THE RELATIONSHIP BETWEEN DIRECT COST OF RAISING EQUITY CAPITAL AND GROSS PROCEEDS OF COMPANIES LISTED ON THE NAIROBI STOCK EXCHANGE (NSE)

BY

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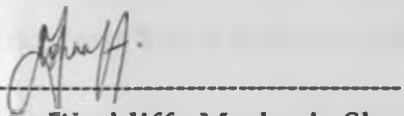
DECLARATION

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



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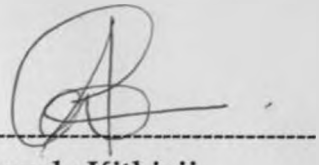
This Management project has been submitted for examination with my approval as the University Supervisor



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DEDICATION

To my wife Mary, children Robert, Elaine and Edwin, brothers Justus, Evans and Maurice, sisters Brenda, Jane, Ebby and Nelly, my nephew Tom Shamia and last but not least, James Mutua my brother-in-law.

ACKNOWLEDGEMENTS

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Thanks to God for the strength to undertake this study. His grace and love were sufficient at all times.

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ABSTRACT

There have been questions as to why most companies do not raise equity capital from the public in Kenya by issuing shares even with the increased tax incentives for such issuers. It has not been clear as to whether the costs of such funds are prohibitive compared to those of alternatives sources.

No study has been undertaken in Kenya to establish the cost of raising equity capital from the public. This paper is focused on the cost of raising equity capital in Kenya. It utilized secondary data on costs and expenses for a sample of 37 issues being both IPOs and SEOs between 1990 and 2005 as published in the prospectuses, audited financial statements and other source documents obtained from both the Capital Markets Authority (CMA) and Nairobi Stock Exchange (NSE), to test the following hypotheses:

1. Average cost of an issue decreases with increase in gross proceeds
2. Average cost of an issue increases with increase in gross proceeds

Analysis results indicate that the average cost of raising equity capital in Kenya is 10.24% of the gross proceeds. It has also been revealed from the findings that IPOs are more costly than SEOs and that rights issues are cheaper with only 4.5% of the gross proceeds being consumed by direct floatation costs.
On the basis of this analysis it turns out that flotation costs are lower if the issuer opts to raise high proceeds from the issue thus as far as the economies of scale view is concerned, there is clear evidence in favor of this view.

On the relationship between direct cost of capital and gross proceeds, regression analysis was significant that gross proceeds explain changes in direct floatation

costs although other factors exist that may contribute to the change but not on the same extent as gross proceeds.

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background

Companies raise equity capital through the stock exchange because they can raise large sums of money from the public perhaps at reasonable cost. This is possible because investors anticipate great benefits when shares are listed on a stock exchange where they are freely transferable. Individual companies enjoy enhanced stature, perceived stability in addition to benefiting from tax allowances and exemptions where available. But as a trade off, issue of shares to the public dilutes the current share ownership that may influence decisions at the management level. There are costs associated with any source of funds besides costs of raising such capital (Clayton and Arrington, 1998).

Companies can raise equity capital by way of direct private placement or through public offers. Direct private placement involves identifying a few investors that are invited privately to avail the required capital. Issuing equity to the public is done through either Initial Public Offering or Seasoned Equity Offering. Initial Public Offering (IPO) is the first equity issue made available to the public by a company. Seasoned Equity Offering (SEO) on the other hand is a new equity issue of securities by a company that has previously issued securities to the public before (Ross, Westerfield and Jaff, 2002).

When issuing shares to the public, companies incur both direct and indirect floatation costs. Direct floatation costs include expenses incurred prior to or by the completion of the offer exercise, measured by the sum total of the cost on underwriting and brokerage activities, legal advice, financial experts' opinions, accounting, services of other experts, managing advertisements and publicity, filing and approval processes, documentation, telephone, travel and postage among

others. Indirect floatation costs on the other hand, include, first, distraction of management from the operations of the company when the exercise commences until completion. Secondly, regulation of and restriction on certain matters such as publicity and other marketing activities are expected. Regulations place continuing obligations on the issuer for instance compliance with reporting obligations. The impact of such regulations would reduce flexibility in corporate affairs as dictated by good corporate governance practices and likely exposure to regulatory action on violation of the requirements. These costs impact on the issuer in the long run after the issue of the shares (Clayton and Arrington, 1998).

Floatation costs have become very sensitive to most issuers to the extent that they have a great impact on the overall success one expects from such an exercise. In this regard, issuers have become more innovative in controlling these costs. For instance, in August 2004, Google, one of the world's leading internet search engine successfully raised US $1.67 billion via an Initial Public Offering (IPO), conducted in unusual format of online auction in a bid to make its shares more widely available while controlling the issue costs (Google, 2004).

Direct floatation costs are known to exhibit economies of scale, as the average cost of an issue should decrease with the gross proceeds. However, studies elsewhere have indicated that infact the marginal floatation costs increase at least beyond some critical point (Kaserer and Steiner, 2004).

1.2 Statement of the Problem

To engage in a business, financial managers of a firm have to decide on how to raise capital for the required investment. Businesses access funds by issuing shares to investors who become shareholders (equity holders) and own the business.

Companies can also issue debt instruments to investors who would then have indirect stake in the business (Murphy, 1993).

Debt can be less costly than equity capital since most interest rates are less than what a shareholder would require as a rate of return. Unfortunately, debt requires collateral and affects the cash flows of a business, by requiring constant and periodic principal and interest payments.

Equity capital on the other hand, is more flexible than debt, since it does not have collateral requirements. Its repayment terms and conditions can be tailored to the needs of the business. Usually, payments to shareholders can be put off until the business exceeds breakeven or reaches a certain level of profitability. Equity capital can be used to raise large sums of money for a business. However, owners of these funds are interested in ownership of the business and influence main decisions of the organization (Hess, 2001).

According to Murphy (1993), the cost of raising capital is important because the funds availed for productive investments get reduced to the extent of this cost and for protection of shareholders' interests particularly in relation to the proportion of the total project cost and the net amounts raised. If this amount is significant, then the manner of reporting of this cost also becomes important enough to form the part of debate and discussion aiming for better corporate information disclosure practices. A better understanding of relative magnitudes of cost of raising capital may help capital markets monitoring authorities to formulate suitable policy responses to ensure that the cost of raising fresh resources from the community, which is an index of their use, is kept under constant watch and measures are taken from time to time to keep it under reasonable control.

It has been conventional wisdom over the last decades that direct floatation costs exhibit economies of scale, that is, the average cost of an issue should decrease with

increase in gross proceeds. However, studies elsewhere have presented evidence in favour of increasing marginal floatation costs, at least beyond some critical point.

No studies have been carried out in Kenya to determine whether or not floatation costs of equity issues to the public exhibit economies of scale. This study analyses the structure of direct flotation costs incurred by companies listed on the Nairobi Stock Exchange (NSE) when issuing shares through both Initial Public offerings (IPOs) and Seasoned Equity Offerings (SEOs). The study further establishes the relationship between cost of raising capital (direct floatation costs) and the gross proceeds raised.

1.3 Objectives of Study

To determine the direct floatation costs incurred by firms issuing shares through IPOs and SEOs in Kenya and;

To establish the relationship between direct floatation costs incurred and gross proceeds of firms issuing shares through IPOs and SEOs in Kenya.

1.4 Hypothesis

The following hypotheses form the basis of this study:

Ho: Average cost of an issue decreases with increase in gross proceeds

HA: Average cost of an issue increases with increase in gross proceeds

1.5 Importance of the Study

This study will be useful to:

1.5.1 Issuers

Given that it will present direct floatation cost structure for Kenya. Potential issuers will benefit by being able to estimate the extent to which funds for productive

investments could be reduced by the direct floatation costs. Being a component of the overall cost of equity, one is able to use the findings in estimating the overall cost of equity capital. This has an indirect impact on number of companies that can raise equity capital in Kenya since this component has remained unknown. Where a company would have conducted a survey as an alternative to determine these costs, funds intended for such expenditure can be put to other important uses.

1.5.2 Investors

Given that it provides a basis for protecting investors' interests particularly in relation to the proportion of the total project cost and the net amounts raised. If this amount is significant, then the manner of reporting of this cost also becomes important enough to form the part of debate and discussion aiming for better corporate information disclosure practices.

1.5.3 Policy makers

The capital markets regulators in Kenya will have a better understanding of relative magnitudes of direct cost of raising capital hence formulate suitable policy responses to ensure that the cost of raising fresh resources from the community, which is an index of their use, is kept under constant watch and measures are taken from time to time to keep it under reasonable control.

1.5.4 Researchers

In most emerging markets, gaps exist in certain areas even when relevant data is available and only needs to be reorganized. Users of such information encounter difficulties, as they have to relate their situation to other markets, which sometimes could result in inappropriate decisions. This research not only will avail this information but will go a long way to placing Kenya in a category of capital markets that is perceived to be known, open and available in terms of information.

1.5.5 Other East African countries

Uganda and Tanzania in the spirit of cooperation and given that their capital markets are young depend on Kenya for policy formulation. Even other neighbours such as Rwanda, Sudan and Ethiopia have shown interest to learn from Kenya's experience as they struggle to establish their markets. These markets will benefit immensely from this research.

1. 6 The Kenyan Institutional Framework

The Capital Markets Authority is the regulator in Kenyan capital market with NSE being the only stock exchange. Among other participants, are investment banks (11), stockbrokers (10), investment advisers (17), fund managers (12), authorized depositories (4) and collective investment schemes (5) and an automated central depository.

