

**A SURVEY OF THE CHALLENGES AND BENEFITS OF REGIONAL  
CROSS LISTING: THE CASE OF ELIGIBLE COMPANIES  
QUOTED AT THE NAIROBI STOCK EXCHANGE**

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**A MANAGEMENT RESEARCH PROJECT SUBMITTED IN  
PARTIAL FULFILMENT FOR THE REQUIREMENTS FOR THE MASTER OF  
BUSINESS ADMINISTRATION DEGREE  
UNIVERSITY OF NAIROBI**

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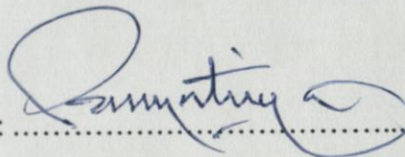


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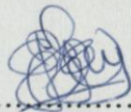
## DECLARATION

I, **Mutisya Peter Mumo**, hereby declare that except where due acknowledgement has been made, this project work is mine alone and has not been previously submitted in whole or in part, to qualify for any other academic award.

Signed:  ..... Date: 29/10/08 .....

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I, **Jay M. Gichana** hereby certify that this project has been presented for examination with my approval as the University of Nairobi Supervisor.

Signed:  ..... Date: 22.11.08 .....

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## ACKNOWLEDGEMENTS

### DEDICATION

This work is dedicated to my wife, Elizabeth and dear Daughter, Maureen.

Thank you Elizabeth for your patience, support, encouragement and understanding throughout the study period. Thanks to my friend and wife for having encouraged me and assisted with the general work and finally the completion of this research project. Maureen thanks for the overwhelming interest, wisdom and persistent encouragement & support which played a key role in the completion of this work.

To my mother and joyfully my late father, I thank you for sowing the seed of education in me and always encouraging and challenging me to reach my full potential.

Thanks to my lecturers, supervisors and colleagues in the MBA program for guidance and encouragement during the course.

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To my mother and posthumously my late father, I thank you for sowing the seed of education in me and always encouraging and challenging me to reach my full potential.

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## ABSTRACT

The objective of this study was to identify the challenges that companies listed at the Nairobi Stock Exchange (NSE) and are eligible for cross listing in the regional exchanges face, and the benefits that accrue or are realizable upon cross listing.

Past research has mainly focused on the impediments to listing at the NSE and the benefits accruing to firms listed at the NSE. It might be of interest to establish what challenges and benefits are there in cross listing regionally, Research in different markets has also come out with different results in addition to highlighting that there are in majority of cases, net benefits that accrue to firms that cross list.

Regional cross listing has performed dismally since the time the NSE started trading some 54 years ago and since 2001 when the first Kenyan company cross listed, and with only a further two companies cross listing into the regional exchanges, namely the Uganda Securities exchange and the Dar es Salaam Stock exchange thereafter. This is despite about 40 being listed on the main investment market segment and therefore meeting the main eligibility requirement for cross listing regionally. This would portend there are issues or challenges that eligible NSE listed companies have faced.

The study used primary data collected through questionnaires administered to respondents from 40 targeted eligible NSE listed companies. The response rate for the questionnaires administered was 60%. The data analysis procedure involved the tabulation of the responses such as the factors considered by the respondent companies to be challenges and impediments to regional cross listing. Data was also presented using tables from coded questionnaires and means, and their rankings were used to analyze and present the findings.

From the study, the firms' need to attain an increased market visibility, the ability to finance growth and development out of cross listing initiative, having an improved firm's image and status, and attaining desired liquidity of company shares, are the main challenges for eligible NSE listed companies seeking regional cross listing at the Dar es Salaam and Uganda Stock exchanges. The research findings reveal that the other

challenges firms listed in the Main investment market segment consider or encounter in order of ranked importance include: the development of strategic alliances and, meeting shareholder requirements.

However, tax incentives, governance and capital structure issues, received low ratings in the importance of challenges.

In the case of benefits realizable, those highly rated were attaining an improved corporate image and prestige, acceptance and recognition of company brand across the region, and attaining a wider capital base.

