A STUDY OF THE UNDERLYING IMPEDIMENTS TO ISSUANCE OF CORPORATE BONDS THROUGH NAIROBI STOCK EXCHANGE

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DECLARATION

I declare that, this project proposal is my own original work and has not been presented for award of any degree in any university that I know of.

Signed: ______________________ Date 12/11/09

This research has been submitted for examination with my approval as the University:

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ABSTRACT

Corporate bonds are debt securities issued by private and public corporations. Companies issue corporate bonds to raise funds for a variety of purposes, such as building a new plant, purchasing equipment, or growing the business. A purchaser or "holder" of a corporate bond is a lender of funds to the "issuer," the company that issued the bond. In exchange, the company promises to pay back the face value of the bond, also known as "principal," on a specified maturity date. Until that date, the corporation usually pays interest at a stated rate, generally semiannually. This study was designed to determine the underlying impediments to the issuance of corporate bonds through the Nairobi Stock Exchange market.

A descriptive survey design was chosen to carry out the study. A purposive census was carried out on all the listed firms at the NSE with the intention of obtaining feedback from the entire target population. The data was collected using a set of open and closed questions.

The study recommends the major issues of focus to the Capital Markets in Kenya if the bond market is to grow. Such issues include market benchmarks and corporate governance requirements among others.

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1.0 INTRODUCTION

1.1 Background to the study

Corporate bonds are debt securities issued by private and public corporations (Roldos et al, 2004). Companies issue corporate bonds to raise funds for a variety of purposes, such as building a new plant, purchasing equipment, or growing the business. A purchaser or "holder" of a corporate bond is a lender of funds to the "issuer," the company that issued the bond. In exchange, the company promises to pay back the face value of the bond, also known as "principal," on a specified maturity date. Until that date, the Company usually pays interest at a stated rate, generally semiannually. While a corporate bond gives the investor creditor rights in the company, the holder does not have ownership interest in the issuing company unlike a shareholder of a company's stock (Reszat, 2003).

The term 'corporate bond' is usually applied to longer-term debt instruments, generally with a maturity date falling at least a year after the issue date. (The term "commercial paper" is sometimes used for instruments with a shorter maturity). Sometimes, the term "corporate bonds" is also used to include all bonds except those issued by governments in their own currencies. Strictly speaking, however, it only applies to those issued by Companies. However, despite being listed on exchanges, the vast majority of trading volume in corporate bonds in most developed markets takes place in decentralized, dealer-based, over-the-counter markets (Roldos, 2004).

Some corporate bonds have an embedded call option that allows the issuer to redeem the debt before its maturity date. Other bonds, known as convertible bonds, allow investors to convert the bond into equity. There are a variety of bond types that can be issued which includes: convertible bonds, zero-coupon bonds, floating rate bonds, variable /adjustable bonds, callable bonds, step up bonds, and step down bonds. However underlying constraints restrict growth of corporate bond markets yet there has been little analysis of these impediments (Krishnan, 2000).

Compared to government bonds, corporate bonds generally have a higher risk of default. This risk depends, of course, upon the particular corporation issuing the bond, the current market conditions and governments to which the bond issuer is being compared and the rating of the company. Corporate bond holders are compensated for this risk by receiving a higher yield than government bonds.

Consequently, this risk can be quantified using spread analysis, which seeks to determine the difference in yield between a given corporate bond and a risk-free treasury bond of the same maturity. Common statistics used include Z- Spread and Option-Adjusted Spread (OAS). The new issue concession is used when valuing soon to be issued corporate bond from the same issuer for about the same maturity.

The bond market started in 1996 with the issue of a corporate bond by East African Development Bank followed by the listing of Kenya Treasury bonds. For both, the interest rate was pegged to the 91 day Treasury bill rates. Up to date, there are only 10 other corporate bonds listed among them Shelter Afrique, Mabati Rolling Mills and Barclays. The Kenyan bond market is characterized by government bonds accounting for more than 95% of the market. The bond market operates within a certain legal framework. The exchange rules had its own rules and regulations, including those for membership, listing, trading and settlement. In addition, there is a multiplicity of regulators and regulations at play in the Kenyan bond market. They include the government, Capital Market Authority and Nairobi Stock Exchange.

Capital Markets Authority (CMA) enacts policies that affect the development of the bond market. CMA gives non-coordinated and sometimes conflicting policies that often lead to poor performance of the market. CMA ensures investor protection through supervision of the securities market and enforces government regulation. (http://www.nse.co.ke/newsite/pdf/2008). The government has overall responsibility to institute macro economic measures and a strong legal framework that create an enabling environment. This is done through the treasury (Ministry of finance).

The NSE on the other hand provides a market place for secondary trading activity and approves the listing of new bonds (http://www.nse.co.ke/newsite/pdf/2008). This market was started in the 1920's by the British as an informal market for Europeans only. In 1854, the market was formalized through incorporation into a company as an overseas stock exchange while Kenya was still a British colony with permission of the London Stock Exchange. The NSE is a member of the African Stock Exchanges Association. In 1963, Africans were allowed to join and trade in the market. For many years the market operated through the telephone with a weekly meeting at The Stanley Hotel. In 1991, this market moved to IPS building and was opened to the public. In 1994, the market moved to its current location, on the 1st Floor of the Nation Centre, along Kimathi Street; with the introduction of the Central Depository and Settlement Corporation (CDSC) where investors were then required to open share and bond accounts in electronic accounts similar to their bank accounts.

Nairobi Stock Exchange is Africa's fourth largest stock exchange in terms of trading volumes, and fifth in terms of market capitalization as a percentage of GDP (Gross Domestic Product). The exchange works in cooperation with the Uganda Securities Exchange and Dar es Salaam Stock Exchange, including the cross listing of various equities. The exchange has pre market sessions from 09:00am to 09:30 am and normal trading sessions from 09:30 am to 03.00pm on all days of the week except Saturdays and Sundays and Holidays declared by the Exchange in advance. (http://www.nse.co.ke/newsite/pdf/2008).

Trading is done through Electronic Trading System (ETS) which was commissioned in 2006. A wide Area Network (WAN) platform was implemented in 2007 and this eradicated the need for brokers to send their staff (dealers) to the trading floor to conduct business. Trading is now mainly conducted from the broker's offices through the WAN. However, brokers under certain circumstances can still conduct trading from the floor of the NSE. Two indices are popularly used to measure performance. The NSE 20 Share Index has been in use since 1964 and measures the performance of 20 blue-Chip companies with strong fundamentals and which have consistently returned positive financial results. (http://www.nse.co.ke/newsite/pdf/2008).

In 2008, the Nairobi Stock Exchange All Share Index (NASI) was introduced as an alternative index. Its measure is an overall indicator of market performance. The index incorporates all the traded shares of the day. Its attention is therefore on the overall market capitalization rather than the price movements of select counters.

There is however a third index; the AIG 27 Index that compares price movements of 27 companies identified as relatively stable. The rationale behind the index compares to that of the NSE share Index. But whereas the AIG is primarily defined by the AIG company (a financial service company that is part of the AIG Group), the 20- Share Index is from the NSE itself. (http://www.nse.co.ke/newsite/pdf/2008).

Investment banks give advice to companies that are planning to float bonds in the Exchange. They give advice on several aspects like funding strategy, regulatory and legislative issues, obtaining credit rating, migration of best practices e.g. system and procedures for settlement, clearing, custodial services and reporting. Investment banks also manages the debt issue to ensure overall success of the transaction (structuring, underwriting and obtaining credit enhancements where required). They also assist the issuer in producing the information memorandum, legal documentation and obtaining regulatory approvals from the capital markets authority and the stock exchange, education of investors, marketing and placement of bonds (distribution).

Investment banks also make markets in the securities to support the issue overtime and extend their services to develop interest rate and cross currency derivative applications. Investment bans have in-depth expertise in each respective local debt market environment and also excellent distribution capabilities (onshore and offshore) and access to global network of experienced Debt Capital Markets (DCM) professionals, access to reach teams offering economics and commentaries on markets, industries, currencies, interest rate and settlement options.

1.2 Statement of the problem

The main sources for financing capital expenditure in companies are bank loans and issuance of more equity. The question, which stands begging, is whether there is a cheaper source of funds other than these, which have been used over and over again. The main objective is therefore to examine impediments to issuance of corporate bonds as an instrument of medium and long term debt financing in Kenya through the Nairobi Stock Exchange (NSE).

Issuance of corporate bonds as a possible cheaper source of medium and long term debt financing has not been significantly exploited in Kenya. Though corporate bonds market is largely underdeveloped given the "third world" economic tendencies for Kenya, this study hopes to specifically establish if market benchmarks, infrastructure, regulation, policy, local and foreign investor base coupled with corporate governance and transparency could be inhibitors to issuance of corporate bonds at Nairobi Stock Exchange.

