elicits outside competition to its lenders and ensures a lower cost of credit, a larger supply of external finance, or both.

Liquidity and portfolio diversification is realized through listing. Listed securities have more liquidity than unlisted ones and security holders of listed companies can efficiently and economically diversify their portfolios than for unlisted companies. Pagano et al (1998), established that shares trading on an organized exchange are cheaper, especially for small shareholders who want to trade on short notice. As a result, if the initial owners raise money from dispersed investors, they factor in the liquidity benefit provided by being listed on an exchange. Pagano (1993) stated that taking a company public provides to its owners opportunities for diversification. He stated that this can be achieved directly, by divesting from the company and reinvesting in other assets, or indirectly, by having the company raise fresh equity capital after the IPO and acquire stakes in other companies. Consequently, if diversification is an important motive in the decision to go public, as in Pagano (1993), we should expect riskier companies to be more likely to go public, and controlling shareholders to sell large portion of their shares at the time of the IPO or soon afterward.

Investor recognition is boosted through listing. Listing of companies acts an advertisement for them and their products or services. Investors are commonly known to hold portfolios comprising substantially shares of listed companies ignoring existence of unlisted companies. Listing can help to overcome this problem, by acting as an advertisement for the company. Merton (1987), captured this point in a capital asset pricing model with incomplete information, showing that stock prices are higher the greater the number of investors aware of the company's securities. Kadlec and McConnell (1994), found and indirect support for the investor recognition motive when they established that companies listed elsewhere who announce their decision to list in the New York Stock Exchange, their shares yielded 5% abnormal return on average.

Managerial monitoring assured by listing on a stock exchange. The stock market also provides a managerial discipline device, both by creating the danger of hostile takeovers and by exposing the market's assessment of managerial decisions. Holmstrom and Tirole (1993), argued and was documented by Schipper and Smith (1986), that the shareholders of a public company can use the information embodied in share prices to design more efficient compensation schemes for their managers, for instance by indexing their salaries to the share price or by offering them share options. Pagano and Roell (1998) argued that private companies owned by more than one shareholder may be overmonitored and if the scale of planned expansion is very large, and thus needs to be financed by many investors, the cost of this overmonitoring becomes large that it is preferable to go public. Consequently, this model predicts a positive correlation between the probability of an IPO and the scale of the subsequent investment.

Convenient and efficient change of control is achieved through an IPO. Zingales (1995a) established that the decision to go public is the result of a value maximizing decision made by a owner(s) who want to eventually sell their company. The initial owner(s) can change the proportion of cash flow rights and control rights, which they will retain when they bargain with potential buyers. This is easily done when the company is listed on a stock exchange. If change of control is an important motivation in an IPO, high incidence of control transfers after listing is expected.

Exploitation of windows of opportunity is made easier by listing. Owners of companies, which perceive to be overvalued, prefer to go public so as top reap maximum benefits than to remain private. Similarly, companies with high expected growth in the future prefer to go public so as to raised funds to finance the growth opportunities in the future. Ritter (1991) suggested that companies, which recognize that other companies in the industry are overvalued, have an incentive to go public. To the extent that entrepreneurs manage to exploit the overvaluation of their companies by investors, one would also expect a company to be more likely to go public when the market for comparable companies is particularly buoyant.

Holmes and Dixon (1992) contends that the secondary securities market is the key to the efficient operation of the securities market since its absence could force investors to hold their investments in one firm perpetually which could deny them a chance to gain more returns from other profitable ventures out there. It would also limit firms' ability to raise more funds, as investors would not be able to sell equities to buy those offered by the other firms.

The benefits of getting listed are numerous hence companies are expected to take advantage of the infrastructural systems put in place to allow them go public so as to reap these perceived benefits. However, this has not been the case for Kenya where the listed companies since 1954 when the NSE formally came into existence, the number of listed companies have oscillated around fifty. This led to a statement made by the NSE Chairman in November 2004 when NSE was celebrating its fifty years of existence that, the fifty years of existence with fifty companies listed may not be a good thing to be proud of.

1.5. Statement of the Problem

Studies have shown that when companies go public, they stand to enjoy several benefits and this is the drive of thousands of listed companies in developed economies. In their study carried out in Italy, Pagano et al (1998), found out that companies derive several benefits from going public. This include overcoming borrowing constraints, greater bargaining power with lenders, investment liquidity and portfolio diversification for investors, promotion of managerial monitoring, boosting investors recognition, convenient and efficient change of control and exploitation of windows of opportunities. Holmes and Dixon (1992), argued that when ordinary shares are used to raise funds they do not have to be compensated immediately as dividend payout is not strictly required. Thus, stock exchanges provide vehicles for raising relatively cheap funds for long-term investments. Kimura and Amoro (1999) argued that despite the expenditure involved to get listed, companies are willing to incur since they are able to raise funds for long term investments, it enhances the companies' prestige and public image as well as allowing citizens of a country to participate in the ownership of companies operating in their countries.

Despite the numerous enumerated benefits, the number of listed companies in the developing economies including Kenya has not increased as it has in the developed ones. Several reasons have been put forward as being the impediments to increased listings and they include lack of awareness, stringent regulatory requirements, enormity of costs, loss of confidentiality and lack of investment opportunities among others. These impediments seem to have impacted negatively on the urge of companies to list in the emerging economies than in the developed world. Pagano et al (1998) stated that adverse selection, fixed costs and loss of confidentiality are the main impediments to listing by companies in Italy. Leland and Pyle (1977) established that information asymmetry adversely affects the average quality of the companies seeking a new listing and thus the price at which their shares can be sold. Similarly, Rock (1986) found out that adverse selection determines the magnitude of the under pricing needed to sell the shares of the company as it goes public. Ritter (1987) indicated that the fixed costs of getting listed are not proportional to the sizes of issue hence smaller companies are disadvantage and by extension probability of going public are proportional to the company size.

Most of the studies have been done in the developed countries as to the reasons why companies go public or the impediments to listing. However, scanty reliable empirical evidence exists on the factors, which impede private companies from going public in most emerging economies and Kenya in particular. This suggests that Regulatory Authorities and other capital market players may not be addressing the real impediments in their continued policy incentives developed and implemented aimed at boosting the listings at the Nairobi Stock Exchange. Consequently, this study seeks to answer the question what factors are responsible for the relatively low drive for private companies in Kenya to list at the Nairobi Stock Exchange?

1.6. Objective of the Study

The objective of the study is to establish the factors that account for the dismal number of additional listings at the NSE over the last 50 years of its existence.

1.7. Importance of the Study

This study will be of importance to the following:

Regulators

The Capital Markets Authority and the Nairobi Stock Exchange (as a self Regulatory Organizations) will find the study of greater importance since it is its business to facilitate the development of the capital markets hence the findings can be a basis of formulating policies to facilitate growth of the market as well as for regulatory purposes. They will also have a basis of conducting their investor education campaigns especially those that target at potential issuers of securities.

Corporate Managers and Directors

Corporate managers and directors, especially of unlisted companies will be able to compare their reasons of not going public with those of competitors and decide as to whether that could be the correct decision based on the potential incentives from being listed at the stock exchange. The study will afford managers and directors an opportunity to "soul search" themselves and compare the pros and cons of being listed hence make a more prudent decision.

Investment Advisers and Financial Consultants

They will be interested in the study since they will discover the reasons why companies may not wish to be listed hence can offer advisory services which will enable the companies make more prudent financing and investment decisions than before.

Individual Investors

Investing public will be able to discover the reasons put forward by private companies for not wanting to be listed hence decide as to whether their securities should form part of their portfolios or not.

Academicians and Scholars

They will find the study useful since it will add to the body of knowledge in the finance discipline and to those who may wish to conduct further research in this area.

2.0. CHAPTER TWO: LITERATURE REVIEW

2.1. Empirical Studies on Why Companies Go Public

There are several studies, which have been done in the developed countries as to the reasons why companies go public or the impediments to listing. Pagano et al (1998), found out that companies derive several benefits from going public. This include overcoming borrowing constraints, greater bargaining power with lenders, investment liquidity and portfolio diversification for investors, promotion of managerial monitoring, boosting investors recognition, convenient and efficient change of control and exploitation of windows of opportunities. Holmes and Dixon (1992), argued that when ordinary shares are used to raise funds they do not have to be compensated immediately as dividend payout is not strictly required. Thus, stock exchanges provide vehicles for raising relatively cheap funds for long-term investments.