With the demystifying of the perception that major bottlenecks exist and hardly any significant net benefits accrue from cross listing, more eligible companies should cross list regionally in order to reap the benefits of cross listing.

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**ABBREVIATIONS**

ADRs	American Deposit Receipts
AIMS	Alternative Investment Market Segment
AMEX	American Exchange
ATS	Automated Trading System
CDS	Central Depository Settlement
CMA	Capital Markets Authority
DSE	Dar es Salaam Stock Exchange
EASEA	East African Securities Exchanges Association
FISMS	Fixed Income Securities Market Segment
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
IPO	Initial Public Offer
LSE	London Stock Exchange
LTD	Limited Company
MIMS	Main Investment Market Segment
N	Number of responses
NSE	Nairobi Stock Exchange
NYSE	New York Stock Exchange
OTC	Over the Counter markets
SEC	Securities & Exchange Commission
Sh	Kenya shillings
US	United States of America
USE	Uganda Securities Exchange
%	Percentage

## CHAPTER ONE

### 1.0 INTRODUCTION

#### 1.1 Background

##### 1.1.1 Role of Capital Markets

An essential part of the financial sectors of modern economies is the capital markets, which provide alternative savings tools to savers, and non-bank sources of financing for enterprises. Capital markets promote economic growth through improved efficiency in savings mobilization (Schimdt-Hebbal and Solimano, 1996). According to Aggarwal (2001) capital markets allow for efficient capital raising and allocation of limited resources. Primary and secondary capital markets provide issuers the ability to raise capital and investors to invest in various financial instruments at low transaction costs, helping to lower the cost of capital for issuers so that they can compete globally. Capital markets also facilitate improving corporate governance disclosure standards, transparency and accounting standards and help increase savings that are channeled into productive investments.

Primary markets facilitate the issuance of new securities and provide funds to the initial issuer of the securities while trading of existing securities takes place in the secondary markets and enhances liquidity. Secondary stock market transaction take place at organized exchanges such as the New York Exchange, London Stock Exchange, Nairobi Stock Exchange (NSE), Uganda Securities Exchange and the Dar es Salaam Stock Exchange while other financial market transactions take place in the over-the-counter markets (OTC), a telecommunication markets with several market players.

Capital markets mostly deal with securities of listed companies although sometimes unlisted shares are traded at the OTC markets. Shares represent a significant part of wealth for both institutional and individual investors. Similar to debt securities, firms issue shares to raise funds, and the purchasers of these shares become part owners. The issuing company is under no obligation to purchase this stock but the shareholders can sell it in the secondary markets to other investors.



According to Samuelson (1992) an investment is an economic activity, which foregoes consumption today in order to increase output in the future. It includes tangible capital – equipment, inventories and structures, and intangible investment (human capital or education, research and development, and health). In finance an investment is a purchase of a security such as stock, bonds and can be taken by corporate bodies, the state or individuals. An investment can take the forms of expansion of new business, expansion of existing business or replacement and modernization (Reiley & Brown, 1996). In simple terms, an investment can be defined as any vehicle into which funds can be placed with expectations that it generates positive income and its value will be preserved or increased.

Investors get rewards in form of returns such as current income or increased value through investments. Investment opportunities available range from interest in bank savings to investments in newly issued stocks (Gitman & Joehmk, 2002). They can be securities such as stocks, bonds, options or property.

Investments chosen by investors will depend on their goals, resources and personality.

Investors can be institutional, individuals, local or foreign and each category may consider different factors before making an investment decision. Factors considered by investors include – risk, firm profitability, liquidity position, dividends, asset structure of firm in terms of level of liquidity, monetary and fiscal policies of governments, industrial factors that affect the firm operation, financing policy and capital structure of the firm. Other factors may include future expansion plans, diversification into new markets, management and staff of the company. (Reily & Brown, 1996; Hurt & Bloch, 1993; Fisher & Jordan, 1996; Bhalla, 1979; Gitman & Joehmk ,2002).