On the NSE, there are currently 68 government bonds issued by the Government of Kenya and 10 corporate bonds issued by 7 companies. Of the corporate bonds, there is none whose issued value is more than Kshs 2 billion. The combined value of all listed government bonds is approximately Kshs 350 billion, while that of the listed corporate bonds is approximately Kshs 10 billion, bringing the NSE debt market's capitalization to about Kshs 360 billion.(http://www.nse.co.ke/newsite/pdf/2008)

The maturities of the government bonds range between one and twenty years while those of the corporate bonds range between two and eight years. All the listed government bonds have fixed coupon rates ranging between 6% and 14%. (http://www.nse.co.ke/newsite/pdf/2008)

1.3 General Objective

This study set out t establish the impediments to issuance of corporate bonds as an instrument of medium and long term debt financing in Kenya through the Nairobi Stock Exchange (NSE).

1.4 Importance of the study

This study is important to the following;

Companies

The study enlightens management teams of Companies on bottlenecks to cheaper financing options through issuance of corporate bond at NSE that lead to over dependence on traditional bank loans and overdrafts. Cheaper business financing opportunities through issuance of medium and long term corporate bonds would help in containment of cost of debt and improve shareholder value.

Regulators (CMA and NSE)

The study highlights impediments experienced by issuers of corporate bond to the regulators who can use the information to remove barriers to entry and create an enabling environment for a vibrant corporate bond market through formulation of an informed regulatory framework.

Government

The Ministry of Finance can benefit from the study to aid legislative agenda, policy formulation and implementation.

Intermediaries (Stock brokers and Investment Advisors)

Since these benefit from, and have a role to play in realization of a vibrant corporate bond market, the study makes recommendation on likely issues that need to be addressed to expand the corporate bond market and make it efficient and vibrant.

Researchers and Academicians

The study provides reference for previously scarcely researched and underutilized field of the Kenyan corporate bond market. The study can therefore be extended to the other related products such as mortgage related securities and assets backed securities among others.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The chapter reviews various available literatures on corporate bond markets and the necessary conditions relevant to the development of bond markets. Specific literature is reviewed on factors affecting issuance of bonds such as market benchmarks, market infrastructure, regulation and policy, local and foreign investor base, corporate governance and transparency. A conceptual framework is then provided as derived from the stated problem and augmented by the relevant literature review.

2.2 Corporate debt markets

The experience across countries, both among mature and emerging markets, suggests that a set of key features must coexist in order for the corporate debt market to evolve and develop. In mature markets, where corporate bond markets are more developed, institutional and policy factors have played a very important role.

In some emerging markets, the pickup in corporate debt issuance in recent years has resulted from necessity, for example, in Asia; bank lending dried up following the Asian financial crisis. Many of the necessary features for the deepening of the corporate bond markets in the emerging market countries are either still under-developed or do not exist at present. For those seeking to emulate their mature market counterparts, the implementation and sequencing of reforms are important for market development. The pattern of development of corporate bond markets within mature market countries has been different across countries. The corporate bond market in the United States has been, for a long time, an important source of funds for the private sector, while Canada, Japan, and most European countries have only seen their corporate debt markets develop in more recent decades.

The institutional structure has played an important role in the different pace of corporate debt market development in these mature market countries. The relative unimportance of the corporate bond market in Europe was mirrored by the corresponding dominance of the banking sector. This is in direct contrast to the United States, where banks play a small role in the financing of large companies, and face strong competition from the corporate bond market even for medium-sized companies (Schinasi and Smith, 1998). In Canada, loan financing by non-financial Companies has declined since the early 1980s as bond and equity financings have increased. This change in trend coincides with the major Canadian banks' expansion into the brokerage and investment banking business in the 1980s after legislative changes (Calmès, 2004).

Importantly, much of the issuance activity in the United States has been accounted for by public issues rather than private placements, resulting in beneficial spillover effects for secondary market liquidity. This is key because private issues tend not to change hands in secondary markets nearly as often as public issues; indeed, the former are often considered fairly close substitutes for (syndicated) bank loans (Schinasi and Smith, 1998). In comparison, corporate bond issues in some of the larger, advanced economies are more focused on private placements. The result is that during the 1990s, turnover ratios of corporate bonds in the United States were about 5 times as large as those in Japan, and about 50 percent higher than in the Euro market (Smith, 1995).

In emerging markets, local bond markets are gradually becoming an alternative source of funding for both governments and Companies. The authorities' efforts to develop local bond markets, combined with the corporate sector's efforts to diversify away from refinancing and foreign exchange risks, have contributed to an expansion in local corporate bond markets (with the exception perhaps of countries in central Europe). In Asia and Latin America, the pullback in bank credit during the crisis years has also contributed to the increase in corporate bond issuance. In the former, the dearth of bank financing, as well as the need to restructure balance sheets, provided an additional impetus for corporate debt issuance. In the latter, the rapid growth of local institutional investors, together with large refinancing needs of the corporate sector in a difficult external environment, has been key drivers.

While a number of countries have made substantial headway in developing their government bond markets, progress has been slower in corporate bond markets. The development of local corporate bond markets in general (and particularly true for Kenya) could be constrained by a variety of factors (Roldos, 2004a). The lack of liquidity in secondary markets and a meaningful investor base with developed credit assessment skills, as well as high costs of local issuance, are key reasons. Low liquidity in secondary markets reflects such factors as the scale of local issuance, the characteristics of the instruments, and the nature of the investor base. In most emerging markets, only a few large corporate companies are able to issue bonds on sufficient scale that they create a market where investors can change their trading positions without moving the price against them. Access to local bond issuance has largely been restricted to top-tier corporate companies, a situation attributable to the risk aversion of investors, investment restrictions on institutional investors (such as pension funds and insurance companies), as well as the lack of tools for reliable credit pricing and risk management in these markets.

There is growing importance of local securities markets as a source of funding for both the corporate and public sectors and there are policies that have proven most effective in stimulating the development of these markets. It is therefore important to consider the requisite characteristics for corporate bond market development, and compare the experiences in these areas across both mature and emerging markets. The discussions on these issues can be divided into two parts—regulation and infrastructure—followed by the factors affecting the demand and supply of corporate bonds.

There is broad agreement that fundamental issues such as improvements in market infrastructure and benchmarking, better corporate governance and transparency, combined with the maturing of domestic institutional investors, all contribute to the development of local securities markets. However, the experience among countries with respect to other aspects of the development of local securities markets—credit risk pricing, government policies toward the development of local securities markets (taxes, issuance regulations), the role of foreign investors and the sequencing of local securities market reforms—is less clear-cut (Mathieson and Roldos, 2004). These issues are discussed in the following subsections.

2.3 Possible Impediments

2.3.1 Market Benchmarks

In financial markets it is usual to price financial instruments relative to comparable investment alternatives (relative pricing) (Sand, 2000). When pricing a bond, one can use the market rate of comparable bonds as the basis, and price components that are specific to the individual bond. For example, the yield on a corporate bond could be priced as the yield on a government bond of the same duration with a premium corresponding to the credit and liquidity risk associated with the corporate bond. The yield on the government bond can then be regarded as the benchmark for the corporate bond.

Pricing relative to a benchmark contributes to consistent pricing of underlying factors that are common to different bonds, and at the same time simplifies pricing (Fleming, 2000). Relative pricing also makes it easier to compare prices for different bonds. However, smoothly functioning and effective pricing is contingent on the existence of suitable benchmarks. The basic premise for the choice of a benchmark instrument is that the value of the instrument is fundamentally similar to that of the instrument that is to be priced.

The reference instrument should contain few value components that are specific to the instrument. In other words, an appropriate benchmark instrument should reflect as "purely" as possible components that are relevant to the value of the instrument that is to be priced. If we assume that the yield on a corporate bond consists of a required risk-free real rate of return, inflation expectations and compensation for credit risk, the requirement for an appropriate benchmark rate for the bond will be that it co varies as closely as possible with these components. The yield on the corporate bond must be adjusted for factors that are specific to the corporate bond and any components of the benchmark rate that are not relevant to the corporate bond (Rakkestad and Hein, 2004).

Government bond yields have traditionally been used, both internationally and here in Kenya, as fundamental benchmarks for the pricing of corporate bonds. A large outstanding volume, long and spread maturity profile and the absence of credit risk have made government bonds appropriate for reflecting the market's required real rate of return and inflation expectations. Moreover, government bonds are homogeneous instruments that are available to all investor groups, and they are sold in transparent markets. When government bond yields are used as benchmarks for pricing corporate bonds, a premium must be estimated for the credit risk associated with the corporate bond, since there is no credit risk associated with the yield on government bonds (Cooper and Scholtes, 2001).

In the late 1990s, government borrowing in Kenya almost dried up as a result of the government's unfavorable rating then with the World Bank and other development partners. The result was reduced liquidity in the market (and increased borrowing by the government in the domestic market) and market participants looked around for alternative benchmark instruments. Among the alternatives to government bonds are semi-government bonds and government-guaranteed bonds, interest rate swaps and corporate bonds. In most countries, interest rate swaps have emerged as the most appropriate alternative (Rakkestad and Hein, 2004).