According to the Capital Markets Act, Capital Markets Authority regulates the listing of securities on NSE. In this regard Capital Markets Authority has released regulations, Capital Markets (Securities)(Public Offers Listing and Disclosures) Regulations 2002. However application is also made to NSE to facilitate admission as per the requirements of the NSE Listing Manual. Securities can only be listed on three boards i.e. Main Investment Market Segment (MIMS), Alternative Investment Market Segment (AIMS) and Fixed Income Securities Market Segment (FISMS)

A prospective issuer of securities is required to develop a prospectus or information memorandum containing all the information required by the law. This includes information such as identity of management; offer statistics and expected timetable, information describing the issuer, financial information and major shareholders.

In Kenya, underwriting has not taken root due to mainly absence of reputable investment banks. Infact investment banks as a class of market operators never existed before the year 2002. Unfortunate still large commercial banks have never taken the advantage of becoming underwriters. Stockbrokers are now upgrading their operations into investment banks, slowly gaining capacity to underwrite issues in the market. One major limitation is that the legal framework on underwriting is not adequate. For instance it is not clear whether foreign companies can underwrite issues in Kenya.

A company in the process of issuing shares to the public is required to acquire the services of financial advisers, a lead or sponsoring stockbroker and legal advisers. Competitive bidding or private selection could be used to acquire these services. The team together with the management of the issuer is expected develop an information memorandum or prospectus containing some prescribed minimum information, including:

The identity of the directors, senior management and advisers including a declaration by the directors of the issuer accepting responsibility for the information contained in the document;

The offer statistics and the expected timetable clearly describing the shares to be issued, the volume and the stock exchange on which the shares will be listed.

A cautionary disclaimer statement absolving the regulator from any implied responsibility for the issue by virtue of its approval of the issue;

Information on the issuer including the name, registered office, country of incorporation and material contracts entered into by the issuer or a member of its group within the preceding two years;

Financial information including audited financial statements for three years (AIMS) or five years (MIMS) in a comparative table, accountants report on the audited accounts, particulars of the dividend policy to be adopted and details of material loans by the issuer or its subsidiaries;

On expenses, the total amount of the discounts or commissions agreed upon by the underwriters or other placement or selling agents and the issuer, an itemised statement of the major categories of expenses incurred in connection with the issuance and distribution of the securities to be listed. Some expenses must be disclosed separately including advertisement, printing of prospectus, approval and listing fees, brokerage commissions, financial advisory fees, legal and underwriting fees;

A statement or estimate of the overall amount, percentage and amount per share of the charges relating to the issue payable by the issuer, stating the total remuneration of the intermediaries, including the underwriting commission or margin, guarantee commission, placing or selling agent's commission; and

General information including the main business of the issuer, risk factors specific and those general to the industry, major shareholders holding 3% and more.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Types of Equity Issues

2.1.1 Private Direct Placement

Private Direct Placement involves sale of shares privately and directly to a few buyers. This kind of issue is simple to arrange and is usually subjected to the agreement between the contracting parties. It can be used where admission of a strategic partner is necessary. Part of the capital may be provided by venture capitalists, who could be high net worth individuals providing start up capital to promising businesses or simply some private partnerships and corporations formed to provide investment funds. In addition to providing capital, venture capitalists may backup management and technical capacity but eventually target to exit after such businesses have picked up. However, it might be limited to small amounts of capital being raised. It is also difficult to find a few but strong investors who may be agreeable to the terms favourable to the party seeking for capital. Private companies commonly use it to raise funds from specific investors (Hess, 2001).

2.1.2 Public Offer

According to Ross, Westerfield and Jaff (2002), this involves equity issue to the public or a section of it in the form of Initial Public Offering (IPO) or Seasonal Equity Offering (SEO). An IPO is the first equity issue made available to the public by a company. A SEO refers to any other subsequent and could further consist of open offer for cash and also rights offers. Open offer for cash refers to an offer made directly to investors for cash either through underwriting or "best efforts"

arrangements. In rights issues, the current shareholders at the time of the issue are given an opportunity to exercise their " pre-emptive rights" before "outsiders" can participate in the issue. When issuing shares, an issuer may use investment banks in underwriting an issue or the issue remains on a "best efforts" arrangement. In underwriting, firm commitment is used where underwriters buy the securities for less than the offering price and accept the risk of not being able to sell them. In this case, the issuer receives full amount of the proceeds less the spread (the difference between the underwriters buying price and the offering price). Where the underwriter cannot sell the whole issue at an agreed upon price, it may need to lower the price on the unsold shares. On the other hand, in "best efforts" agreement, intermediaries involved merely act as agents hence receive a commission for the shares sold. The best efforts are to sell the shares at the agreed upon offering price. If the issue cannot be sold at this price, the issue is then usually withdrawn.

2.1.3 Benefits of Raising Equity Capital

According to Clayton and Arrington (1998), raising equity capital benefits many parties as explained below:

2.1.3.1 Issuer

First, issuers benefit from raising the required capital at reasonable costs for investment in productive projects, resulting in favourable performance, others things being equal. This also increases the chances of the issuer being listed at a stock exchange to benefit from free transferability of ownership and improved credibility among others. It could create investment opportunities for possible strategic partners and be used as consideration in acquisitions, saving on scarce resources. Finally, issue of shares to employees through employee share ownership schemes improves on their productivity. It could also improve on the general capital structure of the issuer thus minimize risks associated with distress calls.

2.1.3.2 Investors

Investors get to have access to investment opportunities that yield a rate of return. They also learn to make good decisions from being a member of collective decision-making process. There is a likelihood of exercising pre-emptive rights at a future date before other investors, in case of rights issues by the issuer. They can use share certificates issued as evidence of ownership as collateral for loans and realize capital gains on disposal of the shares.

2.1.3.3 Regulatory Agencies

Issue of shares to the public contributes towards deepening the market and potential increase in listings. Regulators receive fees levied for processing and approval of such issues. Licensed persons being involved as underwriters and lead advisers, generate revenue that supports the regulator through licence fees. Finally, there is improved credibility and perception that the regulator is achieving its objective of mobilizing resources and allocating them to needy sectors.

2.1.3.4 Economy

Issuers accessing funds increase their productivity and contribution to economic growth other things being equal. Jobs are generally created to all those gainfully involved in the activities. A well-developed capital market can avail long-term funds at lower costs. Investment basket is expanded in the economy while foreign exchange earnings are enhanced if foreign investors are allowed to participate.

2.1.3.5 Other Capital Markets

Especially those developing which have limited "ready" funds available for investment projects may widen the area of focus by issuing shares in foreign markets or to foreign investors so as to raise the required capital. This in a way

mitigates against cases where an offer is likely to fail if restricted to a certain market given some factors. However, there are benefits for each side involved since one market is able to raise the required funds, investment opportunities are available to investors in the markets and experts participating as consultants also benefit.

2.1.4 Rationale for Raising Equity Capital from the Public

Brown (2001) argues that the exercise of raising capital from the public opens up the opportunities for additional funding and boosts growth. This process suddenly puts the company into the spotlight with the media, analysts, investors, customers and suppliers. Attaining listing status enhances the company's marketing and expansion plans, and brings attention to a company's strategy and future prospects without much investment in advertising campaigns. Listed companies acquire creditworthiness in the eyes of banks and suppliers who rely on information from the public. Being listed simply provides an assurance to the market that an organization complies with the best practice globally.

2.1.5 Impacts of Raising Equity Capital From the Public

According to Brown (2001), raising equity from the public would be associated with high cost of raising capital, in some incidences, in addition to the cost of the funds. The cost of equity funds is considered more expensive compared to debt due to lack of direct tax benefits. Dilution of the ownership of the company is the trade off with the new owners influencing decisions made at the management level. Due to the long process involved in mobilizing funds from many investors, it takes a longer period before funds are realized. To create order and protect investors, companies are required to meet certain conditions including disclosure of certain information before they are allowed to raise funds. They become exposed to regulatory sanctions in case of violation of set continuing requirements. This may result in reduced flexibility in corporate affairs as dictated by good corporate governance practices

since both management and shareholders make certain important decisions collectively. Finally, there is increased vulnerability to hostile takeover bids resulting from disclosure on business operations as per requirements and also the ease with which the firm can be valued.

2.1.6 Why Companies Choose to Raise Equity Capital Through the Stock Exchange

Companies raise equity capital through the stock exchange by issuing shares that are admitted to the stock exchange's official list that facilitates free transferability of such shares. There are various other benefits derived by a company from listing on a stock exchange other than raising long-term funds (gross proceeds).

A listed company creates a denomination for possible acquisitions at a future date for other interested parties since the company can easily be valued. It is also easier for such company to access the public market for future financing since it has established relationships. Because of regulatory requirements, a listed company gains in terms of its stature, perceived stability and competition as there is enhanced separation between ownership and management. It has been a common practice to grant tax allowances and exemptions especially on dividend and interest earned so as to increase number of listings in most jurisdictions.

Shareholders in such companies also benefit directly since it creates an exit mechanism for the current shareholders in the company. Individual ownership in company (shares) can be passed over to other investors at reasonable market prices (The Stock Exchange of Thailand, 2005).

2.2 Determination of Gross Proceeds

Gross proceeds refer to the total amount raised from an equity issue. According to Murphy (1993), this amount is determined by the responses of the target investors as acceptances to the issue's terms and conditions as specified in the issue document.