A stock exchange is a competitively centralized market place where institutions and individuals may buy or sell existing corporate securities. Stock exchanges are economically important institutions as they provide investors with homogeneous



corporate assets, liquidity and price information. A stock exchange brings together in one market place the providers of capital and organizations that require capital.

The NSE and Capital Markets Authority have encouraged investment in securities of companies quoted at the NSE. Over the years the NSE has provided necessary information regarding stock trading and also in creating the necessary legal framework for trading to take place. The NSE has been in existence for the last 53 years having been established in 1954 and, the number of listed companies has averaged about 50 but of these less than six percent have cross-listed in the regional East African stock exchanges.

In 2006 and this year, new listings and those in the pipeline include Kenya Electricity Generating Company (KenGen), ScanAd Group, Equity Commercial Bank, Eveready, Access Kenya, Kenya- Re, and Safaricom. However, no significant cross listing has taken place at the three exchanges during the period they have been in existence despite the known benefits from studies done elsewhere by Karolyi (1998,2004),Foerster & Karolyi (1999),Chowdhry,B.&V.Nanda (1991),Merton (1986),Coffee,J.(1999,2002), Baker,Nofsinger & Weaver (2002) among others, in the developed world and in markets in America, Europe, Asia. These benefits, which are further addressed hereunder, include getting access to a wider capital base across the region, access to cheaper additional sources of capital, having a foreign or regional presence, acceptance and recognition of a firm's brand outside the domestic market, and increased liquidity of the firm's shares. The purpose and justification for this study is hence in order to have a better understanding of what the local experience has been.

The companies listed in Kenya at the NSE are 55 whilst those listed at the Uganda Stock Exchange and the Dar es Salaam Stock Exchange are nine at each of the bourses. However there are only 3 Companies listed at the NSE that have cross-listed in the two other East African Stock Exchanges.

Mugo (1999) identified factors considered by institutional investors in selecting investments in shares from the NSE as economic factors, industry factors, company factors, return and risk factors. Ayieye (2004) identified factors considered by individual



investors in investing in shares of company's quoted at the NSE. Njiraini (2006) identified benefits accruing to companies listed at the NSE. Chepng'ar (2006) carried out a survey of the factors that account for the dismal listing at the NSE. However, no known study has been undertaken to identify the challenges that face Kenyan firms in cross listing so that the company's shares are quoted at the East African stock exchanges.

This study will concentrate on the challenges, factors that have influenced cross listing by eligible firms quoted at the NSE. The study aims at finding out the causes for the dismal cross listing by the eligible listed firms and the benefits that accrue from cross listing.

Listing is the process by which a business owned by one or a few individuals changes into a business with many owners. It entails offering part ownership of a company to the public. It is the process through which privately owned firms transit to public owned ones with shares traded at a stock exchange.

According to Lubberink and Huijgen (2006), cross-listing of shares occurs when a firm lists its equity shares on one or more foreign stock exchange in addition to its domestic exchange.

It was once assumed that cross listing was basically a means of integrating segmented markets and thus enabling the issuer to access trapped pools of liquidity. The traditional explanation was that cross listing broke down market segmentations and allowed the firm to reach trapped pools of liquidity. Segmentation of markets because of investment barriers such as taxes, regulatory restrictions, or informational constraints, creates an incentive for firms to cross-list in order to achieve market integration. Economic theory has long suggested that stock prices should rise for firms in segmented markets that cross-list (Merton, R.1987; Eun and Janakiramanan, 1986; Jayuranum, Shastri and Tandan, 1993). A variation with a finding, that cross-listing between two segmented markets leads initially to a higher equilibrium market price and a lower expected return thereafter on this basic theory has suggested that, as cross-listing increases the shareholder base, the firm's risk is shared among more shareholders, which reduces the



firm's cost of capital. For a time, empirical evidence seemed to confirm this explanation because abnormal returns incurred by cross-listing firms seemed to rise and then decline post-listing (Foerster and Karolyi, 1999; Alexander, Eun and Janakiraman, 1987). Until recently, little evidence suggested that a dual listing actually increased firm value.