Information from market participants indicates that interest rate swaps are used extensively as a reference for long-term rates and pricing of corporate bonds. Interest rate swap markets have grown strongly in recent years, and in a number of countries the liquidity of these markets is greater than that of government bond markets (Baz, et al, 1999).

Well-functioning money markets represent a critical factor in the development of deep, liquid corporate debt markets. Money market provide an anchor for the short-end of the yield curve and thus serves as a benchmark for pricing other fixed-income securities that differ in terms of liquidity, credit quality, and maturity.

Short-term fixed income markets also play a unique role in that they facilitate cash management and position financing by financial intermediaries and corporate entities. Consequently, these short-term markets act as a catalyst for the development of longer-term debt markets. Within emerging markets, Korea and Thailand provide examples of the difficulties of developing a secondary bond market and the associated derivatives markets without the support of a money market (Cha, 2002; Roldos, 2004a).

The importance of the benchmark role of the money market is reflected in the fact that corporate money markets in the advanced economies are largely represented by the big, highly rated companies. In Canada, Japan, the United Kingdom and the United States, almost all commercial paper (CP) is rated for credit quality. Alworth and Borio (1993) observe that the bulk of CPs in advanced economies receive the highest possible credit rating, and the share of CPs rated below the top two categories is negligible. The development of the CP market is a relatively recent phenomenon. Until the mid-1980s, U.S. CPs accounted for 90 percent of all outstanding CP globally. CPs were issued in France and the United Kingdom only in 1986, and it was not until 1991 that they were first offered in Germany.

Benchmarks provided by government debt securities play a critical role in the development of domestic bond markets. Arguably, other liquid securities with relatively low default risk could also be used as the benchmark issues, as discussed above. However, the low credit risk and high liquidity features of government securities have made them natural providers of benchmark interest rates (IMF, 2001). These have, in turn, facilitated issuance of bonds by the private sector.

Increasingly, in emerging markets such as Brazil, Chile, Malaysia, and Mexico, measures are being implemented to improve the liquidity in secondary markets for government securities and enhance their credibility as benchmarks. These include various combinations of (i) extending the yield curve; (ii) setting up issuance calendars to improve transparency; (iii) increasing the disclosure of information on public debt issuance and statistics; (iv) holding regular meetings with dealers, institutional investors, and rating agencies; (v) introducing a system of primary dealers; and (vi) establishing a repurchase (repo) market in the government bond market (and in Mexico's case, the corporate bond market as well). Direct and Conscious necessary action is yet to be taken in our Kenyan market to this effect.

2.3.2 Market Infrastructure

The most common platform for trading debt securities is over the counter (OTC), even though many debt securities are listed on exchanges. This is true even in the advanced economies of Europe, Japan, the United Kingdom, and the United States. This concentration is predominantly attributable to the diversity of debt securities (maturity, duration, coupon, credit risk), which tends to limit the trading in most corporate debt issues; a dealership trading system could thus improve liquidity.

Schinasi and Smith (1998) argue that stock exchange listing may serve a useful function in the secondary bond market, even if most of the trading occurs OTC. In the United States, listing bonds on the New York Stock Exchange serves two purposes for the secondary bond market: it provides an important safeguard for small investors and facilitates information flow and the price discovery process. A number of other countries have also listed their corporate bonds on stock exchanges (IOSCO, 2004).

In addition to advanced market infrastructure in trading, clearing and settlement systems are necessary to ensure efficiency and credibility of the trading system and to facilitate flows of information and the price discovery process. For instance, problems with bond settlement systems have, in the past, affected corporate bond markets even in mature market economies (for example, the United Kingdom and Japan). To date, many countries in East Asia have adopted script less electronic trading and real-time gross settlement (RTGS) and delivery versus payment (DvP) clearing and settlement systems on a transaction by transaction basis (EMEAP, 2002).

Transparency in regulations is all the more important for non-residents who are unfamiliar with the market and are handicapped with language barriers (ADB, 2002). For non-resident investors, search cost for applicable regulations should not be underestimated. The release of adequate information to the public helps in gaining credibility from non-residents for the country's regulatory (and supervisory) framework.

By its very nature, a bond is a contract that involves the handover of cash today in exchange for a claim of payment with agreed-upon interest rates at some future date. The longer the lag between handover and complete payment, the more risks of non-delivery the claim has to face. Rules and their enforcement guarantee that the counterparty's rights and claims are properly protected through the life of the contract or in case of its dissolution. When these are not provided for, investors prefer to invest in assets with shorter maturities (e.g., commercial paper and bank deposits) thus discouraging bond financing. Learning from the experiences of countries with better developed bond markets, both within and outside the region, many countries need to improve the regulatory framework for the bond market (ADB, 2002).

Enforcing the formal regulatory framework is as important as the developing it. It is important to ensure that courts and enforcement agencies act and decide fairly and with dispatch to resolve commercial disputes. In many countries, the enforcement of the regulatory framework is lax. In some countries, it may even be necessary to set up specialized enforcement entities and courts to ensure that capital market transactions and contracts are enforced effectively and expeditiously (ADB, 2002).

The formal regulatory framework in Kenya; though in place is weak and needs to be strengthened to be transparent and predictable so as to give credibility and confidence to the investors. The shutting down of three brokerage firms (players at NSE) in three years (2006-2008) is a reason enough to re-look at this.

2.3.3 Regulation and Policy

A reliable regulatory framework is critical for instilling investor confidence. Regulations in securities markets are normally justified by one or more of the following objectives: (i) fair and equal treatment of investors (investor protection); (ii) market integrity; and (iii) containment of systemic risk. The experience from advanced economies shows that regulatory policies have played a role in the development of corporate bond markets, by either encouraging or inhibiting the development of these markets (Schinasi and Smith, 1998). Generally, while regulations governing the issuance of securities should ensure a level playing field for all, they should not interfere with the terms of issuance.

The regulatory process must also be efficient: market timing is of the utmost importance to both issuers and investors in securities markets, since any regulatory delay would be tantamount to prohibitive regulation. In Germany, for instance, the legal requirements for a private sector bond issue has historically made this option more expensive than raising funds through a bank loan. The permission process was time consuming and impeded the ability of corporate companies to issue when market conditions were favorable. Although the regulatory burden was reduced during the 1990s, much of the deutsche mark corporate bond market had already been established in London. Similar rigidities in regulatory policy in France appear to have had similar results.

In Mexico, the authorities have worked on improving the regulatory framework for the repo and securities lending markets in order to make it consistent with international best practice. In August 2003, a new regulation, which requires the use of standard contracts—and enabled both corporate bonds to be traded and foreign investors to finance their positions in the repo market—was implemented.

Many countries still maintain tight regulation over asset allocations by institutional investors to prevent excessive risk taking, but this may be a double-edged sword (Roldos, 2004b). In Mexico, factors such as the restrictions and limits placed on pension funds, the lack of high-quality corporate (only about 10 local "blue chips" are considered investible), the risk aversion of local investors, and the shortage of interested players, have hindered liquidity in the secondary corporate debt market. As a result, the general portfolio composition in the pension industry currently consists of around 85 percent in federal government bonds.

In Brazil, tight regulatory requirements have prevented investors other than local buy-and hold pension and mutual funds from participating actively in the market, thus limiting demand for corporate issues.

In Chile and other markets, regulatory restrictions that prevent banks from doing repos with corporate bonds also represent an obstacle for the development of a liquid secondary market. The corporate bond market in Colombia remains very small, partly due to the lack of demand for lower-rated debt from pension funds. Although pension funds in Colombia are, in theory, able to invest in securities rated A-minus or above, in practice they tend to require an AAA rating, especially for big issues. As a result, local corporates that are not AAA-rated have been reluctant to issue new securities locally. In Malaysia, life insurance companies, which are important players in fixed-income markets, cannot invest more than 15 percent of their portfolio in unsecured bonds and loans and may invest only in highly rated corporate bonds.

In most mature markets, there are few restrictions on foreign investment in local bond markets. This openness, together with established market infrastructure and governance have seen foreign participation rates in local debt markets increase significantly in the past decade.

In Poland, a number of regulatory and cost obstacles make private placements the only cost efficient way to issue corporate bonds (Roldos, 2004a). For example, a prospectus has to be issued for each bond issue, ruling out medium-term note programs, and prospective issuers must wait a long time for the approval of the authorities, in addition to paying high fees for issuances. Similarly, the cost of public issuance in Hong Kong Special Administrative Region is estimated to be four times that of a private placement. In contrast, Malaysia's Securities Commission introduced a series of measures to streamline the capital raising process, which has minimized the time and work required in the issuance process and lowered the cost of bond issuance to below that of bank loans. Not surprisingly, bond issuance has dominated bank lending as a source of funding in Malaysia since 1997 (Moody's, 2002).