There are various factors that influence achieving of the expected total amount. Investors, perception of the issuer from its past, anticipated future performance or management can influence the amount raised. The value attached to the issuer by investors and the general state of economy in addition to marketing campaigns of the issue could also affect the gross proceeds. The extent of disclosures on the company and the issue and availability of alternative investment opportunities available would impact on the gross proceeds.

The management of the issuer initially will be cautious on deciding what amount is to be realized without being certain as to how much would be raised during the issue. The accuracy involved in estimating the anticipated floatation costs as part of the total amount is vital in raising an amount that would enable the company undertake its intended projects. Gross proceeds should be able to cover both the floatation costs and the amounts required for the projects.

2.3 Direct and Indirect Costs of Issuing Shares to the Public

When issuing shares to the public, companies incur both direct and indirect floatation costs. Direct floatation costs include expenses incurred prior to or by the completion of the offer exercise, measured by the sum total of the cost on underwriting and brokerage activities, legal advice, financial experts and auditors' opinions, accounting, other experts involved where necessary, managing advertisements and publicity issues, meetings and related activities, filing, processing and approvals, documentation, telephone, travel and postage.

However, this exercise comes with various indirect costs and other burdens in form of adverse market reaction, such as:

Distraction of management from the operations of the company when the exercise commences until completion. The individual company's management team spends more time in this exercise;

Restrictions on publicity and other marketing activities as per regulations in the jurisdiction of issue;

Need to comply with strict continuing reporting obligations that may put pressure on the issuer and also open up certain information to the public affecting the competitive advantage especially where major competitors are not listed therefore not subjected to such obligations;

Reduced flexibility in corporate affairs as dictated by good corporate governance practices prescribed in the jurisdiction of issue;

Exposure to regulatory action on non-compliance issues after listing has been approved;

Vulnerability to a hostile takeover; and

The likelihood of under pricing when the issue is introduced to the market for the first time.

These costs would be relative in nature and impact on the issuer in the long run after the issue and listing of the shares.

2.3.1 Determinants of Direct Cost of Raising Capital from the Public

Direct floatation costs are definite and are incurred by the time the offer exercise is concluded. Part of these costs such as advertising, postage, telephones and travel

may be under the control of the issuer. But amounts paid to experts for opinion such as to accountants, lawyers and others and also underwriting and brokerage activities can be negotiated. But filing, processing and approval fees in most cases remain fixed or vary with the amount being raised. This indicates that the overall direct costs of raising capital from the public have both a fixed and variable components. In the final analysis, these costs depend to a large extent on how well the issuer's management plans its activities related to the issue, negotiates with other parties involved and understands the legal framework that governs issuance of the shares.

2.4 Empirical Research Findings

Various studies on certain aspects of cost of raising equity capital have been carried out in a number of markets especially in developed economies as summarized below:

2.4.1 Results on Average Flotation Costs as a Percentage of Gross Proceeds

Smith (1977) reported flotation costs of 6.17 percent for underwritten cash offers in the US, 6.05 percent for underwritten rights issues, and 2.45 percent for uninsured rights offers. Eckbo and Masulis (1992) presented slightly different figures for industrial firms in the US. According to their study total direct flotation costs equalled 6.09 percent for underwritten cash offerings, while they amount only to 4.03 percent for underwritten rights offerings. Lee, Lochhead, and Ritter (1996) find direct flotation costs in the US to average 7.11 percent.

According to Bühner and Kaserer (2002) direct flotation costs for underwritten rights offerings of industrial firms in Germany amount to 1.65 percent. For underwritten cash offers total costs are significantly higher at 4.61 percent.

In UK, total direct flotation costs average to 5.78 percent according to Armitage (2000), while the average cost for Norwegian industrial firms is 4.4 percent

according to Bøhren, Eckbo, and Michalsen (1997). Both papers analyze only rights offers.

Gajewski and Ginglinger (2002) report average flotation costs of 2.07 percent for listed companies in France. If the placement is arranged as a cash offering these costs increase to 2.89 percent.

Finally, Christopher Kaserer and Fabian Steiner extended the analysis of Bühner and Kaserer (2002) to a Swiss sample of SEOs in 2004 and found that the direct floatation cost spreads average 4.53% of Gross Proceeds.

Of course, one might argue that European and US-based results cannot be compared to the Kenyan situation.

2.4.2 Evidence with Respect to Economies of Scale

Smith (1977) also documented economies of scale as seemingly evidenced in many following studies. Armitage (2000) has also confirmed diminishing marginal flotation costs for the UK market and Gajewski and Ginglinger (2002) for France. However, the evidence with respect to economics of scale is less pronounced as these papers may suggest. In fact, Altinkili and Hansen (2000) argue that the empirical evidence of decreasing flotation costs is misleading. Their point is that the underwriting fees are cheaper for larger firms not because they have larger issues but because larger firms tend to be of higher quality. From this perspective it could be that the alleged larger is cheaper-rule is, in fact, a larger is higher quality-rule. Actually, by estimating an appropriately designed flotation cost function Altinkili and Hansen (2000) showed that the average underwriting spread is U-shaped in issue size. Hence, the marginal spread is rising, at least beyond some critical point. Bühner and Kaserer (2002) and Kaserer and Kraft (2003) have presented mixed

evidence with respect to economies of scale in underwriting fees in the context of German SEOs and IPOs.

Christopher Kaserer and Fabian Steiner (2004) extended the analysis of Bühner and Kaserer (2002) to a Swiss sample of SEOs and found clear evidence in favour of diseconomies of scale. In fact, average floatation costs turn out to be increasing with gross proceeds.

2.4.3 Results on the Impact of Other Variables

Eckbo and Masulis (1992) show that direct flotation costs are increasing in the degree to which a firm is widely held. Similar evidence has been provided by Bühner and Kaserer (2002) for Germany, by Armitage (2000) for UK and by Gajewski and Ginglinger (2002) for France. Moreover, these studies reveal direct flotation costs to be an increasing function of stock price volatility.

Bühner and Kaserer (2002) used an approach where they tried to estimate to what extent flotation costs are fixed and to what extent they are variable, that is, they depend on gross proceeds. In this context they can show that volatility has only an impact on fixed flotation costs but not on variable costs. This is what one would expect, given that volatility can be regarded as a proxy for information costs, which by nature are fixed. As far as rights issues are concerned it has been reported in the literature that an increase in the offer price discount seems to have a positive impact on floatation costs. This is surprising, because at a first glance one would expect the risk position of an underwriter to be more comfortable the higher the offer price discount is. Bøhren, Eckbo, and Michalsen (1997, p. 247) argue that firms may use the offer price discount to signal their quality, with higher quality firms setting lower discounts. In this sense, the offer price discount is a proxy for firm quality or firm risk. Interestingly, Armitage (2000) reports a significant impact of the offer price discount on the non-underwriting issue costs, but a completely insignificant impact

on underwriting fees. Bühner and Kaserer (2002) find the offer price discount to have a U-shaped impact on flotation costs. This aligns the idea that lowering the offer price has a negative impact on flotation costs due to less placement risk for the underwriter with the idea that the offer price can also be regarded as a signal.

Christopher Kaserer and Fabian Steiner (2004) applied cross-sectional test of a floatation cost function which revealed that these costs are lower if the issuer opts for self-registration, the issue is less complex, the free float is higher and the stock price risk is lower.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1. Research Design

The research design is a survey.

3.2. Population and Sampling

In order to gather empirical evidence on direct floatation costs in Kenyan Capital market, a total of 37 issues of shares to the public through prospectus by listed companies both on the Main Market and Alternative Market Segments in the period 1990 to 2005 were selected (refer to Appendix 1). These issues were categorized as follows:

- By nature: 14 IPOs and 23 SEOs (being 9 additional issues and 14 rights issues);
- By Sector: Agricultural-1, Commercial and Services-7, Finance & Industry-18, Industrial & Allied-11
- Banks against non banks: Banks-13 and Non-banks-24

3.3. Data Collection

Relevant data on the respective equity issues disclosed in both prospectuses and audited accounts over the period 1990 to 2005 was collected. Companies seeking to issue shares to the public are required by the Capital Markets (Securities)(Public Offers Listing and Disclosures) Regulations 2002 issued by Capital Markets Authority (who are the regulators that approve all issues of securities in the Kenya capital markets) to develop a prospectus that must contain certain minimum disclosures which include accurate estimates of the floatation costs. In particular instances where issues took place before the enactment of the above Regulations (1990-2001) and the prospectuses do not contain information on floatation costs, these costs were taken as disclosed in annual audited accounts of the respective

issuers. It is worth noting that the minimum disclosure requirements for information memoranda for both IPOs and SEOs are more less the same.

Total assets in the audited accounts of each issuer just before each issue were extracted.

Listing prospectuses and relevant audited accounts were made available in the libraries of the Capital Markets Authority and Nairobi Stock Exchange. Other source documents touching on the cost of raising capital were made available at the Capital Markets Authority.

3.4. Data Analysis

Direct floatation costs were expressed as a percentage of gross proceeds and total assets as per latest audited accounts before the date of the issue.

Comparative analysis based on the sectors of the issuer and the issue bands was undertaken and any differences identified discussed.

The relationship between direct floatation costs to gross proceeds was estimated regression analysis on assumption that the cost function (C), denominated in Kshs., can be modeled as a quadratic function of gross proceeds (GP). In this way increasing, constant, or diminishing marginal costs can be captured. Bühner and Kaserer (2002) used this model in detecting the direct flotation cost structure in Germany while Kaserer and Steiner (2004) extended it on the Swiss capital market. Thus, total costs are defined as:

$$C = aGP + bGP^2 + F \qquad (1)$$

Where F represents fixed costs, while the parameter a and b are proportions of change in regard to GP (Gross Proceeds).