But at least one recent study has found a different pattern: Cross-listing results in positive abnormal returns that are statistically significant and that do not dissipate post-listing. Unlike earlier studies, this study focused on the announcement date of the decision to cross-list, not the actual listing date. The announcement date is clearly the theoretically more appropriate date because the market should react to news of the expected improvement, and frequently there is an appreciable delay between the announcement and the actual listing. In addition, this study by Professor Darius Miller (1999), (the "Miller Study") found that the abnormal returns were considerably greater in magnitude when the firm cross-listed on the NYSE or Nasdaq than when the firm just established a depository receipt facility in the United States and listed only on an over-the-counter market.

Although these findings are not necessarily inconsistent with the market segmentation hypothesis, they better fit the "bonding hypothesis."

A newer interpretation as noted by Coffee J. (2002) is today emerging that cross-listing may also be a bonding mechanism by which firms incorporated in a jurisdiction with weak protection of minority rights or poor enforcement mechanisms can voluntarily subject themselves to higher disclosure standards and stricter enforcement in order to attract investors who would otherwise be reluctant to invest or who would discount such stocks to reflect the risk of minority expropriation. Although both explanations have some validity, the second or "bonding" explanation has the greater predictive power for the future, because the barriers that once segmented markets have largely eroded and will continue to do so, thus reducing the need for issuers to enter distant markets to access trapped pools of liquidity.

"Bonding" is a term that refers to the costs or liabilities that an agent or entrepreneur will incur to assure investors that it will perform as promised, thereby enabling it to market its



securities at a higher price. The classic example would be the surety bond purchased by the agent and protecting its shareholder principals.

Cross-listing on a United States exchange is usually effected by the issuer first establishing a depository receipts facility (typically, with a major U.S. bank). The bank will hold shares of the foreign issuer and issue depository receipts to U.S. investors, who will thereby achieve the convenience of dollar-denominated trading. These depository receipts (ADRs) then may (or may not) be listed on a U.S. exchange or Nasdaq.

While depository receipts are primarily used simply to list a stock in a foreign market, their listings can also be accompanied by equity offerings in the foreign market.

The impact of cross-listings has been particularly pronounced on the NYSE. Foreign listings on the NYSE grew from approximately 2% of all NYSE listings in 1975 and just over 5% in the early 1990's to over 15% in 2000. Foreign listings have more than quadrupled since 1990, while domestic listings on the NYSE actually declined since 1998. The NYSE's inability then to attract a net increase in domestic listings, while its foreign listings soared over the same period, suggested that a NYSE listing did something for a foreign issuer that it does not do for a domestic issuer. For the foreign issuer, the NYSE offered a critical advantage in its reputation as the leading repository of high disclosure standards and market transparency.

The bonding hypothesis posits that cross-listing on a United States stock exchange (including Nasdaq) commits the listing firm to respect minority investor rights and to provide fuller disclosure. Listing on a U.S. exchange does so both because the listing firm becomes subject to the enforcement powers of the SEC; investors acquire the ability to exercise effective and low-cost legal remedies such as a class action and the derivative action that are not available in the firm's home jurisdiction; and the entry into the U.S. markets commits the firm (at least when it lists on an exchange or Nasdaq) to provide fuller financial information and to reconcile its financial statements to U.S. GAAP accounting principles.



### 1.1.2 Benefits in listing and cross listing

The traditional argument within the academic literature to cross-list abroad in addition to a listing in the domestic country is that firms seek such opportunities to benefit from a lower cost of capital that arises from their shares becoming more accessible to global investors whose access would otherwise be restricted because of international investment barriers. Cross listing may also be driven by marketing considerations such as to increase visibility with customers by broadening product identification, to improve labor relations in foreign countries by introducing share and option plans for foreign employees. There are, however, also disadvantages in deciding to cross-list and these include increased pressure on executives due to closer public scrutiny; increased reporting and disclosure requirements and additional listing fees.