The Kenyan market has also commendably opened up (some restrictions still in place) to foreign investments as was the case with foreign investors buying the Safaricom shares recently through the NSE. The Kenya government is also intent on issuing a Sovereign bond; barring adverse effects resulting from the global credit crunch being witnessed. Several corporate bonds have also been listed for issuance in mid 2009

2.3.4 Corporate Governance and Transparency

In many countries, corporate governance problems arise mainly on account of weak protection of minority rights, lack of transparency, and inadequate market discipline for Companies, which often tend to be owner-managed. This is also especially true for the Kenyan market.

In many of these countries, minority shareholder value has traditionally been neglected. While this works against equity financing, it need not necessarily work against bond financing. However, what works against bond financing is that weak minority shareholder rights create uncertainties as to whether or not bondholder rights will be upheld during disputes and bankruptcies.

Inadequate market discipline and transparency means that controlling interests may take unwarranted risks and, thus, raise the likelihood of bond default. This means that bond investors will demand a higher premium for holding corporate bonds. Naturally, the higher cost also makes it likely that the bond issuer will default. All these limit the use of bond financing by the corporate sector. There have been several reforms of equity rights protection in several countries. Indonesia now has one-share, one-rate, proxy voting by mail, shares not blocked, and cumulative voting for board of directors in its statute books. Korea lacks only the proxy voting by mail. In 2000, Malaysia adopted a code on corporate governance. In all economies, new and improved accounting and crediting standards as well as disclosure rules for listed companies are being introduced. However, their enforcement still remains a problem. Violations of these rules and standards are still not uncommon. For bonds, the imperative is for bankruptcy rules to be clear, legally empowered, and explicit on the treatment of creditors' rights. Likewise, improved financial and transaction disclosure will help alleviate the moral hazard problem that raises the credit risk (ADB, 2002).

Improvements in corporate governance and transparency protect investors and encourage the development of financial markets. Better corporate governance can be implemented through several mechanisms—such as improved laws, enhanced regulation and supervision, and stronger enforcement of private contracts—and, whenever changing the law has proven difficult, other mechanisms have proven to be good substitutes to some extent. Capulong, et al. (2000) argue that, in general, creditors have some form of control over companies and hence are important for corporate governance—they can influence major decisions of companies through a variety of controls, and discipline companies in the event of a default or when a violation of debt covenants occurs. The fact that borrowers may have to come back to creditors for more funds may also give creditors significant influence. That said, the effectiveness of creditors' controls depends on the quality of monitoring (which depends on accounting and auditing standards, financial reporting systems, and disclosure standards), how well their rights are protected legally, as well as their negotiation powers. Unlike banks, which usually have much larger stakes in companies, dispersed individual bondholders may find themselves with less bargaining power in case of default. This may explain why market debt is less common in countries with underdeveloped securities laws.

Following the crisis in 1997–98, corporate governance and financial transparency have been high on the agenda of regulators in Asia. Many countries have strengthened their accounting and auditing standards, as well as securities regulations. In Indonesia, Malaysia, Singapore, and Thailand, regulators now require companies to report their annual reports within two months of the fiscal year end. Quarterly reporting is now mandatory in many countries. To increase financial transparency, some countries require the disclosure of stakes in companies of 5 percent or more. Many emerging markets in Asia have also improved their bankruptcy procedures to strengthen the creditors' right to protection and facilitate the process of corporate debt restructuring. For example, Thailand introduced a new Bankruptcy Act Amendment in March 1999, which aims to prevent a company from going into bankruptcy because of temporary liquidity problems and eliminate loopholes that may prolong the proceedings and disadvantage creditors. Revised bankruptcy procedures have also been introduced in Korea and Malaysia. These revisions are aimed at facilitating corporate debt restructuring, preserving viable businesses, and ensuring better representation of creditors in resolution processes (Capulong, et al, 2000).

While these moves are clearly steps in the right direction, it is as yet unclear what benefits have directly accrued from their implementation per se. Another concern often raised by investors is that although many emerging countries have established codes of good corporate governance, which are not substantially different from the OECD Principles of Corporate Governance, practices often fall short in terms of implementation and enforcement in many countries (IMF, 2005).

The dampened investor confidence in the Kenyan market (2008); especially as pertains to the ability of the Capital markets and particularly the NSE to reign in rogue brokerage firms as well as ability to compensate investors will need to be addressed urgently before the same starts to affect the listing of bonds.

2.3.5 The Local and Foreign Investor Base

The growth in local institutional investors such as pension funds, insurance companies, and mutual funds is crucial in driving the demand for domestic securities. A diversified investor base with varied demand requirements, maturity profile, and risk preference is important to ensure high liquidity and stable demand in the market. In mature markets, the investor base for bonds is generally well-diversified, with banks, mutual funds, hedge funds, pension funds, and insurance companies providing a broad demand base for bonds. In some emerging market countries, many of these financial institutions are underdeveloped, and the growth of such an investor base has usually been slow. Increasingly, however, the authorities in these emerging market countries have realized the importance of developing the local institutional investor base to support local securities markets. The recently mooted development of infrastructure bonds in Kenya and the government intention of allowing NSSF to issue and trade in bonds is a step in the right direction.

Pension funds in mature market countries have substantially greater flexibility to manage their portfolios. While some developed countries apply minimum requirements on pension funds' investment on government securities, most do not have explicit ceilings on debt securities in which pension funds can invest (OECD, 2004). Rather, pension funds in these countries are required to follow "prudent man rules"—that is, assets should be invested in a manner that would be approved by a prudent investor (Roldos, 2004b). The issues relating to the imbalance between assets under management and investment opportunities are discussed in Roldos (2004b).

Foreign investors are an important source of demand for local securities, and several emerging markets countries have opened up their local markets in an attempt to widen and diversify the investor base. Although there may be differences in investment strategies among different types of foreign investors, market participants generally perceive foreign investors as playing a supportive role in local markets (Roldos, 2004a). Also, foreign investors usually impose positive pressure for developing robust market infrastructure and transparent market practices. At this stage, however, foreign participation in local debt markets in Asia and Latin America remains limited, despite efforts to open up their markets to foreign investment. As a result, the investor base for local debt instruments continues to be dominated by domestic institutional investors.

The international experience suggests market liberalization alone is an insufficient condition for increasing foreign participation. While Colombia's restrictions on shorter-term holdings by foreign investors have clearly been a barrier to the development of the local corporate bond market, the situation in Korea is less obvious. Even though foreigners are allowed to invest in all types of listed bonds in Korea's local market, they currently hold only about 0.4 percent of listed domestic bonds (compared with foreign participation of over 40 percent in the Korean stock market). The situation may partly be explained by the lack of a developed repo market and hedging instruments. In many emerging markets, the existence of withholding taxes and the threat of discretionary increases in other taxes and capital controls act as a strong deterrent to foreigners buying domestic securities. In contrast, foreign interest in Mexico's longer-term government bonds rose sharply in 2004, as the local market started to realize the benefits from ongoing reform efforts to establish a credible benchmark yield curve, improve transparency, and promote liquidity in the market. Similarly, in Malaysia, foreign investor interest in the local markets has been higher with the government taking new initiatives to make investments into local markets easier and more attractive, and to improve the market infrastructure.

In Australia in 2000, about 45 percent of government bonds are held by non residents, up from about 25 percent in 1994. Non resident holdings of private sector debt are closer to 10 percent. Issuance Costs and Taxation the high costs associated with corporate debt issuance, such as the costs of meeting new disclosure laws and direct issuance costs, have also been a significant deterrent to market development. Bond issuance costs vary substantially across emerging market countries. For instance, bringing an issuer to market in Brazil is relatively expensive. The costs of local issuance (encompassing fiduciary agents, lawyers, registration, rating agencies, and bank fees) make it prohibitively expensive to issue debentures in amounts lower than 50 million reais ($20 million). In contrast, the cost of placing debt in Chile's local market is one-seventh of that paid for a placement in international markets (Cifuentes, Desormeaux, and Gutierrez, 2002). Bond issuance costs in each category (for example, investment banking fees, regulatory fees, legal fees, etc.) tend to be higher in Mexico than Chile; however, Mexico does not impose an issuance tax on securities (Zervos, 2004). In effect, the high issuance costs may be hindering the development of local corporate debt markets by discouraging the supply of bonds, since corporates then opt for bank loans, which tend to be cheaper given the high liquidity in the banking system.