From the above equation, the parameter b captures the curvature of the marginal cost function. Considering that $\partial^2 C / \partial GP^2 = 2b$ holds, marginal flotation costs are diminishing in gross proceeds whenever the condition $b < 0$ holds. Likewise, marginal floatation costs are increasing in gross proceeds whenever $b > 0$ holds. On the other hand, the parameter a characterizes the location of the marginal cost function in that it gives the marginal cost at the point $GP = 0$.

It is necessary to control for other firm or issue specific variables (total asset of the issuer just before the issue) by integrating the allegedly relevant variables into the total cost function. It was then possible to detect marginal cost behavior, holding firm characteristics constant, in a more general way.

CHAPTER FOUR

4.0 DATA ANALYSIS AND INTERPRETATIONS

4.1 Introduction

The analysis was undertaken first by categorizing the sampled issues according to nature (IPOs or SEOs), sector of issuer, and whether the issuer was a bank or a non-bank entity (see appendix 2). The gross proceeds of all the issues were categorized into range bands of Kshs.400 million width. The number of issues within each band was identified and also the ratio in percentage of direct floatation costs to both gross proceeds and total assets calculated (see appendix 3).

Secondly, regression analysis was done on the research data collected to establish the relationship between average cost of raising capital and the gross proceeds from the issues.

4.2 Analysis and Interpretation

The results as given in Appendix 2 can be summarized in the table below:

Table 1: Sample Description

Variable	Total sample	IPOs	SEOs		Banks	No-banks
			Rights Issues	Additional Issues		
Number of issues	37	14	14	9	13	24
Average gross proceeds (Kshs'm)	575	519	702	466	600	562
Average Cost: to Gross proceeds (%)	10.24	14.87	4.50	11.96	15.98	7.13

Source: Research data

4.2.1 Average costs as a percentage of gross proceeds

From table1, the average cost of raising equity capital from the public was10.24% while gross proceeds raised on average were Kshs.575,557,695 for the sample of 37 issues selected. From these findings, one can conclude that direct floatation costs are high in Kenya, being an emerging market, where it is expected that the cost of services required during an issue to the public such as legal, financial advice, investment banking among others is higher compared to developed markets such as United States of America and most European markets. For instance, Lee, Lochhead, and Ritter (1996) found direct flotation costs in the US to average 7.11 percent. According to Bühner and Kaserer (2002) direct flotation costs for underwritten rights offerings of industrial firms in Germany amount to 1.65 percent. While in UK, total direct flotation costs average to 5.78 percent according to Armitage (2000), while the average cost for Norwegian industrial firms is 4.4 percent.

4.2.2 Floatation costs of IPOs versus SEOs

As illustrated in table 1 above, 14 IPOs sampled indicated that the average cost for IPOs is higher being at an average of 14.87% compared to SEOs with additional issues having an average of 11.96% while rights issues 4.5%. However, the average gross proceeds for IPOs were Kshs. 518,938,807 compared to Kshs. 466,483,142 for additional issues and 702,295,945 for rights issues. Although on average, the results indicate high levels of average costs for both IPOs and SEOs, the conclusion that IPOs are more expensive compared to SEOs has been observed even in developed markets. The explanation being that a new company seeking to issue and list shares incurs additional costs compared to one that is simply issuing additional shares. Rights issues are much cheaper due to pre-emptive rights of the current shareholders hence certain costs can be avoided.

For instance, Smith (1977) reported flotation costs of 6.17 percent for underwritten cash offers in the US, 6.05 percent for underwritten rights issues, and 2.45 percent for uninsured rights offers. Eckbo and Masulis (1992) presented for industrial firms in the US total direct flotation costs of 6.09 percent for underwritten cash offerings and only to 4.03 percent for underwritten rights offerings.

4.2.3 Floatation costs in banks versus non-banks

From table 1, the average cost of raising capital for banks in the period was higher being 15.98% compared to 7.13% for the non-bank issues unlike in developed markets where the cost is lower when the issuer is a bank. Christopher Kaserer and Fabian Steiner (2004) return average cost of 4.37% for banks and 4.71% for non-banks SEOs in Switzerland.

This can be explained by the fact that out of the 13 issues for banks sampled, only two were rights issues (which are cheaper), seven were additional issues while four were IPOs.

However, generally it is expected that banks incur less costs since they can issue shares without underwriting or even use in-house investment banking capabilities.

4.2.4 Floatation costs in various sectors:

Table 2: Secterial Cost of Raising Capital

Sector	Number of issues	Cost: proceeds (%)
Agricultural	1	9.04
Commercial & Service	7	6.29
Finance & Investments	18	13.16
Industrial & Allied	11	8.08
Total	37	

Source: Research data

Table 2 indicates that the average costs of raising capital is high in Finance & Investments Service being 13.16%, followed by Agricultural sector with 9.04%, then Industrial & Allied with 8.08% then finally commercial & Services having low average cost of 6.29%. The differences in the average costs largely are explained by the composition of issues depending on whether there were most rights issues as is the case for Commercial & Services unlike Finance & Investments that had many additional issues and IPOs.

4.2.5 Cost of raising capital versus gross proceeds:

The results as given in Appendix 3 can be summarized in the table below:

Table 3: Cost of Raising Capital Across Selected Bands

Gross proceeds (Ksh'm)	Number of issues	Cost: proceeds (%)
0-400	23	12.47
401-800	5	8.08
801-1,200	3	7.40
1,201-1,600	3	4.86
1,601-2,000	1	5.78
2,001 and above	2	4.52

Source: Research data

From table 3 it is evident that the cost of raising capital diminishes with increase in gross proceeds. Raising upto Kshs. 400 million was more expensive with an average cost of 12.47%. 23 issues out of the total of 37 were in this bracket. The next bracket of between Kshs. 401 million and Kshs. 800 million had only 5 issues with an average cost of 8.08%. The next bracket of between Kshs. 801 million and Kshs. 1,200 million had an average cost of 4.86% (being mainly rights issues). However, the next bracket only had one additional issue with an average cost of Kshs. 5.78%. If more issues were within this bracket, the results could perhaps been different. The last bracket of Kshs. 2,001 above had two issues with the lowest average cost of 4.52%.

Generally, the above trends depict economies of scale as the relationship between average cost of raising capital and the gross proceeds in Kenyan capital market.

Armitage (2000) has also confirmed diminishing marginal flotation costs for the UK market and Gajewski and Ginglinger (2002) for France.

4.2.6 The relationship between direct floatation costs and the gross proceeds

To establish the relationship between direct floatation cost and gross proceeds, regression analysis was applied assuming that; first the relation was linear with one dependent variable being gross proceeds. Secondly, the relation was assumed to be quadratic with one dependent variable being gross proceeds. Lastly, the relationship was assumed to be a curve with two independent variables; gross proceeds and total assets.

As per Appendix 4, three equations were derived, being liner equation: C=-9.645E-04 - 5.787E-03GP, quadratic equation: $C = -0.001961 - 0.011769GP + 0.000003GP^2$, and a curve; $C= -0.002 - 0.012GP + 0.365TA + 0.000003\ GP^2$.

The quadratic $C = -0.001961 - 0.011769GP + 0.000003GP^2$ gave the best fit compared to the other two models, since it had an Adjusted R^2 of 0.9852 compared to 0.9467 for the linear model and 0.9831 for the curve model. This implies that the dependent variable in this quadratic explains at least 98.52% level of changes in the direct floatation costs. In the three models, the analyses were significant.

It is worth noting that the fixed floatation part is negative in the three models as well as the coefficients of GP. On the other hand, the coefficient of GP^2 is almost zero indicating that the relationship expected is decreasing as gross proceeds increase.

t seems that inclusion of total assets (TA) in the curve model did not improve the predictability of the model any further since the model could only explain up to 98.31% of changes in direct floatation costs compared to 98.52% when relying on gross proceeds only.

Given that the above quadratic equation can only explain changes in direct floatation costs up to 98.52%, it can be concluded that there are other variables that could result in changes in the direct floatation costs.

The above findings concur with those of Bühner and Kaserer (2002) in detecting the direct flotation cost structure in Germany and Kaserer and Steiner (2004) on the Swiss capital market.

CHAPTER FIVE

5.0 SUMMARY OF FINDINGS AND CONCLUSIONS, RECOMMENDATIONS, LIMITATIONS OF THE STUDY, AND SUGGESTIONS FOR FURTHER RESEARCH

5.1 Summary of Findings and Conclusions

5.1.1 Summary of Findings

The objective of this study was to determine the direct floatation costs incurred by firms issuing shares to the public through IPOs and SEOs in Kenya and to establish the relationship between direct floatation costs incurred by those firms based on the issues in the period 1990 and 2005.

Analysis of the data collected has revealed that the average floatation cost in Kenya is 10.24% of the gross proceeds raised from the public. However, the cost of raising equity capital via rights issues is the cheapest with average floatation costs being 4.50% of the gross proceeds. Raising equity capital through IPOs was more expensive where about 14.87% of the gross proceeds would be consumed by direct floatation costs. There was weak evidence to indicate that cost of raising equity capital would depend on the sector of the issuer or even whether the issuer is a bank or not. But it seems that the nature of the issue (whether IPO or SEO) has a much higher influence on the direct floatation costs.