Pagano et al (1998) stated that adverse selection, fixed costs and loss of confidentiality are the main impediments to listing by companies in Italy. Leland and Pyle (1977) established that information asymmetry adversely affects the average quality of the companies seeking a new listing and thus the price at which their shares can be sold. Similarly, Rock (1986) found out that adverse selection determines the magnitude of the under pricing needed to sell the shares of the company as it goes public. Ritter (1987) indicated that the fixed costs of getting listed are not proportional to the sizes of issue hence smaller companies are disadvantage and by extension probability of going public are proportional to the company size.

Studies on reasons for going public or impediments thereto are mainly from developed economies and there is scanty reliable empirical evidence on these factors from most of the emerging economies and Kenya in particular. This suggests that Regulatory Authorities and other capital market players may not be addressing the real impediments in their continued policy incentives developed and implemented aimed at boosting the listings at the Nairobi Stock Exchange. However, there are two main papers, which have been written about the

Kenyan Capital Markets relating to listing in the stock exchange. There is also a discussion paper done by the Institute of Policy Analysis and Research (IPAR)

The Capital Markets Authority commissioned Coopers and Lybrand in 1992 to carry out a study on the absorptive capacity of the stock market for new equity issues in Kenya and assist in developing plans in connection with the expected privatization of 18 parastatals earmarked by the Parastatal Reform Programme Committee as pioneers in privatization programme through the Nairobi Stock Exchange. The main objectives of the study were to determine the size of Kenya's new equity market; to determine how it may be increased to accommodate up to Kshs 2 billion worth of shares over the next one and a half years and to set guidelines for the marketing of new equity issues.

The study concluded that economic data analysis and surveys carried out among investors, both small and major, and professionals involved in investment including stockbrokers, underwriters and advertising agencies provided overwhelming evidence that privatization of fundamentally sound companies through new issues via the NSE could be successful. It also indicated that there was confidence that an extra Kshs 2 billion could be raised through new issues between one and two years, which would represent a 10% increase in the NSE's market capitalization (which was Kshs 20 billion as at May 1992).

It further stated that, as companies prepared plans for floatation, they must ensure that they communicate clearly the most important information to all types of potential investors: dividend policy, track record, profit performance and future activities.
The report established that there was a large section of the Kenyan society, which did not know how to purchase shares. As a result it recommended that a comprehensive awareness and education programme is necessary to raise their level of knowledge. Privatization was also identified as the major source of companies listed at the Nairobi Stock Exchange (NSE).

The study recommended that the Authority initiates discussions with the relevant government organs, particularly the privatization unit assuring them of the great potential for the capital markets to absorb new issues besides enhancing the operational efficiency of formerly state owned enterprises, once they are listed due to enhanced corporate governance standards.

The report further recommended that the Authority should endeavour to assist in managing the supply side of new equity issues, that is, bringing the shares onto the market, by influencing the timing and pace of privatization. It recommended further that since the market was ready to take up new issues as soon as they were made available, the most pressing need was to have a successful issue, publish a programme of issues and to adhere to that programme.

It concluded by recommending that a practice guide, including marketing guidelines should be developed and circulated to all companies likely to float shares, to supplement the existing regulations governing issues. The guide would describe the tasks and processes involved in floatation and address issues such as pricing considerations, registration logistics, allocation options for over subscriptions, use of advisors and need for underwriters as well as outlining timetables.

In 2002, the World Bank undertook a study on the Capital Markets Integration in the East African Community. In this study, the creation of an enabling environment within which the private sector could flourish was emphasized. Thus, appropriate reforms in the financial sector were identified to be desirable so as to improve their ability to mobilize resources and efficiently allocate them to most productive sectors of the economy. Capital markets were identified as a principal component of the financial sector development as it mobilized medium and long-term capital for the private sector.

It was observed in the World Bank report that there was a clear reluctance to seek equity financing by the private sector with most of the new issues being dominated by the privatized state owned enterprises. A number of factors were attributed to limited supply and they included the dominance of small and medium scale enterprises, which were dependent on bank loans and informal sources for their financing. Many firms relied on overdrafts as major source of finance, even for fixed capital. Although overdrafts are theoretically payable on demand, they are usually renewed every 12 months and function as a source of permanent, long term financing as long as the borrower continues to meet the key covenants in the overdraft agreement; many firms were family owned or closely held and there was a clear reluctance to dilute ownership through public offers and an even stronger aversion to the disclosure and transparency requirements associated with a public listing. They therefore tended to rely on bank finance as well as a proven network of family and friends to raise additional capital when required; and the tedious and costly process of making public offers was a disincentive, as on average an IPO took over 6 months to be completed.

Although most of the costs were tax deductible many firms were not willing or able to make the financial commitments upfront. Further, the high costs were partly attributed to a large number of market agents in the IPO process with some overlapping and indistinct functions. For instance the lead financial adviser and lead sponsoring broker were found to be ambiguous with no value added, as none of them performed underwriting services as is the practice in other jurisdictions. Listed companies also complained about the high costs of mailing quarterly and annual reports to thousands of shareholders, a deliberate government privatization policy to promote widespread ownership of shares.

As part of measures to support the development of capital markets, particularly in attracting more listings, the study recommended that the privatization of state owned enterprises be expedited; the minimum number of shareholders be reviewed in order to encourage small and medium size enterprises to list; as the market develops further, the development of new financial products such as asset backed securities needs to be considered; the investor education programme needs to be enhanced including initiating contacts with individual firms to educate and improve their awareness about the benefits and relevance of capital markets; and the market infrastructure be improved to reduce listed companies costs of operation that includes operationalizing the Central Depository System.

The Institute of Policy Analysis and Research in their discussion paper No. 048/2004 while reviewing the historical trends and challenges in the Capital Markets policies in Kenya, appreciated the importance of securities exchange as providing a useful environment for domestic resource mobilization and allocation. They noted that the steady economic growth in the early years of independence saw the NSE grow at a faster rate with a number of oversubscribed public issues. However this trend declined in 1970s following the world oil crisis, and the trend was reversed in early 1990s as various reforms were put in place including adoption of open outcry trading system and liberalization of financial sector.

The performance of NSE declined again from late 1990s and IPAR attributed this scenario to unstable macroeconomic environment, inadequate product innovation, and insufficient and weak regulatory framework leading to low investor protection, poor governance, and lack of integration with other stock exchanges within the region. However, they observed that the overriding cause to decline in NSE activity was generally the poor formulation and inadequate implementation of policies.

They appreciated the consistently improved policy environment, although the stock market had not grown significantly. Key policy challenges identified included; lack of market integration to achieve risk diversification, non-consistent and non-predictable macroeconomic environment, lack of proper legal and regulatory framework, little demand for securities, low supply of securities, poor market infrastructure, underdeveloped local investment vehicles, lack of adequate positioning to seize the market advantages arising from globalization, presence of non-coordinated multiple regulators, weak investor confidence, politics of privatization and the general parastatal reform initiative.

As a result, they recommended a coordinated, consistent and predictable policy environment as a measure to address policy challenges facing the stock market.

Consequently, this study is designed to find out the factors that have been responsible for the relatively low drive for private companies in Kenya to list at the Stock Exchange. The study aims to obtain the reasons or factors impeding new listings from the private companies themselves.

2.2. Brief History of the Nairobi Stock Exchange

The Nairobi Stock Exchange (NSE) was set up in 1954 as a voluntary association of stockbrokers who were registered under the Societies Act. This was made possible after obtaining clearance from the London Stock Exchange, which recognized it as an overseas stock exchange. This clearance was necessary because any stock exchange not cleared by a leading stock exchange in the world then would not have any credibility and could therefore be of little value to investors. The establishment of the NSE was demand-induced and came about largely on the initiative of certain stockbrokers who, for a number of years, had already been engaged in securities dealings on a sporadic basis.

Activity in the NSE remained low throughout the 1960s and the 1970s. The market remained a members club where stocks were traded over a cup of tea or coffee at the New Stanley Hotel using the "call-over" trading system.

In the 1980s the Government of Kenya realised that for it to foster economic development, there was the need to have an efficient and stable financial system. This required a reform package on a financial system to be designed and implemented. In 1991, the NSE was registered as a limited liability company with a full secretariat and phased out the "call-over" trading system in favour of the current "open outcry" system.