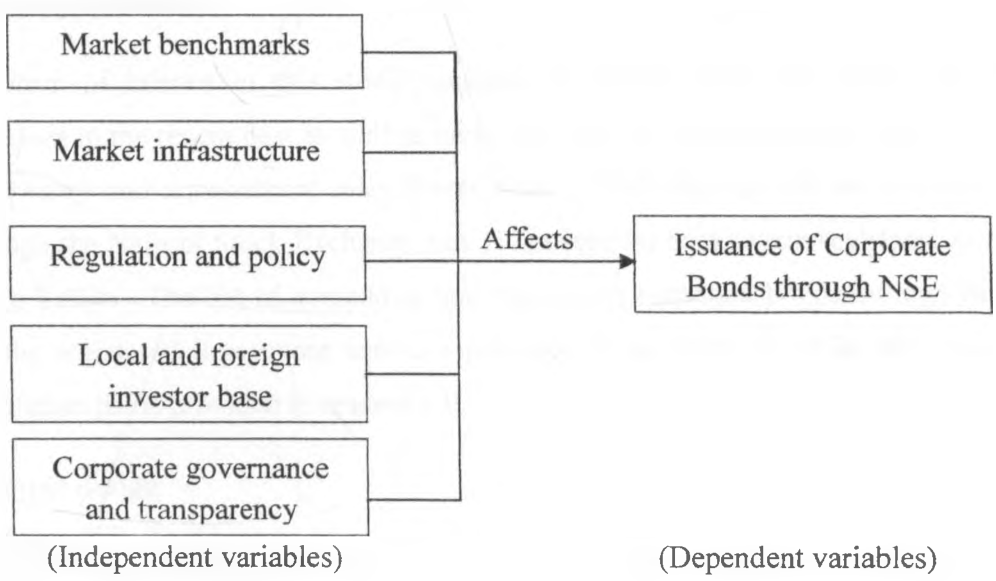
Within mature market countries, Japan is an obvious example where high issuance costs may have played a part in slowing the development of local corporate bond markets. Fixed trustee fees earned by banks, under the "commission bank system," for securities appear to have been an important driver for the relatively high total issuance costs. These costs were estimated at 2.5 percent for 10-year corporate bonds (Karp and Koike, 1990) compared with 0.7–1.3 percent in the United States (Fabozzi, Modigliani, and Ferri, 1994). Bond markets are also sensitive to tax incentives (IOSCO, 2002). The formulation of a tax structure can create distortions in taxation of income from various types of investment. In principle, a system of capital income taxation should treat incomes from all types of investments and savings equally, including bank deposits, equity, as well as bonds and other debt instruments. Excessive distortions in the system of capital taxation affect the attractiveness of instruments not only for investors and savers but also the financing behavior of issuers and borrowers.

For example, some countries levy stamp duties on bond transactions, making investments in the bonds less attractive compared to other investments. Schinasi and Smith (1998) observe that transaction and withholding taxes often result in driving issuance and trading activity offshore; however, regulating to make it more difficult for domestic residents to participate in offshore securities would do little to help the development of domestic securities markets. They emphasize that transaction taxes have historically not been effective in terms of revenue generation for the government; rather they have been effective in restricting the development of securities markets. In Germany, turnover taxes (of 6 percent, which were not removed until December 1990) and withholding taxes are seen to have inhibited the issuance of corporate debt, especially short-maturity securities. The observed trend in mature market economies has been to eliminate such taxes altogether; if this cannot be effected either for equity or political reasons, such taxes are reduced and rebated to foreign investors as quickly and efficiently as possible.

While the entry of Renaissance Capital (strong players elsewhere in the world in the bonds market) as a player in the NSE means well for Kenya; and while the experience and knowledge transfer gained from the participation of Morgan Stanley (another strong player in the global market) during the Safaricom Initial Public Offer is something to rejoice about; a lot needs to be done to woo foreign participation in the Kenya market and particularly for them to participate in the bonds market.

2.4 Conceptual Framework

The conceptual framework is presented in the figure below. It depicts the relationship on the possible impediments to bond issuance through a stocks exchange.



Source (Author, 2009)

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the design of the study, population, sample design, data collection and data analysis. The chapter also presents the expected output.

3.2 Research design

The study adopted a descriptive research design. Descriptive research portrays an accurate profile of persons, events, or situations (Robson, 2002). As the objective of this study was to determine whether various factors affect the issuance of corporate bonds, the descriptive survey was chosen as the best design for the study so as to determine the frequency of each variable related to the stated problem.

3.3 Target population

The population of interest in this study consisted of all the firms that have issued corporate bonds in the recent past as well as those that had not and Investment banks that play the advisory and arrangement roles. There were 7 firms that had issued corporate bonds through the Nairobi Stock Exchange and 11 Investment banks were registered and operating in Kenya. The list of companies that had issued corporate bonds through the NSE and the registered investment banks is provided in appendix II while the entire target population list is provided in appendix III.

3.4 Sample design

The target populations were all the firms that were listed at the Nairobi Stock Exchange irrespective of whether they had issued corporate bonds or not together with the Investment banks registered and operating in Kenya. The population was purposively selected and a census method adopted.

3.5 Data collection

Secondary data were obtained for examination from existing literature at the NSE and Central Bank of Kenya. To compliment the secondary data, primary data was also obtained using structured questionnaires.

The questionnaires are designed based on the research objectives (a questionnaire is provided in appendix 1). It consisted of six sections with the first section seeking to find out the general information about the respondents and their companies while the remaining five sections tackled the research objectives. The respondents were the Finance/Treasury Managers in each of the listed firms at the NSE and managers of the 11 Investment banks registered and operating in Kenya then.

3.6 Research Procedure

A pilot testing was done first in order to ensure reliability of the data collection tool. The pretests were done on a sample of 10 respondents from the population but not on the ones that finally filled the questionnaires. After the pretest, the questionnaires were appropriately amended. The amended questionnaires were then administered to the respondents using the drop and pick method. To ensure high response rate, calls and visits to the selected firms were made as a follow up.

3.7 Data analysis

The primary data collected through the questionnaires were sorted, edited and processed. This was meant to ensure that errors and omissions did not compromise the quality standards.

The data was then coded so as to classify the responses into categories before being entered into the statistical package for social sciences and analyzed based on descriptive statistics. The questionnaire was however designed to have many closed questions (like scaled items) which had been deliberately pre coded to avoid tedious completion of coding sheets for each response. Interpretations were derived from understanding the collected information. The results are presented using tables and charts. Factor analysis was thus adopted. Factor analysis is a statistical procedure used to uncover relationships among many variables. It allows numerous inter correlated variables to be condensed into fewer dimensions called factors. In the context of this research, the variables were the degree of agreement with various specific statements (from parts B and F of the survey). The factor analysis for this research was conducted using the statistical package for social sciences; SPSS.

3.8 Expected Output

The study expected to get information to augment existing literature that impediments to issuance of corporate bonds at NSE included market benchmarks and infrastructure, regulation and policy, local and foreign investor base together with corporate governance and transparency among others.

CHAPTER FOUR

4.0 DATA ANALYSIS AND FINDINGS

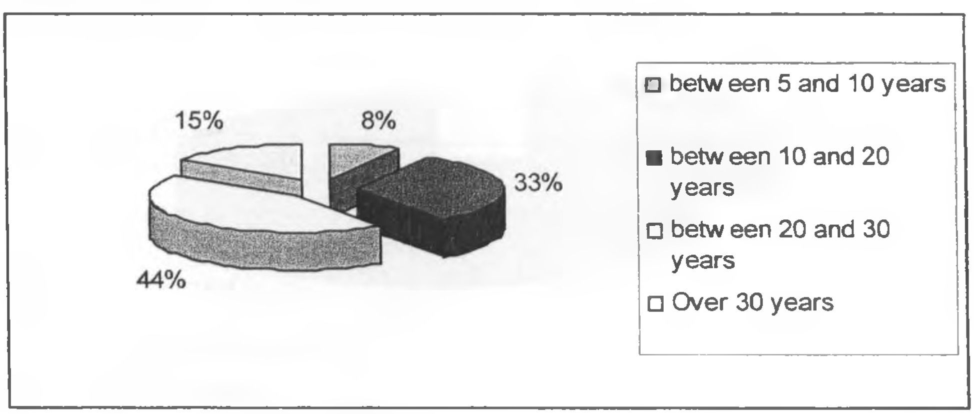
4.1 Introduction

This chapter presents the findings of the study. Of the 60 questionnaires that were administered: 52 were returned and used for the purpose of data analysis. This shows a response rate of 86.6%. The chapter is structured as follows. Section 4.2 presents analysis of demographic data. The next five sections explore the identified underlying impediments to issuance of corporate bonds through the NSE viz market benchmarks, market infrastructure, regulation and policy, local and foreign investor base, and corporate governance and transparency.