Based on the analysis of the data collected, there is strong evidence of economies of scale, where the cost of raising equity capital decreased with increasing gross proceeds.

Regression analysis indicated that the relationship between average direct floatation costs and gross proceeds in Kenya would be described well by a quadratic equation highly dependent on gross proceeds. However, in addition, there are other factors that would influence changes in average direct floatation costs, although, not as serious as the gross proceeds.

5.1.2 Conclusions

This paper addressed the issue of how costs of raising external equity in Kenya can be determined and whether they are governed by economies of scale. It aims at providing the literature on cost of raising capital in Kenya from the past issues. The paper carries out a cross-sectional analysis of 37 public issues including both IPOs and SEOs on the Kenyan capital market over the years 1990-2005. A multiple regression approach has been used to explain the variance in average flotation. This is against the presumption that flotation spreads are clustered.

First, it provides for the first time empirical evidence on the flotation cost structure on the Kenyan capital market. It has observed that flotation costs amount to 10.24 percent of the gross proceeds, leading to the expected conclusion that the cost of raising external equity capital is high in Kenya, given that it is an emerging market compared to the situation in United States or Europe.

Secondly, evidence has been provided for the Kenyan market to support the conventional wisdom that direct floatation costs exhibit economies of scale.

As expected, the findings have revealed that the average direct floatation costs incurred during IPOs is greater than those incurred during SEOs.

The above results have highlighted the likely impacts of lack of developed investment banking services and other related services when raising equity capital in Kenya that translate themselves into high floatation costs.

5.2 Recommendations to the Policy Makers and Potential Issuers

An average floatation cost of about 10.24% is too high to attract companies seeking to raise funds. This is even worse where companies that incur such costs fail to raise the required funds. It is therefore recommended that the policy makers especially the regulator in the Kenyan capital market facilitates the growth of investment banking services in Kenya so as to decrease on the floatation costs that reduce funds available for the intended use.

The regulator should also enhance the legal framework so that unnecessary exposures, delays and costs during the offer period can be avoided. This should be done in line with the most current applications especially in the developed markets.

For companies that are already listed on the Stock Exchange, it would be advisable to always think of issuing shares via rights issues whenever additional equity funds are required. This would reduce on the overall issue costs due to the pre-emptive rights.

Where a company wishes to raise equity capital from the public, it should plan and maximize on the opportunity by raising as much capital as circumstances can allow. Raising little funds results in less amounts being available for productive investments.

Where companies not listed on the Stock Exchange wish to raise funds, they should acquire the services of knowledgeable advisers who have adequate experience.

Having participated in various issues helps them to minimize on wastes and duplications.

5.3 Limitations of the Study

The study was limited by the unavailability of data of a few issues thus the whole population could not be included. This was mainly attributed to lack of adequate legal framework at some point within the period of study. If the information would be available, the regression analysis would be more accurate.

Time value of money in the period is assumed not to change materially thus a Kenyan Shilling in 1990 is the same in 2005. Inflationary effects are assumed to minimum.

The amount of estimated costs of raising capital disclosed in the prospectuses was assumed to be accurate compared to the actual expenditure.

The number of all the issues in the focus period in Kenya is low (about 40 issues). If there were many issues reliable trends could be derived. In some years in the period, there were no issues of shares to the public hence the data is not consistent.

The analysis tools used may be limited in their own nature. Different models may yield different results that could perhaps be more accurate especially alternatives to regression analysis.

5.4 Suggestions for Further Research

This study concentrated on the cost of raising equity capital from the public in Kenya. It would be interesting for such costs to be determined in the case of private

placements. This would explain whether such costs influence companies' decisions of whether to raise capital from the public.

To improve on investment banking services in Kenya, a study in obstacles to growth of investment banking in Kenya should be carried out.

It would be interest to carry out a study on who have participated in equity issues in Kenya from the inception of the Stock Exchange.

There is need to relate the cost of raising equity capital to that of the debt in Kenya for a period of not less than ten years back.

A study should be carried out on the weaknesses of the legal framework in facilitating issuance of securities in Kenya so that any gaps identified can be addressed.

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Glossary of Terms

Average Costs: Mean cost for several classes of gross proceeds

Capital: Funds to be made available

Capital markets: Source of long-term funds

Capital Markets Authority: The regulatory agency in the Kenyan capital market

Issuer: The company that issues shares to raise funds

Investor: Individual entities that can avail funds

Investment banks: Non-deposit taking firms licensed to provide professional financial advice and related services to companies raising capital.

Net amounts raised: Amounts raised less floatation costs

NSE: Nairobi Stock Exchange

Open offer for cash: Offer made directly to investors for cash through placing agents

Prospectuses: A document that contains minimum disclosures regarding the offer in line with the governing law.

Public offer: Open to or involving all or a major part of the investors in a country

Stock Exchange: A market facility where shares are traded

Share price volatility: The tendency of share prices to fluctuate

Underwriting: The passing over of the responsibility of selling shares to investor to a firm at an agreed price with the promise that all the shares will be taken up.

APPENDIX 1

DIRECT COST OF RAISING EQUITY CAPITAL TO TOTAL PROCEEDS BETWEEN 1990 AND 2005

SAMPLE DATA

Name of issuer	Shares issued (No.)	Par value (Kshs.)	Type of issue	Year of issue	Issue price(Kshs.)	Proceeds (Kshs.)	Cost of raising Capital(Kshs.)	Total assets (Kshs'000)	At
1.KCB	9,000,000	10.00	PI	1990	33.00	297,000,000	16,000,000	15,435,467	31/12/1989
2.Trade Bank	16,000,000	5.00	PP	1991	8.50	136,000,000	56,200,000	1,472,826	28/02/1990
3.KFB	3,261,970	5.00	PI	1991	12.50	40,800,000	10,836,000	1,123,778	31/12/1990
4.HFCK	18,000,000	5.00	PI	1992	7.00	126,000,000	16,291,923	3,566,522	31/12/1991
5.Crown Berger	8,630,000	5.00	PI	1992	16.00	138,080,000	13,000,000	240,328	31/12/1991
6.Uchumi	16,000,000	5.00	PI	1992	14.50	232,000,000	22,000,000	581,356	30/6/92
7.EAO(BOC)	1,600,000	5.00	D	1993	26.50	42,400,000	5,652,400	538,453	31/12/1992
8.Marshalls	1,827,700	5.00	RI	1993	11.75	21,475,475	124,960	1,202,600	31/12/1992
9.NIC	17,929,286	5.00	OFS	1994	52.00	93,322,872	40,000,000	3,235,742	31/12/1993
10.Firestone	40,000,000	5.00	OFS	1994	35.50	1,420,000,000	125,000,000	1,444,467	30/06/1994
11.NBK	40,000,000	5.00	OFS	1994	10.00	400,000,000	45,000,000	12,824,654	30/09/1993
12.KFB	2,719,707	5.00	RI	1994	16.50	44,875,000	10,836,000	1,741,589	31/12/1993
13.Rea Vipingo	8,000,000	5.00	PI	1996	10.50	84,000,000	7,597,000	715,527	30/09/1995
14.KQ	235,000,000	5.00	OFS	1996	11.25	2,643,750,000	132,187,500	6,690,375	31/3/95
15.E.A Portland	72,000,000	5.00	RI	1996	14.00	1,008,000,000	38,000,000	4,556,960	30/06/1995
16.NBK	40,000,000	5.00	OFS	1996	15.00	600,000,000	54,000,000	18,256,865	30/09/1995
17.KCB	11,880,000	10.00	OFS	1996	50.00	594,000,000	69,722,000	57,930,778	31/12/1995
18.TPS Serena	12,893,000	5.00	IPO	1997	13.00	167,609,000	26,000,000	999,206	31/12/1996
19.ARM	23,000,000	5.00	IPO	1997	12.25	281,750,000	30,000,000	1,045,384	31/12/1996
20.EABL	28,080,675	10.00	RI	1997	53.00	1,488,275,775	63,735,000	12,523,219	30/06/1996
21.KCB	28,000,000	10.00	OFS	1998	65.00	1,820,000,000	105,135,338	73,535,223	31/12/1997
22.ICDC	9,419,476	5.00	RI	1998	30.00	282,584,280	14,480,000	514,481	30/06/1997
23.HFCK	30,000,000	5.00	OFS	1999	14.00	420,000,000	43,561,454	12,840,829	31/12/1998
24.A. Lakes	4,000,000	5.00	IPO	2000	94.00	376,000,000	18,000,000	3,581,846	30/09/1999
25.Pan Africa Ins	24,000,000	5.00	RI	2000	21.50	516,000,000	35,586,000	3,196,123	30/6/99
26.Unga Group	6,095,710	5.00	RI	2000	17.00	103,627,070	12,000,000	5,195,565	30/06/1999
27.Mumias	300,000,000	5.00	OFS	2001	6.25	1,124,231,350	155,500,000	8,242,361	30/6/01
28.ICDC	13,958,709	5.00	OFS	2001	37.00	331,000,000	20,000,000	2,395,920	30/6/01
29.Standard News	76,871,154	5.00	RI	2001	5.85	306,080,775	13,000,000	630,663	30/6/01