A questionnaire completed by managers of international companies (Mittoo, 1992b; Fanto and Karmel, 1997; Bancel and Mittoo, 2001) has shown that firms cross-list in the US mainly because of specific US business reasons such as US acquisitions, business expansion and publicity, liquidity and status of US capital markets -listing of competitors, benefits of financial analysts. On the other hand, meeting the Securities & Exchange Commission (SEC) disclosure requirements and preparing US – Generally Accepted Accounting Principles (GAAP) reconciliation was cited as the key disadvantages.

Officials of ADR companies without an official listing perceived the expansion of the US shareholder base as the principal benefit followed by specific US business reason, while time-consuming and expensive US-GAAP reconciliations as well as listing fees were cited as the main deterrents and impediments from an official US listing, with additional disclosure requirements being cited as less difficult to overcome (Lubberink and Huijgen, 2006).

In regard to listed companies, the benefits that accrue due to listing and by extension can be associated with cross listing include; the access to cheaper additional sources of capital. Listed firms get the opportunity to raise long-term capital to finance expansion plans, enhance competitiveness, and establish appropriate financial structures through the



stock exchange as it serves as a valuable source of long-term capital for such companies. Besides the issuing and listing of common shares, a listed firm can also raise additional capital by issuing and listing other types of securities like preference shares, warrants, and debentures. In the long term, the access to the stock market increases the company's borrowing power and enhances its bargaining power for the reduction of borrowing costs (Krips Newman, 1985).

Secondly, listed companies can benefit from the facilitation by the Exchanges of promotion and awareness. Regulatory authorities like the Capital Markets Authority (CMA) in Kenya scrutinize listed companies and due to this, these companies generally present a positive public image. Listed companies are usually perceived to be financially healthy and able to maintain transparent information disclosure. This image and the regional presence, acceptance and recognition of the company brand across the region plays an important role in boosting the firm's credibility, increasing its bargaining power, and indirectly building awareness and popularity with regard to its products and services. Moreover, company information released through the CMA is beneficial to the company in terms of enhanced public acceptance and credibility, and the equivalent of substantial advertising expenses, which non-listed competitors have to pay to develop and attain a similar reputation and public acceptance.

Third is access to a wider capital base across the region. Being a listed company can help attract further foreign investment in the firm, therefore opening up opportunities for business expansion and modernization. These opportunities can greatly enhance the competitiveness of a company in today's globalized economy,

Fourth is management accountability. The level of stock prices to some extent can reflect investor confidence, and is a function of the company's standard of operations. The management of a public company must be accountable to their shareholders in ensuring that the company operates efficiently and is professionally managed in order to benefit them, and in so doing mitigate possible removal of the firm's board by the shareholders through exercising their powers at annual general meetings.



Other benefits are the prestige of regional listing and employee pride, the opportunity to use the shareholder capital by offering shares as the means of acquisition during merger and acquisitions negotiations where a business seeks further expansion, and liquidity of securities. Liquidity of securities generally increases upon listing benefiting shareholders as they find potential buyers more easily, and their stocks become now more marketable.

## 1.2 Statement of the Problem

The number of cross-listed companies in the developing economies including Kenya has not increased as it has in the developed countries. Several reasons have been put forward as being the impediments to increased cross listing and they include lack of awareness, stringent regulatory requirement, enormity of costs, loss of confidentiality and lack of investment opportunities among others. These impediments seem to have impacted negatively on the urge of companies to cross list in the emerging economies than in the developed world. Pagano et al (1998) stated that adverse selection, fixed costs and loss of confidentiality are the main impediments to listing by companies in Italy. Leland and Pyle (1977) established that information asymmetry adversely affects the average quality of the companies seeking a new listing.

Scanty reliable empirical evidence exists on the challenges and factors considered by public companies in cross listing in most emerging economies and Kenya in particular. Most of the studies on cross listing have been done in the developed countries (as to the reasons why companies cross list or the impediments to cross listing). It is possible that regulatory authorities and other capital market players may not be addressing the real challenges or impediments in their continued policy incentives aimed at boosting cross listings from the Nairobi Stock Exchange into the East African Exchanges.