4.2 Sample characteristics

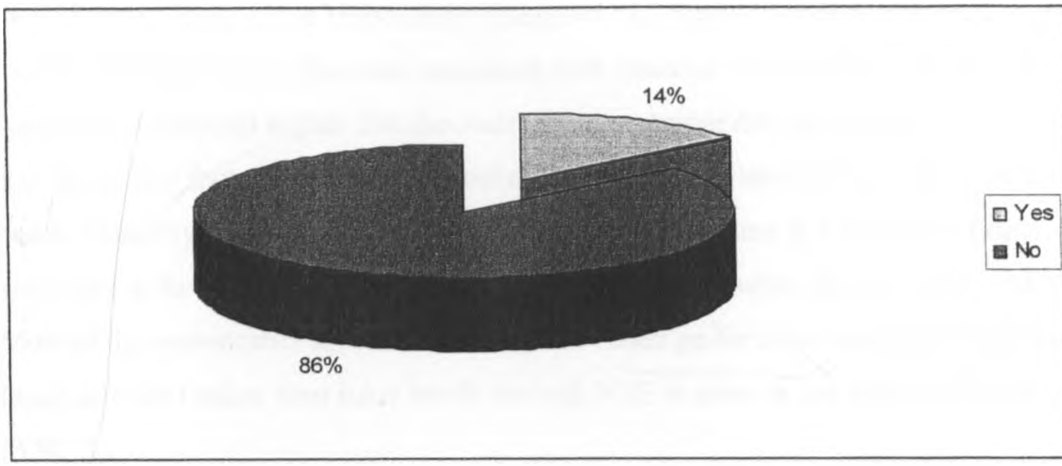
The study found that 44% of firms surveyed had existed for a period between 20 and 30 years. The rest of the analysis is summarized in Figure 1.

Figure 1: Duration the firm has been in existence



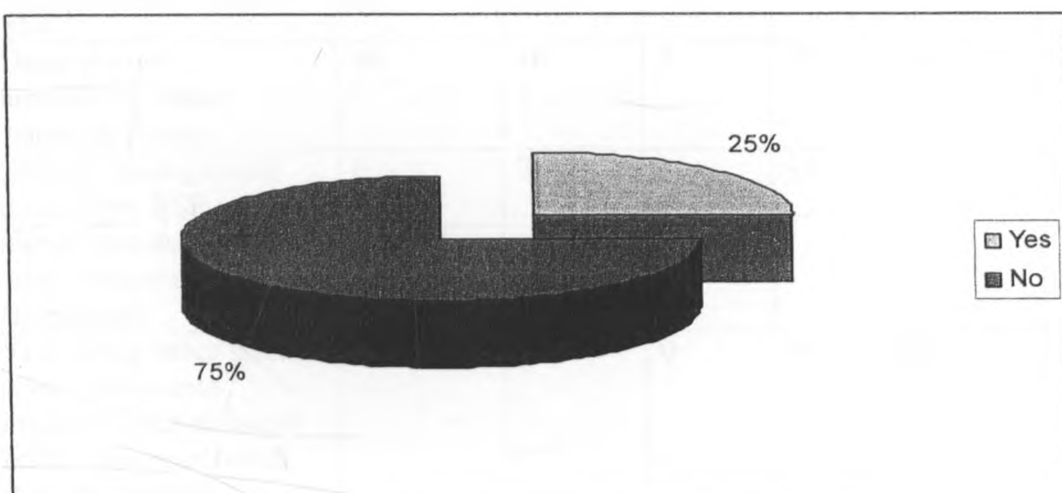
Of the firms surveyed, the study found that 14% had issued corporate bonds while the remaining 86% had never issued. This summary is provided in Figure 2.

Figure 2: Company participation in issuance of corporate bonds through NSE



Of those who said they had never issued corporate bonds, the study found that most of them (75%) were not conversant with the processes of issuing corporate bonds. Only 25% had the knowledge of the process of corporate bond issuance in Kenya

Figure 3: If no, whether the company is conversant with the process of issuing of corporate bonds through NSE



4.3 Market benchmarks

The respondents were to rank the extent to which they agreed with the statements on whether market benchmarks are impediments to issuance of corporate bonds through NSE. The result, presented in Table 1, suggest that most respondents agree that market benchmarks are impediments to issuance of bonds in Kenya. Using the mean scores, it can be observed that the respondents agree that interest rates offered on other sources of finance entice firms wishing to issue bonds through NSE to go for other alternatives (4.1). Further, most of the respondents disagreed that there is a well functioning money market in Kenya (2.1). The costs associated with issuance of bonds through the NSE were also considered higher that the costs of other comparable alternatives.

The study also found that the only benchmarks mostly available in the market are the bonds issued by government (4.4). It was also found that there is a diversity of debt securities at the NSE in terms of maturity, duration, and coupon rate and credit risk (3.9). Most of the respondents agreed that one would rather go for other comparable products (such as loans) rather than issue bonds through NSE in order to get additional financing (3.9).

Table 1: Market Benchmarks

	Strongly disagree	**Mildly disagree**	**neutral**	**Mildly agree**	**Strongly agree**	**mean**
Interest rates offered on other sources of finance entice firms wishing to issue bonds through the NSE	0	0	10	66.7	22.2	4.1
There is a well functioning money market in Kenya	40	40	0	22.2	10	2.1
Costs of issuing bonds through the NSE are higher than the costs of other comparable alternatives	0	22.2	10	40	44.4	3.9
You would rather go for other comparable products (such as loans) rather than issue bonds through the NSE	10	10	0	40	44.4	3.9
The government bonds issued has been the benchmark against other bonds issuance.	0	0	22.2	10	66.7	4.4
There is a diversity of debt securities at the NSE in terms of maturity, duration, coupon rate and credit risk	10	0	40	0	50	3.9

The study found that various measures were being undertaken to improve the liquidity of secondary markets. Some of the measures include setting up issuance of calendars to improve transparency (4.2). The other measure is extension of the yield curve (4) and increasing the disclosure of information on public debt issuance and statistics (3.9). These results are summarized in Table 2.

Table 2: Measures to improve Liquidity of Secondary Market

	Strongly disagree	Mildly disagree	Neutral	Mildly agree	Strongly agree	Mean
Extending the yield curve	0	10	22.2	22.2	44.4	4
Setting up issuance calendars to improve transparency	0	0	10	50	3.3	4.2
Increasing the disclosure of information on public debt issuance	10	10	10	40	40	3.7
Holding regular meetings with dealers, institutional investors and rating	0	40	10	40	22.2	3.4
Introducing a system of primary dealers	10	44.4	40	10	0	2.9
Establishing repurchase (repo) market	10	10	44.4	40	0	3.3

Most of the respondents were of the opinion that the market benchmarks deter issuance of corporate bonds through NSE. 50% said it deters issuance to a great extent while 40% said it does to a greater extent. This is presented in Table 3.

Table 3: Extent to which market benchmarks deter issuance of corporate bonds

	Frequency	Percent
Greater extent	21	40
Great Extent	26	50
Low extent	5	10
Total	52	100

4.4 Market infrastructure

The extent to which market infrastructure deters issuance of corporate bonds was sought. As shown in Table 4, the study found that the infrastructure currently at the NSE is not an impediment to issuance of bonds. The automation process at the NSE has made issuance of corporate bonds easier (4.4) and there is an efficient clearing and settlement system for bonds at the NSE (3.9). The study found that the NSE has a capacity to handle a large investor base (3.9) and that the most common platform for trading debt securities in Kenya is over the counter (OTC) (3.9). However, the only infrastructural impediment was that of the long duration of transactions (3.6). Most of the respondents were neutral on the assertion that the operational process at the NSE is a major hindrance to issuance of corporate bonds (3.0).

Table 4: Market Infrastructure

	Strongly disagree	Mildly disagree	neutral	Mildly agree	Strongly agree	mean
The automation process at the NSE has made issuance of corporate bonds easier	0	0	10	40	50	4.4
The operational processes at the NSE are a major hindrance to issuance of corporate bonds	10	10	20	40	20	3.0
The NSE has the capacity to handle a large investor base	0	0	60	0	40	3.9
The duration of transactions at the NSE is too long hence a major impediment to issuance of bonds	10	0	40	40	10	3.6
The most common platform for trading debt securities in Kenya is over the counter	0	10	40	10	40	3.9
There is an efficient clearing and settlement system for bonds at the NSE	10	0	10	20	40	3.9

4.5 Regulation and Policy

Most respondents agreed that there is a reliable regulatory framework in Kenya which has instilled more investor confidence (69%). 31% of the respondents disagreed. The analysis is summarized in table 5.

Table 5: Reliability of Regulatory Framework in Kenya

	frequency	percent
Yes	36	69
No	16	31
Total	52	100

The respondents were to indicate the extent of agreement with the statements on the role of regulation and policy on corporate bonds issuance in Kenya. The study found that the integrity of the bond market has improved due to improved regulations (4.0). Despite the existence of regulations and policies, it was established that lack of enforcement rules that guarantee the protection of rights and claims through the life of the contact or in case of its dissolution is a major hindrance to issuance of corporate bonds in Kenya (4.0). One other impediment was the longer lad between handover and complete payment which raises the risk of non- delivery of payment and therefore an impediment to the issuance of corporate bonds (3.6). However, the study established that the law treats all investors fairly and equally (3.6) and that the regulatory framework has enabled the control of systematic risk in the market (3.7). These results are summarized in Table 6.