30.Kenya Orchads	7,200,000	5.00	RI	2001	5.00	36,000,000	1,124,000	92,356	31/12/2000
31.Total Kenya	70,030,000	5.00	RI	2001	17.95	1,275,086,508	19,101,350	9,392,338	31/8/01
32.Unga Grp (reorg)	10,134,656	5.00	SWAP	2002	5.00	50,673,280	4,351,050	3,837,229	31/12/01
33.Express Kenya	38,400,000	5.00	RI	2003	6.50	249,600,000	11,460,000	708,303	31/8/03
34.African Lakes	499,149,510	5.00	RI	2003	0.25	115,413,350	7,283,430	3,456,508	30/06/2002
35.KCB	50,000,000	10.00	RI	2004	49.00	2,450,000,000	98,924,974	60,385,257	31/12/03
36. Uchumi	171,428,571	5	RI	2005	7.00	1,200,000,000	55,300,000	3,265,097	30/06/2004
37. CFC Bank	12,000,000	5	RI	2005	65.00	780,000,000	18,682,500	29,815,562	31/12/2004

APPENDIX 2

A) DATA RELATED TO EQUITY ISSUES BY COMPANIES LISTED ON THE NSE BETWEEN 1990 AND 2005

Name of issuer	Type of issue	Shares issued (No.)	Proceeds (Kshs.)	Cost of raising Capital(Kshs.)	Total assets (Kshs'000)	Cost to proceeds %	cost to total assets %	cost to shares
1.KCB	AI	9,000,000	297,000,000	16,000,000	15,435,467	5.39	0.10	1.78
2.Trade Bank	IPO	16,000,000	136,000,000	56,200,000	1,472,826	41.32	3.82	3.51
3.KFB	AI	3,261,970	40,800,000	10,836,000	1,123,778	26.56	0.96	3.32
4.HFCK	IPO	18,000,000	126,000,000	16,291,923	3,566,522	12.93	0 46	0.91
5.Crown Berger	IPO	8,630,000	138,080,000	13,000,000	240,328	9.41	5.41	1.51
6.Uchumi	IPO	16,000,000	232,000,000	22,000,000	581,356	9.48	3.78	1.38
7.EAO(BOC)	IPO	1,600,000	42,400,000	5,652,400	538,453	13.33	1.05	3.53
8.Marshalls ®	RI	1,827,700	21,475,475	124,960	1,202,600	0.58	-	0.07
9.NIC	IPO	17,929,286	93,322,872	40,000,000	3,235,742	42.86	1.24	2.23
10.Firestone	IPO	40,000,000	1,420,000,000	125,000,000	1,444,467	8.80	8.65	3.13
11.NBK	IPO	40,000,000	400,000,000	45,000,000	12,824,654	11.25	0.35	1.13
12.KFB	AI	2,719,707	44,875,000	10,836,000	1,741,589	24.15	0.62	3.98
13.Rea Vipingo	IPO	8,000,000	84,000,000	7,597,000	715,527	9.04	1.06	0.95
14.KQ	IPO	235,000,000	2,643,750,000	132,187,500	6,690,375	5.00	1.98	0.56
15.E.A Portland	RI	72,000,000	1,008,000,000	38,000,000	4,556,960	3.77	0.83	0.53
16.NBK	AI	40,000,000	600,000,000	54,000,000	18,256,865	9.00	0.30	1.35
17.KCB	AI	11,880,000	594,000,000	69,722,000	57,930,778	11.74	0.12	5.87
18.TPS Serena	IPO	12,893,000	167,609,000	26,000,000	999,206	15.51	2.60	2.02
19.ARM	IPO	23,000,000	281,750,000	30,000,000	1,045,384	10.65	2.87	1.30
20.EABL	RI	28,080,675	1,488,275,775	63,735,000	12,523,219	4.28	0.51	2.27
21.KCB	AI	28,000,000	1,820,000,000	105,135,338	73,535,223	5.78	0.14	3.75
22.ICDC	RI	9,419,476	282,584,280	14,480,000	514,481	5.12	2.81	1.54
23.HFCK	AI	30,000,000	420,000,000	43,561,454	12,840,829	10.37	0.34	1.45
24.A. Lakes	IPO	4,000,000	376,000,000	18,000,000	3,581,846	4.79	0.50	4.50
25.Pan Africa Ins	RI	24,000,000	516,000,000	35,586,000	3,196,123	6.90	1.11	1.48
26.Unga Group	RI	6,095,710	103,627,070	12,000,000	5,195,565	11.58	0.23	1.97
27.Mumias	IPO	300,000,000	1,124,231,350	155,500,000	8,242,361	13.83	1.89	0.52
28.ICDC	AI	13,958,709	331,000,000	20,000,000	2,395,920	6.04	0.83	1.43
29.Standard News	RI	76,871,154	306,080,775	13,000,000	630,663	4.25	2.06	0.17
30.Kenya Orchads	RI	7,200,000	36,000,000	1,124,000	92,356	3.12	1.22	0.16

31.Total Kenya	RI	70,030,000	1,275,086,508	19,101,350	9,392,338	1.50	0.20	0.27
32.Unga Grp (reorg)	AI	10,134,656	50,673,280	4,351,050	3,837,229	8.59	0.11	0.43
33.Express Kenya	RI	38,400,000	249,600,000	11,460,000	708,303	4.59	1.62	0.30
34.African Lakes	RI	499,149,510	115,413,350	7,283,430	3,456,508	6.31	47.46	0.00
35.KCB	RI	50,000,000	2,450,000,000	98,924,974	60,385,257	4.04	0.16	1.98
36 Uchumi	RI	171,428,571	1,200,000,000	55,300,000	3,265,097	4.61	1.69	0.32
37. CFC Bank	RI	12,000,000	780,000,000	18,682,500	29,815,562	2.40	0.06	1.56
		1,956,510,124	21,295,634,735	1,415,672,879	367,211,757	**378.87**	**99.17**	**63.14**

Observations

Total cost	average	10.24
Total assets	average	9,924,642.08
Shares issued	average	52,878,652.00
Total proceeds	average	575,557,695.54

IPO -Initial Public Offer

RI - Rights Issue

AI - Additional direct cash issue to the public

APPENDIX 2

B) IPOs Vs SEOs

IPOs

Name of issuer	Type of issue	Shares issued (No.)	Proceeds (Kshs.)	Cost of raising Capital(Kshs.)	Total assets (Kshs'000)	Cost to proceeds %	cost to total assets %	cost to shares
1 Trade Bank	IPO	16,000,000	136,000,000	56,200,000	1,472,826	41.32	3.82	3.51
2.HFCK	IPO	18,000,000	126,000,000	16,291,923	3,566,522	12.93	0.46	0.91
3.Crown Berger	IPO	8,630,000	138,080,000	13,000,000	240,328	9.41	5.41	1.51
4 Uchumi	IPO	16,000,000	232,000,000	22,000,000	581,356	9.48	3.78	1.38
5.EAO(BOC)	IPO	1,600,000	42,400,000	5,652,400	538,453	13.33	1.05	3.53
6.NIC	IPO	17,929,286	93,322,872	40,000,000	3,235,742	42.86	1.24	2.23
7.Firestone	IPO	40,000,000	1,420,000,000	125,000,000	1,444,467	8.80	8.65	3.13
8.NBK	IPO	40,000,000	400,000,000	45,000,000	12,824,654	11.25	0.35	1.13
9.Rea Vipingo	IPO	8,000,000	84,000,000	7,597,000	715,527	9.04	1.06	0.95
10.KQ	IPO	235,000,000	2,643,750,000	132,187,500	6,690,375	5.00	1.98	0.56
11.TPS Serena	IPO	12,893,000	167,609,000	26,000,000	999,206	15.51	2.60	2.02
12.ARM	IPO	23,000,000	281,750,000	30,000,000	1,045,384	10.65	2.87	1.30
13.A. Lakes	IPO	4,000,000	376,000,000	18,000,000	3,581,846	4.79	0.50	4.50
14.Mumias	IPO	300,000,000	1,124,231,350	155,500,000	8,242,361	13.83	1.89	0.52
		741,052,286	**7,265,143,222**	**692,428,823**	**45,179,047**	**208.22**	**35.66**	**27.16**
SEOs								
Additional issues								
15.KCB	AI	9,000,000	297,000,000	16,000,000	15,435,467	5.39	0.10	1.78
16.KFB	AI	3,261,970	40,800,000	10,836,000	1,123,778	26.56	0.96	3.32
17.KFB	AI	2,719,707	44,875,000	10,836,000	1,741,589	24.15	0.62	3.98
18.NBK	AI	40,000,000	600,000,000	54,000,000	18,256,865	9.00	0.30	1.35
19.KCB	AI	11,880,000	594,000,000	69,722,000	57,930,778	11.74	0.12	5.87
20.KCB	AI	28,000,000	1,820,000,000	105,135,338	73,535,223	5.78	0.14	3.75
21.HFCK	AI	30,000,000	420,000,000	43,561,454	12,840,829	10.37	0.34	1.45
22.ICDC	AI	13,958,709	331,000,000	20,000,000	2,395,920	6.04	0.83	1.43
23.Unga Grp (reorg)	AI	10,134,656	50,673,280	4,351,050	3,837,229	8.59	0.11	0.43
		148,955,042	**4,198,348,280**	**334,441,842**	**187,097,678**	**107.61**	**3.54**	**23.37**
Rights Issues								
24.Marshalls ®	RI	1,827,700	21,475,475	124,960	1,202,600	0.58	-	0.07
25.E.A Portland	RI	72,000,000	1,008,000,000	38,000,000	4,556,960	3.77	0.83	0.53