By 1966, the NSE had started measuring daily trading activity by computing the NSE Index, which measured daily average price changes. The basket of stocks used in computing the index consisted of 17 companies representing the most active stocks in the market. The index was computed as a weighted average of the price changes in the selected stocks. The year 1966 was used as the base year and was set at 100 points. In 1991, the NSE adopted a 20-share index and changed the computational method of the index to a geometric mean without revising the previous indices. The system adopted provided a natural link between the old and new indices.

The NSE is today poised to play an increasingly important role in the Kenyan economy, especially in the privatisation of state-owned enterprises. This implies, therefore, that its growth should reflect changes taking place in the economy as a whole.

2.3. The Process of Going Public in Kenya

Generally, a company wishing to sell its shares to the public has first to apply for listing on the stock exchange, in most of the developed economies but in East African Countries and Kenya in particular; they apply to the Regulator-Capital Markets Authority. Each stock exchange or Regulator has eligibility requirements which a company must fulfill before it can be listed. Once the application has been accepted and approved by the appropriate authority, the company issues a prospectus, which provides information pertinent to it and to the issue and invites the public to subscribe thereto. This flotation of a company's shares is usually made through an underwriter who guarantees the issue while at other times the company may underwrite the issue directly. The shares approved for listing are sold to the public mainly through stockbrokers. Investment banks and other financial institutions. After the shares have been sold to the public, the company, having satisfied all the flotation requirements, is formally listed on the stock exchange and its shares are allowed to be traded in the secondary market.

In the secondary market, shares are bought and sold by those who acquired them during the primary issue or from others and those who might want to acquire the shares of the company. Trade is fuelled by demand and supply forces in the market. Whereas a primary issue is used to raise funds for the company, the secondary market trades benefits the individual buyers and sellers of securities.

Companies can list either on the Main Investment Market Segment (MIMS) or Alternative Investment Market Segment (AIMS) depending on their extent of compliance with the prescribed listing requirements. More mature and profitable companies do list directly in the MIMS, whose listing requirements are a bit demanding, whereas young and upcoming companies list under the AIMS as a stepping stone to the MIMS in the future once they will have established a noticeable track record.

2.4. Costs of Going Public

According to Pagano et al (1998), despite the numerous advanced benefits of going public, three of the main potential deterrence for companies not to wish to go public includes;

Adverse selection - Companies may not wish to go public due to fear of adverse selection caused by the investors' low knowledge of their existence which means that under pricing may need to be substantial to attract investors to the offer.

According to Leland and Pyle (1977), information asymmetry adversely affects the average quality of the companies seeking a new listing and thus the price at which their shares can be sold. Rock (1986) established that adverse selection determines the magnitude of the under pricing needed to sell the shares of the company as it goes public.

Chemmanur and Fulghieri (1995) highlighted that adverse selection cost is a more serious obstacle to the listing of young and small companies, which have little track record and low visibility, than old and large companies. So in presence of adverse selection, the probability of going public is positively correlated with the age and/ or the sizes of a company.

Thus, companies may prefer to go public only once they have established a name for themselves in the market, that is, the probability of going public is directly proportional with the age and size of a company.

Fixed costs which includes initial direct costs such as underwriting fees, approval fees, listing fees, printing fees and advertising fees; annual fees such as auditing, continuous listing fees and continuous dissemination of information; and the need to under price the shares so as to attract investors.

Fhe fixed costs are not proportional to the sizes of issue hence smaller companies are disadvantage and by extension probability of going public are proportional to the company size. Ritter (1987), estimated that in the United States the fixed costs equal approximately $ 250,000 and the variable costs were about 7% of the gross proceeds of the IPO. In Italy, the fixed costs were the same as the United States but the variable costs were 3.5%. Consequently, as for adverse selection, the existence of fixed costs of listing suggests that the likelihood of an IPO should be positively correlated with the company size.

Loss of confidentiality - Secrets for competitive advantage such as ongoing research and marketing strategies are revealed to the whole world during an IPO and continuous disclosure after the listing. Listed companies are open to closer scrutiny by regulators hence the probability of going public is lower for those companies which have more sensitive information.

Campbell (1979) was the first to point to confidentiality as a deterrent from getting funding in public markets. Yosha (1995) showed that in equilibrium those firms with more sensitive information are deterred from going public if the costs of going public are sufficiently high. This suggests a negative correlation between the research and development intensity of an industry and the probability of an IPO.

2.5. Policy Incentives to Promote IPO's in Kenya

There are several incentives provided by the Government of Kenya, on advice from the Capital Markets Authority, with an effort to deepening, widening and generally developing the capital market in the country, CMA Annual Report (2004). Most of these incentives hinge on taxation policies and they include:

- In 2005, newly listed companies were to be taxed at a lower rate of 20% as compared to the standard rate of 30% for a period of five years following the date of listing. This is subject to the companies offering at least 40% of their issued share capital to the public;

- In 2002, newly listed companies were to be taxed at a lower rate of 25% as compared to the standard rate of 30% for a period of three years following the date of listing. This is subject to the companies offering at least 30% of their issued share capital to the public;
- In 2000, newly listed companies were to be taxed at a lower rate of 27% as compared to the standard rate of 30% for a period of three years following the date of listing. This is subject to the companies offering at least 20% of their issued share capital to the public;
- Companies that apply and are listed shall get a tax amnesty on their past omitted income, provided they make full disclosure of their assets and liabilities ands undertake to pay all their future due taxes;
- Foreign investors were allowed to acquire share freely in the stock market subject to a minimum reserved ratio of 25% for domestic investors in each listed company. This was a great improvement from the earlier reservation of 60% for domestic investors;
- Expenses of companies issuing shares to the public are fully tax deductible;
- New and expanded share capital for companies approved for listing or already listed are exempted from stamp duty charges;
- Expenses incurred by companies in having their financial instruments rated by an independent rating agency are also tax deductible;
- Transfer of listed securities is exempt from stamp duty and VAT; and
- To encourage transfer of technology and skills, foreign investors were allowed as from 1999 to acquire up to 49% of local brokerage firms; and up to 70% of local fund management companies.

It is on the expectation that with the above policy incentives among others, private companies should have taken advantage to get listed but the converse seems to prevail. Thus, the aim of this study is to attempt to unearth the reasons advanced by the companies for not going public to enjoy the obvious benefits together with the policy incentives put in place by the Government through the Capital Markets Authority.

2.6. Growth of NSE (Number of Listed and Delisted Companies)

The table below shows the growth of the NSE in terms of the number of companies listed, additional listings and the number of companies delisted between 1994 and 2004. This period has been used because data on the prior period since establishment of the NSE is either not available or is incomplete.

Year	Number of Additional Listed Companies	Number of Companies Delisted	Total Listed Companies	Percentage Growth
1994	3	0	56	5.67%
1995	0	0	56	0.00%
1996	2	1	57	1.79%
1997	2	2	57	0.00
1998	0	0	57	0.00%
1999	0	1	56	-1.75%
2000	1	0	57	1.79%.
2001	2	5	54	-5.26%
2002	0	4	50	-7.41%
2003	0	2	48	-4.00%
2004	0	0	48	0.00%
Total	10	15		
10-Year weighted average growth rate				-0.83%

Source: CMA Annual Reports and NSE Hand Books.

It is evident from the table above that the growth in the number of listed companies at the NSE has not been impressive hence the desire to carry out this study to establish the reasons behind this state. A weighted average growth rate of negative 0.83% indicates that indeed more companies were delisted, 15 companies, than additional listings, 10 companies, over the eleven years period under reviewed in the table above.

The NSE celebrated its 50th anniversary in November 2004 with less than 50 listed equity companies. This development does not augur well for Kenya being one of the oldest securities exchanges in Africa and more so to be ranked 6th in 2004 with 48 listed companies whereas Egypt was ranked 1st with 790 listed companies. The number of listed companies in Mauritius has remained static at 40 for the last 10 years. The table below gives comparative statistical data on the trend in growth of listed companies from 1995 to 2004.