Table 6: Regulation and Policy

	Strongly disagree	Mildly disagree	neutral	Mildly agree	Strongly agree	mean
The law treats all investors fairly and equally	10	10	20	20	40	3.6
The integrity of the bond market has improved due to improved regulations	0	10	10	40	40	4.0
The regulatory framework has enabled the control of systematic risk in the market	0	10	30	50	10	3.7
There is longer lad between handover and payment which raises risk of non-delivery of payment	10	10	10	30	40	3.6
Lack of enforcement of rules guarantee the protection of rights and claims	0	0	10	50	40	4.0

4.6 Local and foreign investor base

Most of the respondents (60%) strongly agreed that there has been a growth of the local institutional investors such as pension funds, insurance companies and mutual funds. A further 40% of the respondents mildly agreed. This is summarized in Table 7.

Table 7: Growth of Local Institutional Investors

	Frequency	percent
Strongly agree	31	60
Mildly agree	21	40
Total	52	100

The investor base in Kenya was found to be largely diversified with varied demand requirements as shown by 61% of the respondents. 10% of the respondents were neutral. These results are summarized in Table 8.

Table 8: Diversification of investor base

	Frequency	Percent
Very accurate	32	61
Mildly accurate	15	29
Neutral	5	10
Total	52	100

On the extent to which the respondents agreed that the government has maintained tight security over all asset allocation by institutional investors, the study found that 75% of the respondents agreed to a great extent. 21% of the respondents were neutral. This is summarized in Table 9.

Table 9: Security

	Frequency	Percent
Greater extent	2	4
Great extent	39	75
Neutral	11	21
Total	52	100

The study found that most of the respondents believe that the stock market has opened up in order to widen and diversify the investor base (4.3). The respondents also believe that there are other capital controls that affect foreign investors (4.1). Most of the respondents also believe that foreign investors are an important source of demand for local securities (3.9), liberalization has helped increase foreign participation (3.9), and that there exists withholding taxes for foreign investors (3.9). This is summarized in Table 10.

Table 10: Local and Foreign Investor base

	Strongly disagree	Mildly disagree	neutral	Mildly agree	Strongly agree	Mean
Foreign investors are an important source of demand for local securities	0	0	10	60	30	3.9
The sock market has opened up in order to widen and diversify the investor base	0	0	10	30	50	4.3
Liberalization has helped increase foreign participation	0	10	10	50	30	3.9
There exists withholding taxes for foreign investors	0	0	10	30	50	3.9
There is a provision for discretionary increase in other taxes without prior notice	40	0	10	0	50	3.1
There are other capital controls that affect foreign investors	10	0	0	0	80	4.1

4.7 Corporate Governance and Transparency

On corporate governance, the study found that stringent disclosure requirements for companies are a hindrance to issuance of bonds (4.3). Further, fixed costs related to corporate governance structure deter companies willing to issue corporate bonds through NSE (4.2). The rest of the analysis is presented in Table 11.

Table 11: Corporate Governance and Transparency

	Strongly disagree	Mildly disagree	neutral	Mildly agree	Strongly agree	mean
CMA corporate governance requirements discourages the issuance of corporate bonds	0	30	10	40	20	3.6
Fixed costs related to corporate governance structure deter companies	0	0	10	20	70	4.2
Lack of culture of transparency by potential firms willing to issue corporate bonds	0	20	10	10	60	3.8
Stringent disclosure requirements for companies is a hindrance to issuance of bonds	0	0	10	60	30	4.3
Level of integrity required for companies is a hindrance to issuance of bonds	10	0	10	40	40	3.7

4.8 Summary of Data Analysis

To a large extent the data analysis has shown that the basic underlying impediments to issuance of corporate bonds through the NSE include market benchmarks, market infrastructure, regulation and policy, local and foreign investor base, and corporate governance and transparency. A more detailed analysis of the data and its findings; and which will form the basis of the conclusion and recommendations is provided in the following chapter in 5.1

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of findings

The study found that 41% of the firms surveyed had existed for a period between 20 and 30 years.14% had issued corporate bonds while the remaining 76% had not. 75% of those that had not issued corporate bonds were not conversant with the process of issuing corporate bonds. The results suggest that most of the respondents agree that market benchmarks are impediments to issuance of corporate bonds in Kenya. The respondents agreed that interest rates offered on other sources of finance entice firms wishing to issue corporate bonds through the NSE to go for alternatives (4.1). Further, most of the respondents agree that there is a well functioning money market in Kenya (2.1). The costs associated with issuance of bonds through the NSE were also considered higher than the costs of other comparable alternatives. The study found that the only benchmarks mostly available in the market are the bonds (4.4). It was also found that there is a diversity of debt securities at the NSE in terms of maturity, duration, and coupon rate and credit risk (3.9). Most of respondents agree that one would rather go for other comparable products (such as loans) rather than issue bonds through the NSE in order to get additional financing (3.9). Various measures are being undertaken to improve the liquidity of secondary markets like setting up issuance of calendars to improve transparency (4.2) or extension of the yield curve(4) and increasing the disclosure of information on public debt issuance and statistics(3.9). Most of the respondents were of the opinion that market benchmarks deter issuance of corporate bonds through the NSE. 56% said it deters issuance to a great extent while 33% said it does to a greater extent.

The study found that the infrastructure currently at the NSE is not an impediment to issuance of bonds. The automation process at the NSE has made issuance of corporate bonds easier (4.4) and there is an efficient clearing and settlement system for bonds at the NSE (3.9). The study also found that the NSE has the capacity to handle a large investor base (3.9) and the most common platform for trading debt securities in Kenya is over the counter (OTC) (3.9). The only infrastructural impediment was the long duration transactions (3.6). Most of the respondents were neutral on the assertion that the operational processes at the NSE are a major hindrance to issuance of corporate bonds (3.0). 69% of the respondents agreed that there is a reliable regulatory framework in Kenya which has instilled more investor confidence. The study found that the integrity of the bond market has improved due to regulations (4.0). Despite the existence of policies and regulations, it was established that lack of enforcement rules that guarantee the protection of rights and claims through the life of the contract or in case of its dissolution is a major hindrance to the issuance of corporate bonds in Kenya (4.0). One other impediment was the longer lad between handover and complete payment which raises risk of non-delivery of payment and therefore an impediment to the issuance of corporate bonds (3.6). However, the study established that the law treats all investors fairly and equally (3.6) and that the regulatory framework has enabled the control of systematic risk market (3.7). 60% of the respondents strongly agreed that there has been a growth of the local institutional investors such as pension funds, insurance companies and mutual funds. The investor base in Kenya was largely diversified with varied demand requirements as shown by 61% of the respondents. On the extent to which the respondents agreed that the government has maintained tight security over asset allocation by institutional investors, the study found that 75% of the respondents agreed to that extent. The study found that most of the respondents believe the stock market has opened up in order to diversify the investor base (4.3). The respondents also believe that there are other capital controls that affect foreign investors (4.1). Most of the respondents also believe that foreign investors are an important source of demand for local securities (3.9), liberalization has helped increase foreign participation (3.9), and the study found that stringent disclosure requirements for companies are a hindrance to issuance of bonds (4.3). Further, fixed costs related to corporate governance structure deter companies willing to issue corporate bonds through the NSE (4.2)

5.2 Conclusion

This study sought to establish various dynamics that affect corporate bonds issuance process through the Nairobi Stock Exchange (NSE). The study concludes that market benchmarks and stringent corporate governance requirements are the greatest impediments to issuance of corporate bonds through the NSE. The available alternatives in the market seem to be simple and cheap, according to most the respondents, hence a better alternatives to corporate bond issuance. However, the market infrastructure and the legal framework are not deterrents to corporate bonds issuance. Further, there has been interest from both local and foreign investors to invest in the capital market in Kenya as their investor bases has been growing over the recent past. This may not explain the lower levels of bond listing on the NSE.

5.3 Recommendations

The study recommends that the issues of market benchmarks be the focus of capital market in Kenya if the bond market is to grow. All the bottlenecks that may impede issuance of bonds brought about by market benchmarks need to be ironed out. Further, corporate governance requirements should not be an issue that impedes listing of bonds at the NSE. All the companies should strive to adhere to sound corporate governance practices.

APPENDIX I

Research Questionnaire

Please answer all the questions. Tick or cross(x) in the space provided to the applicable choice. Where there are no characters, write your answer on the space provided.