26.EABL	RI	28,080,675	1,488,275,775	63,735,000	12,523,219	4.28	0.51	2.27
27.ICDC	RI	9,419,476	282,584,280	14,480,000	514,481	5.12	2.81	1.54
28.Pan Africa Ins	RI	24,000,000	516,000,000	35,586,000	3,196,123	6.90	1.11	1.48
29.Unga Group	RI	6,095,710	103,627,070	12,000,000	5,195,565	11.58	0.23	1.97
30.Standard News	RI	76,871,154	306,080,775	13,000,000	630,663	4.25	2.06	0.17
31.Kenya Orchads	RI	7,200,000	36,000,000	1,124,000	92,356	3.12	1.22	0.16
32.Total Kenya	RI	70,030,000	1,275,086,508	19,101,350	9,392,338	1.50	0.20	0.27
33.Express Kenya	RI	38,400,000	249,600,000	11,460,000	708,303	4.59	1.62	0.30
34 African Lakes	RI	499,149,510	115,413,350	7,283,430	3,456,508	6.31	47.46	0.00
35.KCB	RI	50,000,000	2,450,000,000	98,924,974	60,385,257	4.04	0.16	1.98
36. Uchumi	RI	171,428,571	1,200,000,000	55,300,000	3,265,097	4.61	1.69	0.32
37. CFC Bank	RI	12,000,000	780,000,000	18,682,500	29,815,562	2.40	0.06	1.56
		1,066,502,796	**9,832,143,233**	**388,802,214**	**134,935,032**	**63.05**	**59.98**	**12.61**
		1,956,510,124	**21,295,634,735**	**1,415,672,879**	**367,211,757**	**378.87**	**99.17**	**63.14**

Observations

		IPOs	AI	RI	Total
Total cost	average	14.87	11.96	4.50	**10.44**
Total assets	average	3,227,074.79	20,788,630.89	9,638,217	**11,217,974**
Shares issued	average	52,932,306.14	16,550,560.22	76,178,771	**48,553,879**
Total proceeds	average	518,938,801.57	466,483,142.22	702,295,945	**562,572,630**

IPO -Initial Public Offer

RI - Rights Issue

AI - Additional direct cash issue to the public

APPENDIX 2
C) SECTORIAL

Name of issuer	Sector	Shares issued (No.)	Proceeds (Kshs.)	Cost of raising Capital(Kshs)	Total assets (Kshs'000)	Cost to proceeds %	cost to total assets %	cost to shares
Agricultural								
1 Rea Vipingo	IPO	8,000,000	84,000,000	7,597,000	715,527	9.04	1.06	0.95
Commercial and Services								
2.Uchumi	IPO	16,000,000	232,000,000	22,000,000	581,356	9.48	3.78	1.38
3.Marshalls ®	RI	1,827,700	21,475,475	124,960	1,202,600	0.58	-	0.07
4 KQ	IPO	235,000,000	2,643,750,000	132,187,500	6,690,375	5.00	1.98	0.56
5 TPS Serena	IPO	12,893,000	167,609,000	26,000,000	999,206	15.51	2.60	2.02
6.Standard News	RI	76,871,154	306,080,775	13,000,000	630,663	4.25	2.06	0.17
7 Express Kenya	RI	38,400,000	249,600,000	11,460,000	708,303	4.59	1.62	0.30
8 Uchumi	RI	171,428,571	1,200,000,000	55,300,000	3,265,097	4.61	1.69	0.32
		552,420,425	**4,820,515,250**	**260,072,460**	**14,077,600**	**44.02**	**13.74**	**4.81**
Financials and Investments								
9 KCB	AI	9,000,000	297,000,000	16,000,000	15,435,467	5.39	0.10	1.78
10 Trade Bank	IPO	16,000,000	136,000,000	56,200,000	1,472,826	41.32	3.82	3.51
11 KFB	AI	3,261,970	40,800,000	10,836,000	1,123,778	26.56	0.96	3.32
12 HFCK	IPO	18,000,000	126,000,000	16,291,923	3,566,522	12.93	0.46	0.91
13 NIC	IPO	17,929,286	93,322,872	40,000,000	3,235,742	42.86	1.24	2.23
14 NBK	IPO	40,000,000	400,000,000	45,000,000	12,824,654	11.25	0.35	1.13
15 KFB	AI	2,719,707	44,875,000	10,836,000	1,741,589	24.15	0.62	3.98
16 NBK	AI	40,000,000	600,000,000	54,000,000	18,256,865	9.00	0.30	1.35
17 KCB	AI	11,880,000	594,000,000	69,722,000	57,930,778	11.74	0.12	5.87
18 KCB	AI	28,000,000	1,820,000,000	105,135,338	73,535,223	5.78	0.14	3.75
19 ICDC	RI	9,419,476	282,584,280	14,480,000	514,481	5.12	2.81	1.54
20 HFCK	AI	30,000,000	420,000,000	43,561,454	12,840,829	10.37	0.34	1.45
21 A. Lakes	IPO	4,000,000	376,000,000	18,000,000	3,581,846	4.79	0.50	4.50
22 Pan Africa Ins	RI	24,000,000	516,000,000	35,586,000	3,196,123	6.90	1.11	1.48
23 ICDC	AI	13,958,709	331,000,000	20,000,000	2,395,920	6.04	0.83	1.43

24.African Lakes	RI	499,149,510	115,413,350	7,283,430	3,456,508	6.31	47.46	0.00
25.KCB	RI	50,000,000	2,450,000,000	98,924,974	60,385,257	4.04	0.16	1.98
26. CFC Bank	RI	12,000,000	780,000,000	18,682,500	29,815,562	2.40	0.06	1.56
		829,318,658	**9,422,995,502**	**680,539,619**	**305,309,970**	**236.94**	**61.40**	**41.77**
Industrial and Allied								
27.Crown Berger	IPO	8,630,000	138,080,000	13,000,000	240,328	9.41	5.41	1.51
28.EAO(BOC)	IPO	1,600,000	42,400,000	5,652,400	538,453	13.33	1.05	3.53
29 Firestone	IPO	40,000,000	1,420,000,000	125,000,000	1,444,467	8.80	8.65	3.13
30.E.A Portland	RI	72,000,000	1,008,000,000	38,000,000	4,556,960	3.77	0.83	0.53
31.ARM	IPO	23,000,000	281,750,000	30,000,000	1,045,384	10.65	2.87	1.30
32.EABL	RI	28,080,675	1,488,275,775	63,735,000	12,523,219	4.28	0.51	2.27
33 Unga Group	RI	6,095,710	103,627,070	12,000,000	5,195,565	11.58	0.23	1.97
34.Mumias	IPO	300,000,000	1,124,231,350	155,500,000	8,242,361	13.83	1.89	0.52
35.Kenya Orchads	RI	7,200,000	36,000,000	1,124,000	92,356	3.12	1.22	0.16
36 Total Kenya	RI	70,030,000	1,275,086,508	19,101,350	9,392,338	1.50	0.20	0.27
37 Unga Grp (reorg)	AI	10,134,656	50,673,280	4,351,050	3,837,229	8.59	0.11	0.43
		566,771,041	**6,968,123,983**	**467,463,800**	**47,108,660**	**88.87**	**22.98**	**15.61**
		1,956,510,124	**21,295,634,735**	**1,415,672,879**	**367,211,757**	**378.87**	**99.17**	**63.14**

Observations

		A	C	F	I
Total cost	average	9.04	6.29	13.16	8.08
Total assets	average	715,527.00	2,011,085.71	16,961,665	4,282,605
Shares issued	average	8,000,000.00	78,917,203.57	46,073,259	51,524,640
Total proceeds	average	84,000,000.00	688,645,035.71	523,499,750	633,465,817

F- Financial & Investment sector

I - Industrial & Allied sector

C- Commercial & Services sector

A- Agricultural sector

APPENDIX 2

D) BANKS Vs NON-BANKS

Name of issuer	Sector	Shares issued (No.)	Proceeds (Kshs.)	Cost of raising Capital(Kshs.)	Total assets (Kshs'000)	Cost to proceeds %	cost to total assets %	cost to shares
Banks								
1.KCB	AI	9,000,000	297,000,000	16,000,000	15,435,467	5.39	0.10	1.78
2.Trade Bank	IPO	16,000,000	136,000,000	56,200,000	1,472,826	41.32	3.82	3.51
3.KFB	AI	3,261,970	40,800,000	10,836,000	1,123,778	26.56	0.96	3.32
4 HFCK	IPO	18,000,000	126,000,000	16,291,923	3,566,522	12.93	0.46	0.91
5 NIC	IPO	17,929,286	93,322,872	40,000,000	3,235,742	42.86	1.24	2.23
6 NBK	IPO	40,000,000	400,000,000	45,000,000	12,824,654	11.25	0.35	1.13
7 KFB	AI	2,719,707	44,875,000	10,836,000	1,741,589	24.15	0.62	3.98
8 NBK	AI	40,000,000	600,000,000	54,000,000	18,256,865	9.00	0.30	1.35
9 KCB	AI	11,880,000	594,000,000	69,722,000	57,930,778	11.74	0.12	5.87
10 KCB	AI	28,000,000	1,820,000,000	105,135,338	73,535,223	5.78	0.14	3.75
11 HFCK	AI	30,000,000	420,000,000	43,561,454	12,840,829	10.37	0.34	1.45
12.KCB	RI	50,000,000	2,450,000,000	98,924,974	60,385,257	4.04	0.16	1.98
13 CFC Bank	RI	12,000,000	780,000,000	18,682,500	29,815,562	2.40	0.06	1.56
		278,790,963	**7,801,997,872**	**585,190,189**	**292,165,092**	**207.78**	**8.67**	**32.82**
NON-BANKS								
14 Rea Vipingo	IPO	8,000,000	84,000,000	7,597,000	715,527	9.04	1.06	0.95
15 Uchumi	IPO	16,000,000	232,000,000	22,000,000	581,356	9.48	3.78	1.38
16 Marshalls @	RI	1,827,700	21,475,475	124,960	1,202,600	0.58	-	0.07
17 KQ	IPO	235,000,000	2,643,750,000	132,187,500	6,690,375	5.00	1.98	0.56
18 TPS Serena	IPO	12,893,000	167,609,000	26,000,000	999,206	15.51	2.60	2.02
19 Standard News	RI	76,871,154	306,080,775	13,000,000	630,663	4.25	2.06	0.17
20 Express Kenya	RI	38,400,000	249,600,000	11,460,000	708,303	4.59	1.62	0.30
21 Uchumi	RI	171,428,571	1,200,000,000	55,300,000	3,265,097	4.61	1.69	0.32
22 ICDC	RI	9,419,476	282,584,280	14,480,000	514,481	5.12	2.81	1.54
23 A Lakes	IPO	4,000,000	376,000,000	18,000,000	3,581,846	4.79	0.50	4.50
24 Pan Africa Ins	RI	24,000,000	516,000,000	35,586,000	3,196,123	6.90	1.11	1.48
25 ICDC	AI	13,958,709	331,000,000	20,000,000	2,395,920	6.04	0.83	1.43
26 African Lakes	RI	499,149,510	115,413,350	7,283,430	3,456,508	6.31	47.46	0.00
27 Crown Berger	IPO	8,630,000	138,080,000	13,000,000	240,328	9.41	5.41	1.51