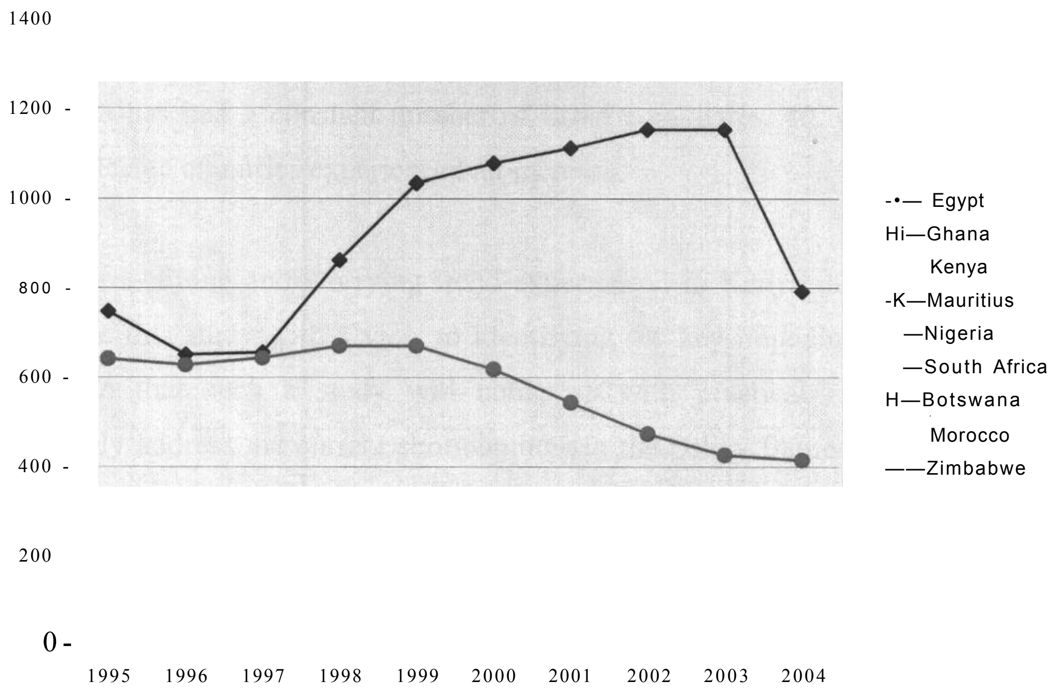
2.7. Comparative Statistics

The table below presents the number of listed companies in selected African countries' stock exchanges between 1995 and 2004

	1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Egypt	746	649	654	861	1033	1076	1110	1151	1151	790
Ghana	19	21	21	21	22	22	22	24	26	30
Kenya	56	56	58	58	57	57	55	50	48	48
Mauritius	40	40	40	40	41	40	40	40	40	40
Nigeria	181	183	182	186	194	195	194	195	260	276
South Africa	640	626	642	668	668	616	542	472	425	414
Botswana	12	12	12	14	15	16	16	19	32	32
Morocco	44	47	49	53	55	53	55	56	54	54
Zimbabwe	64	64	64	67	70	69	72	77	78	78

Source: Liquid Africa; S&P Emerging markets handbook; stock exchanges' websites (various)

NO OF LISTED COMPANIES IN SELECTED AFRICAN STOCK EXCHANGES

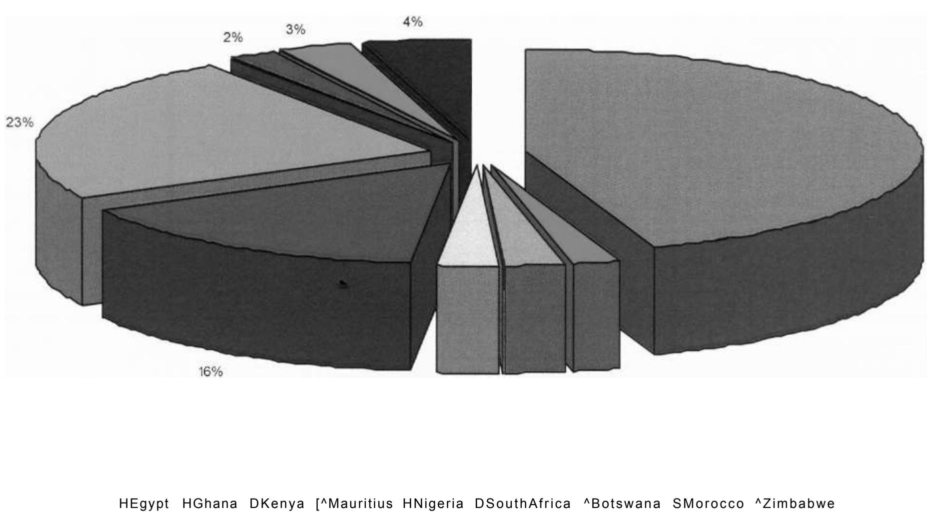


Source: Liquid Africa; S&P Emerging markets handbook; stock exchanges' websites (various)

Kenya accounted for 3% in the ratio of listed companies for the nine African markets as shown below:

Source: Liquid Africa; S&P Emerging markets handbook; stock exchanges' websites (various)

PROPORTION OF LISTED COMPANIES IN 2004



Among the nine selected African countries, South Africa and Kenya are the only countries to experience a decline in the number of listed companies between 1995 and 2004. South Africa's felt from 640 in 1995 to 414 in 2004 and Kenya's felt from 56 in 1995 to 48 in 2004. Whereas Mauritius has had a constant number of listed companies, 40, over the period, all the other seven selected countries experienced an increase.

It is this declining and worrying trend experienced in Kenya that has necessitated a need to undertake this study with a view to identifying the key impediments to listings at NSE. It is envisaged that such a study will come up with practical recommendations that would adequately address the current shortcomings in the policy framework as a means to revitalize the securities primary market.

3.0. CHAPTER THREE: RESEARCH METHODOLOGY

3.1. Research Design

The research design of this study was aimed at attaining maximum information efficiently and at a minimum cost possible. It was aimed in achieving unbiased responses. Research design according to Babbie et al (1989) is a plan of scientific investigation. It is a plan of action for finding something. In research designing, the researcher is concerned with the purpose of study, type of investigation, extent of research interference, study setting, unit of analysis and time horizon.

A study can be exploratory study taken to comprehend the nature of the problem or descriptive study undertaken to describe certain characteristics of the variables of interest or hypothesis study undertaken to test a hypothesis, it may also be a case study which is examination of studies done in other similar organizations (Sekaran, 2000).

This study is a survey aimed at finding out the factors that account for the dismal additional listings by private companies in Kenya. It also seeks to find out the suggested ways and means of increasing the number of listed companies at the Nairobi Stock Exchange.

3.2. The Population

Conceptually, the population of interest is the entire economically active non-listed companies in Kenya. However, it may not be economically viable to survey all these companies hence the population is reduced to all private companies operating in Nairobi who qualify for listing. A company must, among others, have a share capital of at least Kshs. 20 million and at least 100 shareholders to qualify to list in the Alternative Investment Market Segment (AIMS) whereas those which wish to list in the Main Investment Market Segment (MIMS) must have a share capital of at least Kshs. 50 million and at least 1,000 shareholders. Information on all incorporated or registered companies in Kenya is maintained at the Registrar of Companies office. However, according to Kimura and Amoro (1999), a pilot survey they carried out established that many registration records were either misplaced or lost. In addition, many companies did not file the required statutory annual returns with the Registrar. Establishing the total sub-population of interest was thus not possible. However, similar information on such companies can be obtained from the Ministry of Commerce, the Kenya Association of Manufacturers and the Kenya National Chamber of Commerce and Industry. Consequently, a convenient sample of at least 60 companies was drawn from the largest qualifying companies, which are not listed at the NSE. This was also adopted by Kimura and Amoro (1999).

3.3. Sample description

A convenient sample of 60 private companies was taken for the study (Kimura and Amoro, 1999). The companies sampled are based on the fact that they are of the same size or even bigger than some of the listed companies, have returned sizeable profits over several years in the past and have a past track record in their line of business. These are some of the elements of the eligibility criteria for listing at the Nairobi Stock Exchange.

The companies were also selected based on convenience and all of them have their headquarters in Nairobi and based on media reports they are close competitors of the companies already listed at the Nairobi Stock Exchange. The sample selected was made in such a way that all sectors, as categorized at the NSE are represented.