Section A: General Information

1. What is your gender?

   Male [ ]

   Female [ ]

2. What is your age?

   Below 25 [ ]

   25-35 [ ]

   36-45 [ ]

   Above 45 [ ]

3. What is your highest level of education?

   A' Level [ ]

   Graduate [ ]

   Masters [ ]

   O' Level [ ]

   Primary level [ ]

4. How long has the company been in existence?

   Less than 5 years [ ]

   Between 5 and 10 years [ ]

Between 10 and 20 years [ ]

Between 20 and 30 years [ ]

Over 30 years [ ]

5. Has your company participated in issuance of corporate bonds through NSE?

   Yes [ ]

   No [ ]

   If no, are you conversant with the process of issuing corporate bonds through NSE?

   Yes [ ]

   No [ ]

Section B: Market Benchmarks

6. To what extent do you agree that interest rates offered on other sources of finance entice firms wishing to issue bonds through the NSE to go for the other alternatives?

   Strongly agree [ ]

   Mildly agree [ ]

   Neutral [ ]

   Mildly disagree [ ]

   Strongly disagree [ ]

7. Please rank the extent to which you agree with the following statement: there is a well functioning money market in Kenya.

   Strongly agree [ ]

   Mildly agree [ ]

   Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

8. Are the costs of issuing bonds through the NSE higher than the costs of other comparable alternatives? Please rank the extent of agreement.

Strongly agree [ ]

Mildly agree [ ]

Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

9. To what extent do you agree that you would rather go for other comparable products (such as loans and commercial papers) rather than issue bonds through the NSE in order to get additional financing?

Very large extent [ ]

Large extent [ ]

Neither large nor low extent [ ]

Low extent [ ]

Very low extent [ ]

10. The government bonds issued has been the benchmark against which other bonds are issued: to what extent do you agree with the statement?

Strongly agree [ ]

Mildly agree [ ]

Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

11. Do you agree that the measures in the table below are being implemented in order to improve the liquidity of secondary markets?

1 means strongly disagree

2 means mildly disagree

3 means neutral

4 means mildly agree

5 means strongly agree

Measure	**1**	**2**	**3**	**4**	**5**
Extending the yield curve					
Setting up issuance calendars to improve transparency					
Increasing the disclosure of information on public debt issuance and statistics					
Holding regular meetings with dealers, institutional investors and rating agencies					
Introducing a system of primary dealers					
Establishing repurchase (repo) market					

12. To what extent would you say the market benchmarks affect issuance of corporate bonds at NSE?

Greatest extent [ ]

Great extent [ ]

Neutral [ ]

Low extent [ ]

Least extent [ ]

13. Do you agree with the following statement? There is a diversity of debt securities at the NSE in terms of maturity, duration, coupon, and credit risk.

Strongly agree [ ]

Mildly agree [ ]

Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

Section C: Market Infrastructure

14. To what extent do you agree with the following statements?

1 means strongly disagree

2 means mildly disagree

3 means neutral

4 means mildly agree

5 means strongly agree

Measure	1	2	3	4	5
The automation process at the NSE has made issuance of corporate bonds easier					
The operational processes at the NSE are a major hindrance to issuance of corporate bonds					
The NSE has the capacity to handle a large investor base					
The duration of transactions at the NSE is too long hence a major impediment to issuance of corporate bonds					

15. What is your opinion as regards to the following assertion: the most common platform for trading debt securities (and bonds in particular) in Kenya is over the counter (OTC).

Strongly agree [ ]

Mildly agree [ ]

Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

16. What is your opinion on the statement that: there is an efficient clearing and settlement system for bonds at the NSE (such as electronic trading of bonds).

Strongly agree [ ]

Mildly agree [ ]

Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

Section D: Regulation and Policy

17. Do you agree that there is a reliable regulatory framework in Kenya which has instilled more investor confidence?

    Yes [ ]

    No [ ]

18. Please explain the extent to which you agree with the following statements:

    1 means strongly disagree

    2 means mildly disagree

    3 means neutral

    4 means mildly agree

    5 means strongly agree

Measure	1	2	3	4	5
The law treats all investors fairly and equally					
The integrity of the bond market has improved due to improved regulations					
The regulatory framework has enabled the control of systematic risk in the market					

There is a longer lad between handover and complete payment which raises the risk of non-delivery of payment					
Lack of enforcement of rules to guarantee the protection of rights and claims through the life of the contract or in case of its dissolution is a major hindrance to issuance of corporate bonds in Kenya					

Section E: Local and Foreign Investor Base

19. There has been a growth of local institutional investors (such as pension funds, insurance companies, mutual funds): do you agree with this statement?

Strongly agree [ ]

Mildly agree [ ]

Neutral [ ]

Mildly disagree [ ]

Strongly disagree [ ]

20. What is your assessment of the statement that "there is a much diversified investor base in Kenya with varied demand requirements, maturity profile and risk preference"?

Very accurate [ ]

Mildly accurate [ ]

Neutral [ ]

Mildly inaccurate [ ]

Very inaccurate [ ]

21. To what extent is it true that the Government has maintained tight security over asset allocation by institutional investors?

Greatest extent [ ]

Great extent [ ]

Neutral [ ]

Low extent [ ]

Least extent [ ]

22. Fill in the table below by stating the extent to which you agree with the following statements:

1 means strongly disagree

2 means mildly disagree

3 means neutral

4 means mildly agree

5 means strongly agree

Statement	**1**	**2**	**3**	**4**	**5**
Foreign investors are an important source of demand for local securities					
The stock market has opened up in order to widen and diversify the investor base					
Liberalization has helped increase foreign participation					

There exists withholding taxes for foreign investors					
There is a provision for discretionary increase in other taxes without prior notice to the investors					
There are other capital controls that affect foreign investors					

Section F: Corporate Governance and Transparency

23. State the extent to which you agree with the following statements.

1 means strongly disagree

2 means mildly disagree

3 means neutral

4 means mildly agree

5 means strongly agree

Statement	1	2	3	4	5
CMA corporate governance issues discourages the issuance of corporate bonds					
Fixed costs related to corporate governance structure deters companies willing to issue corporate bonds through NSE					
The lack of a culture of transparency by firms willing to list bonds in the market is the reason for the low issuance of bonds through the NSE					
Stringent disclosure requirements for companies is a hindrance to issuance of bonds					

24. In your own opinion, what do you think is the main issue/issues that deter corporate entities from issuing bonds through the NSE....................

....

....

....

....

APPENDIX II

Companies that have issued corporate bonds through NSE

1. Barclays Bank of Kenya
2. The Company for Habitat and Housing in Africa, " Shelter-Afrique"
3. East African Development Bank
4. Mabati Rolling Mills Ltd.
5. Faulu Kenya
6. The Eastern and Southern African Trade and Development (PTA) Bank
7. Athi River Mining Company (ARM)

Investment Banks

1. Drummond Investment Bank Limited
2. Dyer & Blair Investment Bank
3. Suntra Investment Bank Limited
4. Afrika Investment Bank Limited
5. Sterling Investment Bank Limited
6. ApexAfrika Investment Bank Limited
7. Faida Investment BANK limited
8. Starndard Investment Bank Ltd
9. CFC Final services
10. African Alliance Kenya Security Services
11. Renaissance Capital (Kenya) Limited

APPENDIX III

Agriculture

1. Rea Vipingo Ltd
2. Sasini Tea & Coffee Ltd
3. Kakuzi Ltd.

Commercial and services

1. Access Kenya Group
2. Marshalls E.A Ltd.
3. Car & Generals Ltd.
4. Hutchings Biemer Ltd.
5. Kenya Airways Ltd.
6. CMC Holdings Ltd.
7. Uchumi Supermarkets Ltd.
8. Nation Media Group Ltd.
9. TPS (Serena) Ltd.
10. ScanGroup Ltd.
11. Standard Group Ltd
12. Safaricom Ltd

Finance and Investment

1. Barclays Bank of Kenya Ltd
2. CFC Stanbic Bank Ltd
3. Housing Finance Company of Kenya Ltd
4. Centum Investment Ltd.
5. Kenya Commercial Bank Ltd.
6. National Bank of Kenya Ltd.
7. Pan Africa Insurance Holdings Co. Ltd.
8. Diamond Trust Bank of Kenya Ltd.
9. Jubilee Insurance Co. Ltd.

10. Standard Chartered Bank Ltd.
11. NIC Bank Ltd.
12. Equity Bank Ltd.
13. The Co-operative Bank of Kenya Ltd

Industrial and Allied

1. Athi River Mining Ltd
2. BOC Kenya Ltd
3. British American Tobacco Kenya Ltd
4. Carbacid Investments Ltd
5. Olympia Capital Holdings Ltd
6. E.A. Cables Ltd
7. E.A. Breweries Ltd
8. Sameer Africa Ltd
9. Kenya Oil Ltd
10. Mumias Sugar Company Ltd
11. Unga Group Ltd
12. Bamburi Cement Co. Ltd
13. Crown Berger (K) Ltd
14. E.A. Portland Cement Co. Ltd
15. Kenya Power & Lighting Co. Ltd
16. Total Kenya Ltd
17. Eveready East Africa Ltd
18. Kengen Ltd

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