28.EAO(BOC)	IPO	1,600,000	42,400,000	5,652,400	538,453	13.33	1.05	3.53
29.Firestone	IPO	40,000,000	1,420,000,000	125,000,000	1,444,467	8.80	8.65	3.13
30.E.A Portland	RI	72,000,000	1,008,000,000	38,000,000	4,556,960	3.77	0.83	0.53
31.ARM	IPO	23,000,000	281,750,000	30,000,000	1,045,384	10.65	2.87	1.30
32.EABL	RI	28,080,675	1,488,275,775	63,735,000	12,523,219	4.28	0.51	2.27
33.Unga Group	RI	6,095,710	103,627,070	12,000,000	5,195,565	11.58	0.23	1.97
34.Mumias	IPO	300,000,000	1,124,231,350	155,500,000	8,242,361	13.83	1.89	0.52
35.Kenya Orchads	RI	7,200,000	36,000,000	1,124,000	92,356	3.12	1.22	0.16
36.Total Kenya	RI	70,030,000	1,275,086,508	19,101,350	9,392,338	1.50	0.20	0.27
37.Unga Grp (reorg)	AI	10,134,656	50,673,280	4,351,050	3,837,229	8.59	0.11	0.43
		1,677,719,161	**13,493,636,863**	**830,482,690**	**75,046,665**	**171.10**	**90.50**	**30.33**
		1,956,510,124	**21,295,634,735**	**1,415,672,879**	**367,211,757**	**378.87**	**99.17**	**63.14**

		B	NB	Overall
Total cost	average	15.98	7.13	10.23983295
Total assets	average	22,474,237.85	3,126,944.38	9,924,642.08
Shares issued	average	21,445,458.69	69,904,965.04	52,878,652.00
Total proceeds	average	600,153,682.46	562,234,869.29	575,557,695.54

B- Banks
NB- Non Banks

ation of APPENDIX 3

RELATING TO COST AS A % OF PROCEEDSAND TOTAL ASSETS

GPSQRf	c=Cf	ta=TAf	
920,000	401 24	65,136 30	
1,800,000	221 55	122,040 16	
3,000,000	248 80	16,084 42	
5,880,000	207 84	23,360 02	
3,240,000	105 14	73,535 22	
9,680,000	231 11	67,075 63	
24,520,000	**1,415.67**	**367,211.76**	

gpsqr+ta+F

APPENDIX 4

Table : OLS-Estimation Results for Different Specifications of Equatons

Definations: C is Total direct floatation costs in percentage of gross proceeds , a,b and d are coefficients, GP is Gross proceeds(in Kshs.), TA is Total Assets(in Kshs) and F is Fixed proceed. N Is the number of observations.

	Dependant variable: Total Floatation Costs (C)			
Model		1	2	3
F-Constant		9.966497	20.579147	25.079659
a-GP		0.064566	0.083362	0.083085
b-GP^2		n/a	(0.000019)	(0.000019)
d-TA		n/a	n/a	(0.000050)
	N	6	6	6
	Adj. R^2	0.5388	0.8154	0.7240

N being the number of bands

Source: Research data

Model 1

C=aGP+ F

Results: C=9.966497 + 0 064566GP
(64.0) (2.30E-02)

Model 2

C= aGP+bGP^2 +F

Results: C=20.579147 + 0.083362GP - 0.000019GP^2
(61.566) (0.018) (0.000)

Model 3

C= aGP+bGP^2 + dTA + F

Results: C= 25.079659 + 0.083085GP - 0.000050TA - 0.000019GP^2
(92.961) (0.022) (0.000) (0.001)

APPENDIX 5

DATA ON RANGE BANDS OF KSHS. 400 MILLION WIDTH

Proceeds (Kshs.)	Cost of ra Capital(K	Gross proceeds (Kshs)	Cost of Issue (Kshs.)	Total Assets (Kshs'000)	Cost/Gross Proceeds(%)	Cost/Total Assets(%)
0-400m Band						
1.KCB	AI	297,000,000	16,000,000	15,435,467	5.39	0.10
2.Trade Bank	IPO	136,000,000	56,200,000	1,472,826	41.32	3.82
3.KFB	AI	40,800,000	10,836,000	1,123,778	26.56	0.96
4.HFCK	IPO	126,000,000	16,291,923	3,566,522	12.93	0.46
5.Crown Berger	IPO	138,080,000	13,000,000	240,328	9.41	5.41
6.Uchumi	IPO	232,000,000	22,000,000	581,356	9.48	3.78
7.EAO(BOC)	IPO	42,400,000	5,652,400	538,453	13.33	1.05
8.Marshalls ®	RI	93,322,872	40,000,000	3,235,742	42.86	1.24
9.NIC	IPO	21,475,475	124,960	1,202,600	0.58	0.01
10.African Lakes	RI	115,413,350	7,283,430	3,456,508	6.31	0.21
11.NBK	IPO	400,000,000	45,000,000	12,824,654	11.25	0.35
12.KFB	AI	44,875,000	10,836,000	1,741,589	24.15	0.62
13.Rea Vipingo	IPO	84,000,000	7,597,000	715,527	9.04	1.06
14.TPS Serena	IPO	167,609,000	26,000,000	999,206	15.51	2.60
15.ARM	IPO	281,750,000	30,000,000	1,045,384	10.65	2.87
16.ICDC	RI	282,584,280	14,480,000	514,481	5.12	2.81
17.A. Lakes	IPO	376,000,000	18,000,000	3,581,846	4.79	0.50
18.Unga Group	RI	103,627,070	12,000,000	5,195,565	11.58	0.23
19.ICDC	AI	331,000,000	20,000,000	2,395,920	6.04	0.83
20.Standard News	RI	306,080,775	13,000,000	630,663	4.25	2.06
21.Kenya Orchads	RI	36,000,000	1,124,000	92,356	3.12	1.22
22.Unga Grp (reorg)	AI	50,673,280	4,351,050	3,837,229	8.59	0.11
23.Express Kenya	RI	249,600,000	11,460,000	708,303	4.59	1.62
		3,956,291,102	**401,236,763**	**65,136,303**	**286.87**	**33.94**
401-800m Band						
24.HFCK	AI	420,000,000	43,561,454	12,840,829	10.37	0.34
25. CFC Bank	RI	780,000,000	18,682,500	29,815,562	2.40	0.06
26.NBK	AI	600,000,000	54,000,000	18,256,865	9.00	0.30
27.KCB	AI	594,000,000	69,722,000	57,930,778	11.74	0.12
28.Pan Africa Ins	RI	516,000,000	35,586,000	3,196,123	6.90	1.11
		2,910,000,000	**221,551,954**	**122,040,157**	**40.40**	**1.93**

801-1,200m Band						
29. Uchumi	RI	1,200,000,000	55,300,000	3,265,097	4.61	1.69
30.E.A Portland	RI	1,008,000,000	38,000,000	4,556,960	3.77	0.83
31.Mumias	IPO	1,124,231,350	155,500,000	8,242,361	13.83	1.89
		3,332,231,350	**248,800,000**	**16,064,418**	**22.21**	**4.41**
1,201-1,600m Band						
32.Firestone	IPO	1,420,000,000	125,000,000	1,444,467	8.80	8.65
33.Total Kenya	RI	1,275,086,508	19,101,350	9,392,338	1.50	0.20
34.EABL	RI	1,488,275,775	63,735,000	12,523,219	4.28	0.51
		4,183,362,283	**207,836,350**	**23,360,024**	**14.58**	**9.37**

1,601-2,000m Band

35.KCB	AI	1,820,000,000	105,135,338	73,535,223	**5.78**	**0.14**

2,001m and above

36.KCB	RI	2,450,000,000	98,924,974	60,385,257	4.04	0.16
37.KQ	IPO	2,643,750,000	132,187,500	6,690,375	5.00	1.98
		5,093,750,000	**231,112,474**	**67,075,632**	**9.04**	**2.14**