3.4. Data Description and Collection Method

Data used in this study is primary data. This data was collected by use of semi-structured questionnaires, which were administered through personal interviews supplemented with "drop and pick" method as well as by use of e-mails where available. The questionnaires were addressed to the Managing Directors/Chief Executive Officers/Finance Directors. The researcher briefed the respondents on the contents of the questionnaires where possible to facilitate co-operation and also save the respondents' time in assisting to complete the study.

3.5. Methods of Data Analysis

The data collected will be analyzed by use of descriptive statistics such as mean, tables and percentages. The analysis will be tied to the objective of the study so as reach reliable conclusions. An example of the analysis is shown in the table below:

Reasons, which impede new Listings at the Nairobi Stock Exchange:

Factors	Responses	Percentage
Lack of awareness		
Too stringent entry requirements		
Too many entry requirements		
Enormity of costs		
Loss of confidentiality		
Lack of investment opportunities		
Too stringent continuous listing requirements		
Too many continuous listing requirements		
Availability of listing benefits even when not listed		
Fear of loss of control		
Others		

4.0. CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1.0. Research Findings

This chapter presents the compilation of the responses from the respondents. This is done in tabular form. The frequency of responses is cumulated then inferences are made based on these findings. Comparisons of the findings with those of other similar studies are also done.

4.1.1. Response Rate

Out of the 60 targeted respondents, 25 responded drawn from the finance and investment, commercial and services and manufacturing sectors. The response rate was thus, 42%. A non-response rate of 58% may potent a high non-response rate bias but since there was only on category of respondents, unlisted companies, the bias is believed not to be material. All the respondents demonstrated their understanding of broad capital market concepts. They all responded to the affirmative as to their knowledge of existence of the capital markets.

4.1.2. Benefits of Being Listed

All the respondents indicated their awareness of the existence of benefits from being listed at the stock exchange.

Pagano et al (1998) and Kimura and Amoro (1999) agreed that there are numerous benefits, which companies enjoy from being listed. The principal benefits are sufficient publicity, enhanced corporate governance and social responsibility; raising additional capital, fair valuation of the company and liquidity for the shareholders. The table below indicates the responses as to the benefits that can be derived from being listed.

Table 1: Potential Benefits enjoyed by listed companies

Benefit	Number of Responses					
	Very much	%age	A little	%age	Not at all	%age
Sufficient publicity	19	76%	6	24%	0	0%
Tax incentives	2	8%	12	50%	10	*42%*
Promotes corporate governance	16	64%	7	28%	2	*8%*
Promotes social responsibility	6	26%	13	57%	4	*17%*
Raise additional capital for development	23	92%	2	8%	0	*0%*
Cross-listing made easier	8	32%	8	32%	9	36%
Liquidity - ease of transfer of shares	25	100%	0	0%	0	0%
Efficiency in operations enhanced	9	36%	8	32%	8	32%
Fair valuation of company	19	76%	6	24%	0	0%

The respondents regard liquidity, raising additional capital, fair valuation of the listed companies, publicity and promotion of corporate governance as the main benefits derived by companies from being listed. They were rated at 100%, 92%, 76%, 76% and 64% respectively. Other potential benefits of being listed namely, promotion of efficiency in operations, facilitating cross listing, promotion of social responsibility and tax incentives were not regarded as being of greater benefits by the respondents who rated them at 36%, 32%, 26% and 8% respectively. Tax incentives, cross-listing and efficiency in operations were rated as being the least benefits derived from being listed with 42%, 36% and 32% of the respondents indicating that they are not benefits of being listed at all. Given that most of the policy incentives put forward by the Government and CMA are tax related, these finding indicates that they may either be too insignificant to be attractive or the same benefits can be derived even when not listed through other tax avoidance avenues available.

4.1.3. Main Sources of Raising Capital

The main sources of financing include bank loans, private issue of shares, internally generated cash flows mainly plough back of profits and loans from other institutions. The responses on preferred sources of raising capital by the respondents are summarized in the table below.

Table 2: Preferred Sources of Finance for unlisted companies

Source of financing	Number of responses as being Most preferred	Percentage of responses	Number of responses as being Least preferred	Percentage of responses
Bank loans	23	92%	2	8%
Loans from other institutions	13	57%	10	43%
Public issue of shares	7	30%	16	70%
Private issue of shares	20	80%	5	20%
Issue of Corporate bond	6	26%	17	74%
Issue of Commercial Paper	12	52%	11	48%
Micro-finance Institutions	0	0	5	100%
Others - plough back of profits	6	100%	0	0%

Majority of the respondents indicated that their preferred sources of financing are bank loans, private issue of shares, loans from other institutions and issue of commercial paper. These were rated at 92%, 80%, 57% and 52% respectively. Six of the respondents indicated plough back of profits as their other main source of financing. Mbui Wagacha (2001) established that the vast majority of unlisted firms sourced start-up capital from own private savings (58.3%) and bank loans (12.5%). However, since this survey targeted already existing firms, their responses seem to refer to additional capital for growth and expansion hence the reason bank loans are more utilized then followed by private issue of shares. The least preferred sources of financing by the respondents are micro-finance institutions, public issue of shares and corporate bonds, which received a preference rating of 0%, 30% and 26% respectively. This may imply that the respondents still have a desire to raise funds through public issue of shares and corporate bonds but are hindered by the various existing obstacles.

Flexibility of funding arrangement, ease and speed of access and predictability of outcome are the main reasons, which determine the preferred mode of raising capital among the respondents. All the respondents ranked these reasons, though not in the same order, but they seem to agree that they are the main factors to consider in choosing their sources of financing.

4.1.4. Requirements for Issuing and Listing Shares and Bonds

The respondents indicated on an almost equal basis that the minimum requirements for issuing and listing of both shares and bonds are stringent or reasonable with few appreciating that they are a little more stringent. These responses were as below.

Table 3: Rating of the Requirements for Issuing and Listing Shares and Bonds

	Responses							
	Too stringent	%age	Stringent	%age	Reasonable	%age	Too low	%age
Shares	8	32%	6	24%	11	44%	0	0%
								%
Bonds	4	16%	14	56%	7	28%	0	0%

Most of the respondents rated the minimum requirements for issuing and listing shares and bonds as being reasonable and stringent respectively. The responses as to the requirements for issuing and listing shares were more diverse than those for bonds. 32%, 24% and 44% respectively were of the opinion that the requirements are too stringent, stringent and reasonable whereas for corporate bonds were 16%, 56% and 28% of the respondents respectively. The findings indicate that the respondents appreciate that public issue and listing of both shares and corporate bonds require regulation but the requirements should be realistic. This is shown by the finding that none of the respondents indicated that the requirements in place are too low. These findings agree with those of Mbui Wagacha (2001) wherein the regulatory framework was rated good by 44.4% of the respondents while a cumulative 56.6% regarded it as very poor to fair.

4.1.5. Existing Legal and Regulatory Requirements that Inhibit Listing at the NSE

The stringent entry requirements, their number, initial and continuous listing fees and continuous reporting obligations are the main factors, which inhibit listing at the NSE.

Table 4: Legal and Regulatory Requirements that Inhibit Listing at the NSE

	Ranking							
Factor	Very stringent	**%age**	Stringent	**%age**	Reasonable	**%age**	Less stringent	**%age**
Stringent and numerous entry requirements	18	72%	6	24%	1	4%	0	0%
Stringent and numerous Continuous reporting obligations	4	16%	14	56%	6	24%	1	4%
Quantity and quality of disclosures	4	16%	6	24%	12	48%	3	12%
Initial and continuous listing fees	0	0%	10	40%	15	60%	0	0%
Profitable track record	8	32%	7	28%	10	40%	0	0%

The respondents indicated that stringent and numerous entry requirements are the maintain obstacles for private companies not to seek listing at the stock exchange. The respondents ranked entry requirements under very stringent, 72% or stringent, 24%. Profitable track record, stringent and numerous continuous listing requirements as well as the quantity and quality of disclosures are the other factors rated as either being very stringent or stringent obstacles for private companies to seek listing at the stock exchange. The combined rating by the respondents for these other obstacles under very stringent and stringent were 60%, 72% and 40% respectively. Initial and continuous listing fees were rated as stringent with 40% of the respondent. 60% and 48% of the respondents indicated that initial and continuous listing fees and quantity and quality of disclosures are reasonable. This agrees with Mbui Wagacha (2001) who found out that 66.7% of the unlisted firms he surveyed considered the annual fees charged at the NSE to be satisfactory while half the firms considered application fees satisfactory and this is indicative that the fees at the NSE are thus unlikely to be inhibiting factor to listing.

40% and 24% of the respondents respectively said that profitable track record and continuous reporting obligations are reasonable which indicates the unlikely hood of them being inhibiting factors to listing.

4.1.6. Other Factors that Inhibit Listing at the NSE

The respondents were also requested to identify factors other than those under the legal and regulatory framework, which may be inhibiting additional listings of companies at the NSE. Their responses indicate lack of awareness, absence of investment opportunities, and unrealistic or unachievable policy incentives as these other factors.

Table 5: Other Factors that Inhibit Listing at the NSE

	Ranking					
	Greatest Inhibitor	%age	Moderate inhibitor	%age	Least Inhibitor	%age
Factor						
Lack of awareness	13	52%	8	32%	4	16%
Absence of investment opportunities	2	8%	7	28%	16	64%
Unrealistic and unachievable policy incentives	10	40%	4	16%	11	44%
Availability of benefits even when not listed	0	0%	6	24%	19	76%

Lack of awareness and unrealistic and unachievable policy incentives were indicated as the other factors, which inhibit companies from listing at the stock exchange with 52% and 40% of the respondents indicating so. This agrees with Ngugi and Njiru (2005) who stated that unless the culture of share trading is cultivated, the efforts of boosting the number of listed companies might not succeed. They recommended that mass education on the stock market operations is important to the business community. Most of the respondents seem to agree that availability of benefits even when not listed, absence of investment opportunities and unrealistic and unachievable policy incentives are the least inhibitors with ratings of 76%, 64% and 44% respectively.

Most of the respondents, 72%, indicated that there is possibility for them to consider listing if the listing requirements are relaxed. Those with expressed certainty were 28% of the respondents. None of the respondents -indicated that they had no intention of listing if the listing requirements were relaxed.

From the responses above, it can be implied that the potential issuers proposals to encourage more listings include; relaxation of the listing requirements, reduction of bureaucratic listing procedures by both CMA and NSE, reduction of both listing and issue costs, more attractive and attainable fiscal and monetary incentives, investor awareness and education of potential issuers and investing public to remove perception that NSE is for an exclusive club.

5.0. CHAPTER FIVE: RESEARCH CONCLUSIONS AND RECOMMENDATIONS

5.1. Summary of the Research Findings and Recommendations

The results depict that most of the unlisted companies are aware of the existence and operations of the capital markets as an avenue for raising equity and debt. They are also very well aware of potential benefits that can be derived from being listed. Despite this, they had not listed due to: restrictions under the legal and regulatory framework, fear of loss of control, it is cheaper and faster to borrow from the banks; unwillingness to expose the affairs of the company to the public; and discouragement of dividend policy.

Some aspects of the regulatory framework are considered too stringent to the extent that it discourages potential issuers. Some of the listing requirements, which are considered limiting, are the five years track record, approval and listing fees, disclosures requirements and capital requirements. A review of the regulatory framework to cater for the sentiments from non-listed companies and practices in other markets, which have been able to attract more listings, is the way out. The legal and regulatory framework should provide sufficient investor protection and promote stronger corporate governance by the listed companies. This will by extension boost investor confidence. This agrees with Aggarwal (2001) assertion that a strong legal and regulatory framework is essential for a well-functioning capital market but is not sufficient without enforcement. He noted that many emerging markets had started to set up an acceptable regulatory framework but enforcement has been severely lacking. This seems to apply to Kenya as well.

Disclosure and transparency requirements associated with a public listing act as a hindrance to some companies from listing. In some cases these requirements may be seen as a loss of privacy and an exposure to the public domain, which can mean higher future taxes and loss of competitive advantage. A clear explanation of the benefits from accountability and transparency in operations of a company will make companies change their notion.

Costs involved in going public, direct and indirect, are considered too high in Kenya especially because the companies have to pay annual listing fees. The process is subject to approval and sometimes can take too long before it is concluded which serves as a major disincentive.

Most of the respondents do not regard tax incentives available from being listing as an important benefit to be derived from being listed. This may imply that there is need to re-look at the policy incentives put forward by the government and CMA aimed at promoting more listing at the NSE, which have mainly been tax related. The finding indicates that they may either be too insignificant to be attractive or the same benefits can be derived even when not listed through other tax avoidance avenues available.

The process to raise funds through the capital markets is perceived by some of the respondents to be a specialised and complex field compared for example to other traditional financing methods like retained earnings and bank loans. The CMA and NSE can only change this incorrect notion through vigorous public awareness and sensitization campaigns in conjunction with the intermediaries since they interact with the investing public frequently.

5.2. Implications of the Study Findings

There is need for a concerted efforts by all the players in the capital markets, the Regulators, CMA, NSE, market intermediaries, the Government and investing public for each one of them to play their due roles so as to ensure that the capital markets contributes its due share in the economic development of the country. The regulators and the government should create a conducive environment by ensuring that the legal and regulatory framework in place is realistic and provide achievable incentives for companies which list while at the same time joining hands with the intermediaries in public awareness and sensitization of the public on the role ad benefits of the capital market. Ngugi and Njiru (2005) stated that unless the culture of share trading is cultivated, the efforts of boosting the number of listed companies might not succeed. They recommended that mass education on the stock market operations is important to the business community. Kimura and Amoro (1999) also raised the need for greater efforts for public awareness and sensitization when they established that lack of public awareness on the operations of NSE was the greatest challenge facing the capital markets operations.

There survey has established that the respondents do not regard tax incentives afforded by being listed as being a greater benefit of being listed compared to the other potential benefits. This means that the tax incentives are either too insignificant to the extent that they do not cover the costs involved or the said incentives are available through other avenues for non-listed companies. Ngugi and Njiru (2005) stated that the response to the various tax incentives is highly inelastic and that although CMA and NSE have lobbied the government for tax incentives, the response from firms has been poor. They continued to state that the tax incentives provided are coupled with rising implicit and explicit listing costs which may out-weigh the benefits of tax incentives. Consequently, the much attention paid to tax incentives by the CMA and the government in the annual financial budgets may require a re-examination to ensure that they are attractive, uniquely available to listed companies and both implicit and explicit listing costs do not out-weigh the benefits from such tax incentives. Ngugi and Njiru (2005) recommended that tax incentives need to be accompanied by efforts to strengthen the institutional setup with credit bureau and underwriter services as well as to understand the link between the capital structure and tax incentives.

There is need for CMA and NSE to address the prevailing legal framework especially on the requirements to list, continuous reporting obligations and listing costs to ensure that they are realistic and pragmatic rather than idealistic and regressive. Investor awareness and education is their other role, which they need to aggressively pursue to ensure that all players realise their concerns and effectively contribute to the deepening and widening of the capital markets in Kenya. As stated by Masinde and Kibua (2004), that one of the strong foundations of a capital market is the regulatory framework that protects investor assets and promotes public confidence. The legal framework within which the capital market operates should be reasonable and realistic rather than idealistic. Ngugi and Njiru (2005) indicated that a regulatory system creates an enabling environment for facilitate listing since it defines the procedures for listing, the listing requirements and negotiates with the government for favourable policy incentives.

Masinde and Kibua (2004) stated that the small number of listed companies on the stock market has resulted to low supply of securities, leading to an overvaluation of the shares traded. It has also led to an unmet demand that has impacted negatively on the development of the stock market since investors have limited choice of companies listed. Efforts to increase the number of listed companies will not only address the supply side of the market but also demand side since investors will be assured of a fair valuation of the existing securities.

As noted by Ngugi and Njiru (2005) that efforts towards regional integration are a potential source of expanded market scope for listings. Privatization of state enterprises has also made a significant contribution to the growth of the capital market. Therefore, continuous encouragement of privatisation of strategic parastatals through the stock exchange will be a boost to the capital markets. Privatisation of state enterprises through the stock exchange will act as a motivator to the private enterprises to consider listing.

Finally, economic growth and macroeconomic stability are important as they enhance the creation of a pool of net-worth borrowers, a prerequisite for successful growth of capital markets (Gertler and Ross, 1996). The scope of the market eases the financial constraint and exposes firms to wider pool investors and it also facilitates growth of listed firms by extending listing to firms outside the country. Consequently, sustaining a favourable macroeconomic environment will attract firms and investors to the stock exchange.

5.3. Limitations of the Study

Low response rate was experienced. Out of the targeted 60 respondents only 25 responded. This is approximately 42% response rate. If the response rate was higher than this, the results and conclusions could probably have been different or more insightful into the specific aspects, which need to be addressed to increase IPO's at the stock exchange.

There were several instances of incompletely answered questionnaires. The questionnaires were mainly distributed through drop-and-pick method and the e-mail. These methods resulted in some questions not being answered. If all respondents answered all the questions, conclusions could probably have been different.

5.4. Suggestions for Further Research

The study was not directed to the specific private companies which qualify for listing due to lack of financial information to sort them out. In deed most of the respondents who responded did not disclose their profitability levels over the last 5 years as requested or paid up share capital. Consequently, we could not separate those, which qualify for listing from the rest. A pre-qualification survey may be necessary when such a separation is necessary.

The study did not consider other aspects, which may greatly account for the dismal listing at the NSE. Experiences and concerns of the already listed companies which if addressed could attract new listings is an issue worth pursuing.

The several delistings experienced over the years, which have surpassed additional listings, is an issue worth studying. Knowing the reasons, which drive companies to delist, could be of assistance in knowing whether there benefits of listing are real and by extension attracting new listings.

Similarly, the reasons why a small proportion of the Kenyan adult population are investing in the capital market products could assist in developing measures to boost demand of capital market products and by extension pull the supply of the same. The benefits derived from listing can only be achieved if both the supply and demand sides are addressed.

A study on the above aspects could further contribute to unearthing the real factor(s) which account for the persistent dismal listing at the more than 50 years old Nairobi Stock Exchange.

LIST OF REFERENCES

Aggarwal Reena, 2001, **"Globalisation, Technology, and Regulation in Capital Markets Strategies for Latin American Caribbean",** Inter-American Development Bank's Conference, February 5-6, 2001, Washington, D.C.

Aggarwal, Reena, Carla Inclan, and Ricardo Leal, 1999, **"Volatility in Emerging Markets,"** *Journal of Financial and Quantitative Analysis,* March 1999.

Aggarwal, Reena, 1999, **"Stock Market Development: Role of Securities Firms and New Products,"** presentation at the World Bank workshop on Non-Bank Financial Institutions.

Agrawal, A and K. Tandon, **"Anomalies or Illusions? Evidence from Stock Markets in eighteen Countries",** Journal of Finance, 1994, Vol.13 Pg. 83 - 106.

Annual Reports and Accounts of the Capital Markets Authority, 1992-2003

Aworolo, E.A. (1971), **"The development of capital markets in Africa with particular reference to Kenya and Nigeria."** IMF staff Paper 118, 420-469.

Babbie, E., & Theodore, C., 1989, **The Practice of Social Research.** 5th Ed., USA: Wadsworth Publishing Company

Bhide, Amar, 1993, **The hidden cost of stock market liquidity.** Journal of financial Economics 34, 31-52.

Campbell, Tim, 1979, **Optimal investment financing decisions and the value of confidentiality,** Journal of Financial and Quantitative Analysis 14, 913-924.

Capital Markets Act, Cap 485A

Chemmanur, T.J. and Fulghieri, P. (1999), **" A theory of the going public decsion",** Review of Financial Studies, 12, 249-279.

Chemmanur, Thomas, and Paolo Fulghieri, 1995, **Information production, private equity financing, and the going public decision,** Working Paper, Columbia University.

Dickson, J.P. and K. Muragu, **"Market Efficiency from Developing Countries: A Case Study of the Nairobi Stock Exchange",** Journal of Business Finance and Accounting, Vol 21, No. 1, January 1994, 133 - 150.

Domowitz, Ian and Ruben Lee, **"The Legal Basis for Stock Exchanges: The Classification and Regulation of Automated Trading Systems,"** Working Paper, Pennsylvania State University, March 1998.

Francis, J. C., 1980. **Investments: Analysis and Management,** 3rd Ed., McGraw Hill Book Co., New York.

Global Stock Markets Fact Book by Standard & Poor's, 2004.

Graham, **B.,** D.L. Dodd and S. Cottle. **1962. Security Analysis: Principles and Techniques,** 4th Ed., McGraw Hill Book Co., New York.

Henry, Peter Blair, 2000a, **"Do Stock Market Liberalizations Cause Investment Booms,"** Journal of Financial Economics, 58.

Henry, Peter Blair, 2000b, **"Stock Market Liberalization, Economic Reform, and Emerging market Equity Prices,"** *Journal of Finance,* 55.

Holmes P. and Dixon R., 1992, **Financial Markets: The Guide for Business,** London Chapman & Hall

Holmstrom, Bengt, and Jean Tirole, 1993, **Market liquidity and performance monitoring,** Journal of Political Economy.

Kadlec, Gregory B., and John J. McConnell, 1994, **The effect of market segmentation and illiquidity on asset prices.** Journal of Financial Economics 4, 305-350.

Kimura, J.J. and Amoro, Y.; **Impediments to the Growth of Nairobi Stock Exchange;** ISBN 9966-9631-7-0, August 1999.

Leland, Hayne E., and David H. Payne, 1977, **Informational asymmetries, financial structure, and financial intermediation,** Journal of Finance 32, 371 - 387.

Levine, Ross, 1997, **"Financial development and Economic Growth: Views and Agenda,"** Journal of Economic Literature, 35, 688-726.

Levine, Ross and Sara Zervos, 1998, **"Stock Markets, Banks, and Economic Growth,"** American Economic Review, 88, 537-558.

Ljungqvist, Alexander P., 1995, **When do firms go public? Poisson evidence from Germany,** Working paper, University of Oxford.

Masinde, M. and Kibua, T., 2004, **"Capital Market Policies in Kenya: Historical Trends and Challenges".** IPAR Discussion Paper No. 048/2004 (http://www.ipar.or.ke).

Merton, Robert C., 1987, **Presidential address: A simple model of capital market equilibrium.** Journal of Finance 42, 483- 510.

Mbui Wagacha, **2001 /'Kenya's Capital Market: To List or Not to List, A Survey of Enterprise Attitudes "**, IPAR Discussion Paper No. 28 (http://www.ipar.or.ke).

Mbui Wagacha, 2001,**"Mobilizing Domestic Resources in Kenya: A survey of Shareholder Strategies in the Capital Market",** IPAR Discussion Paper No. 022, May 2000 (http://www.ipar.or.ke).

Michaely, Roni, and Wayne H.Shaw, 1995, **The choice of going public: Spin-offs vs. carve-outs,** Working paper, Cornell University.

Moko, S K., 1995. **"The Relationship Between Offering Price and the Subscription Rate of Initial Public Offering at the Nairobi Stock Exchange."** An unpublished M B.A research

Munga, D.N., " **The Nairobi Stock Exchange, Its History, Organisation and Role in Kenyan Economy",** Unpublished MBA Research Project, University of Nairobi, 1974.

Nairobi Stock Exchange **Annual Hand Books,** 1992-2003

Ngugi, R.W., **" Does the Revitalisation Process Rally Enhance Stock Market Microstructure? Evidence from the Nairobi Stock Exchange",** African Finance Journal, Vol.4, Part 1,2003.

Ngugi, R.W. and Njiru, R., **" Growth of the Nairobi Stock Exchange Primary Market",** KIPPRA Discussion Paper No. 47, September 2005..

Obonyo, A.E., 1989. **"An Investigation into the Existence and Characteristics of the Dividend Yield Clientele Phenomenon Among the Equity Stock Investors in Kenya."** An unpublished M.B.A. research project, University of Nairobi.

Pagano, M., Panetta, F., Zingales, L.; **Why Do Companies Go Public? An Empirical Analysis,** The Journal of Finance, Vol. LIII(l) 27-64, February 1998.

%

Pagano, Marco, 1993, **The floatation of companies on the stock market: A coordination failure model,** European Economic Review 37, 1101-1125.

Pagano, Marco, and Ailsa Roell, 1996, **The choice of stock ownership structure: Agency costs, monitoring and the decision to go public,** Quarterly Journal of Economics.

Pandey, I.M., **Financial Management,** Eighth Edition, 2000.

Professor Stuart, R. C., **"Confidence Building in Sub-Saharan Stock Markets",** Article Reference: Document No. 13, November 2000.
(http://www.unitar.orR/dfm/resource centre/Document Series/Document 13/Cohn)

Rajan, Raghuram G., 1992, **Insiders and outsiders: The choice between informed and arm's length debt,** Journal of Finance 47, 1367-1400.

Rajan, Raghuram G., and Henri Servaes, 1997, **The effect of market conditions on initial public offering.** Journal of Finance 52, 507-529.

Ritter, Jay R.. 1987, **The costs of going public.** Journal of Financial Economics 19, 269- 281.

Ritter, Jay R., 1991, **The long-run performance of initial public offerings,** Journal of Finance 46, 3- 27.

Rock, Kevin, 1986, **Why new issues are underpriced,** Journal of Financial Economics 15, 187-212.

Sekaran. U., 2000, **Research Methods for Business: A Skill-Building Approach,** USA, John Wiley & Sons, Inc.

Schipper, Katherine, and Abbie Smith, 1986, **A Comparison of equity carve-outs and seasoned offerings.** Journal of Financial Economics 15, 153-186.

Schmidt-Hebbal, K., L. Serven and A. Solimano (1996), **"Saving Investment: Paradigms, Puzzles, Policies,"** The World bank Research Observer, Vol. 1, No. 1 (February 1996)

Sharpe, F. William; **Investments, 1st Edition, Prentice Hall, 1964.**

Soo J. Kim, **"Government Intervention and Regulation in Emerging Stock Markets:** A **Case Study of the Korean Stock Exchange,"** *ICSID Review - Foreign Investment Law Journal*, pp.53-91.

Sprecher, R.C., 1975, **"Introduction to Investment Management",** Boston, Houghton Mifflin Company.

Strahota, Robert, 2000, **"Key Principles of Securities Regulation for Emerging Markets,"**

Presented at SEC International Institute, April.

The Capital Markets (Securities) (Listing, Public Offers and Disclosures) Regulations, 2002

Yosha, Oved, 1995, **Information disclosure costs and the choice of financing source,** Journal of Financial Intermediation 4, 3-20.

Zingales, Luigi, 1995a, **Insider ownership and the decisions to go public,** The Review of Economic Studies 62, 425 - 448.

APPENDICES

Appendix 1

Number of Companies Newly Listed Companies and those Delisted between Years 1994 and 2004

Year	Number of Additional Listed Companies		Number of Delisted Companies		Total Listed Companies
1994	3	NBK, Firestone, NIC			56
1995	0		0		56
1996	2	KQ, Rea Yipingo	1	KFB	57
1997	2	ARM, TPS	2	African Tours, Kingfisher Properties Ltd	57
1998	0				56
1999	0		1	01 pejeta	56
2000	1	African Lakes	0		54
2001	2	Mumias, Kenya Orchards	5	Kenya Hotels, Lonrho, Pearl Dry cleaners, Theta Group & Regent.	54
2002	0		4	KNM, Kenstock, Chancery & African Tours	50
2003	0		2	EA Packaging & African Lakes	48
2004	0		0		48

Appendix 2

LETTER OF INTRODUCTION

Dear Sir/Madam,

RE: RESEARCH INFORMATION

I am a postgraduate student at the faculty of commerce, University of Nairobi. As part of my MBA (Finance) Course requirements, I am undertaking a research project that seeks to establish the reasons why private companies do not list at the Nairobi Stock Exchange (NSE) despite several policy incentives provided by the Government.

To fulfill information requirements of my study, I request that you spare some few minutes of your time to fill for me the brief questionnaire here attached. The information requested is needed for purely academic purposes and will be treated in strict confidence, and will not be used for any other purpose other than for my research.

Your assistance is highly appreciated.

Yours faithfully,

Reuben Chepng'ar

Supervisor
Mr. Luther Otieno
Department of Accounting
University of Nairobi.

Appendix 2

QUESTIONNAIRE

This questionnaire is for collecting data aimed at finding out what factors account for the dismal listings (IPO'S) over the last fifty years of existence of the Nairobi Stock Exchange (NSE).

Completing the Questionnaire

The questions call for ranking of options provided but unless self-evident please explain your answer in more detail and refer to any relevant future plans.

Please I would encourage you to provide some responses in a separate sheet if the spaces provided are inadequate.

Name of the Company

Name and title of the respondent

1. (a). Is you organization aware of the existence of the capital markets, especially the stock exchange? YES/NO

   (b). Are there any benefits that an organization gains by being listed at the Nairobi Stock Exchange (NSE)? YES/NO

2. a) If your answer to question 1(b) is YES, what is your assessment of the benefits that an issuer enjoys by being listed at the NSE?

	Very much	A little	Not at all
i. The NSE gives it sufficient publicity	[ ]	[ ]	[ ]
ii. It benefits financially through tax incentives	[ ]	[ ]	[ ]
iii. It promotes corporate governance	[ ]	[ ]	[ ]
iv. It promotes social responsibility		]	[
iv. It is able to raise additional capital for development	]	[ ]	[
v. It can be listed in other stock markets in East Africa	]	[ ]	[

vi. Shares can be transferred easily, hence liquidity

vii. Efficiency in operations due to follow up by regulator [

vii. Provides a platform for the proper valuation of company [ ] [ ] [ ]

b) Are there other benefits? Please list them

i

ii

iii

3. a) What is the size of your company as per your latest audited financial statements, in terms of:

   i). Total assets : Kshs

   ii). Paid up share Capital: Kshs

   ii). Turnover : Kshs

   iii). Current Liabilities : Kshs.............—

   b). What has been the profit after tax of your company over the last five years:

   2000 : Kshs -....-

   2001 : Kshs.....-........—

   2002 : Kshs

   2003 : Kshs

   2004 : Kshs —-.....—

4. a). In your experience and contact with the public/private companies and in your own opinion what is their preferred way of raising capital?

	Most Preferred				Least preferred
Bank loans	{ }	{ }	} {	}	{ }
Loans from other institutions	{ }	{ }	} {	}	{ }
Public issue of shares %	{ }	{ }	} {	}	{ }
Private issue of shares	{ }	{ }	} {	}	{ }
Corporate Bond Issue (Bonds)	{ }	{ }	} {	}	{ }

Commercial Paper issue	{ }	{ }	{ }	{ }	{ }
Micro-Finance Institutions	{ }	{ }	{ }	{ }	{ }

b) Please indicate other preferred forms of financing IF NOT SPECIFIED ABOVE.

ii

c) Which of the following could be the main reasons behind the preferences of the sources of financing above? Please rank in order of preference.

Ranking

i). Ease and speed of access

ii). Flexibility of the funding arrangement

iii). Reputable institutional and infrastructural developments

iv). Predictability of outcome

vi). Others. Please list them

5. (a). How do you rate the current minimum requirements for listing at the NSE?

KEY

1. Too stringent
2. Stringent
3. Reasonable
4. Too low

	1	2	3	4
Shares	[ ]	[ ]	[ ]	[ ]
Corporate Bonds	[ ]	[ ]	[ ]	[ ]

(b). In your opinion which of the following are the most stringent aspects of listing if any?

(Please indicate them in order of stringency)

	1	2	3	4
i. Initial listing requirements	[ ]	[ ]	[ ]	[ ]
ii. Continuous reporting obligations				
iii. Quantity and quality of disclosures	[ ]	[ ]	[ ]	[ ]
iv. Initial and continuous listing fees	[ ]	[ ]	[ ]	[ ]
v. Number of profitable years in the past				
vi. Others. Please list them				

6. Do you think if some of the requirements were relaxed would attract more companies to seek capital through the securities exchange?

Certainly	Possibly	No
{ }	{ }	{ }

7. In your own opinion what are the factors inhibiting listings at the NSE? Please rank them in a descending order from the greatest inhibitor to the last.

Rank

i). Too stringent entry requirements

ii). Too many entry requirements

iii). Lack of awareness of the entry requirements and policy incentives by the unlisted companies

iv). Too stringent continuous listing requirements

v). Too many continuous listing requirements

vi). Absence of new investment opportunities to warrant seeking of permanent capital through the stock exchange

vii). Unrealistic and unachievable policy incentives

viii). Availability of listing benefits even when not listed

ix). Others. Please list them_

Thank you.