This study therefore seeks to find out what challenges and factors eligible listed companies quoted at the NSE face and consider in cross listing at the Uganda Securities



Exchange and Dar es Salaam Stock Exchange, and identify the benefits that accrue from cross listing at the East African Exchanges.

### 1.3 Objectives of the Study

The Objectives of the study are:

(i) To identify the challenges or impediments that listed companies quoted at the Nairobi Stock Exchange encounter in cross listing at the Regional Stock Exchanges that is, the Uganda Securities Exchange and the Dar es Salaam Stock Exchange.

(ii) To determine the benefits that accrue to companies as a result of cross listing at the East African Stock Exchanges.

### 1.4 Importance of the Study

This study is important to the following groups of people:

#### 1.4.1 Corporate Managers and Directors

Corporate managers and directors need to appreciate the key challenges and evaluate several factors before taking up investment opportunities particularly those of ordinary shares quoted at the East African Exchanges through cross-listing to ensure that they make the correct investment decisions that maximize shareholders wealth. This study thus enables them to identify some of the main challenges and factors they need to evaluate before cross-listing their companies stock at the East African bourses.

#### 1.4.2 Regulators

The CMA and the NSE as self regulatory organizations in facilitating the development of the capital markets can use the findings of this study as a basis of formulating policies

that facilitate growth of the market and also for regulatory purposes, address the real challenges or impediments in the continued policy incentives developed and implemented that are aimed at cross-listing. It will also provide a basis of conducting the Regulating Authorities investor education campaigns that target firms that wish to cross list.

#### 1.4.3 Investment Advisors and Consultants

Knowing the main challenges and considerations in cross-listing, they will be able to offer appropriate advisory services that enable potential companies make more prudent decisions.

Investment advisors just like stockbrokers and agents need to advice both institutional investors and individuals. The study would also encourage listed companies since they would be able to get some of the information, which would initially not be available and make informed decisions on cross listing.

#### 1.4.4 Individual Investors

The Investing public will know what the key challenges to cross listing are and the important considerations made by companies in seeking cross-listing and decide whether or not to include them in their portfolios.

#### 1.4.5 Academicians and scholars

The findings of this research would be basic to academicians and would help them to carry out further research in the field of finance. This would further help them understand some of the challenges and specific factors that apply to business as compared to what theorist say about cross listing.



## CHAPTER TWO

### 2.0 LITERATURE REVIEW

#### 2.1 Empirical Studies on why Companies cross list.

During the past two decades, the pace of globalization in capital markets has accelerated and broadened in scope to make easier ownership and trading in securities from around the world. Total cross-border portfolio flows of capital between residents of the U.S. and all other countries represented less than 1% of U.S. Gross Domestic Product (GDP) in 1980, according to the U.S. Treasury; today, they comprise almost 30% and total \$3.5 trillion.

Equities have been an important component of this rapid expansion of cross-border capital flows. As a result, tremendous competition has arisen among major stock exchanges around the world to attract listings and trading volume and to stir up capital-raising activity by overseas companies in their markets. Companies have responded in kind. During the 1990s, the number of foreign companies with shares cross-listed and trading on major exchanges outside of their home markets reached as high as 4,700 and included not only companies from developed economies, but also many from emerging economies opening up their stock markets to foreign investors for the first time.

During the 1990s, there was a concomitant growth in the number of theoretical and empirical studies in the economics, finance, strategy and accounting fields seeking to understand the net benefits of the corporate decision to list shares on overseas exchanges. These studies emphasized the importance of the benefits of a lower cost of capital, an expanded global shareholder base, greater liquidity in the trading of shares, prestige, and publicity over the costs of having to reconcile financial statements with home and foreign standards, direct listing costs, exposure to legal liabilities, taxes and various trading frictions according to Karolyi, G.A (1998) in his survey of recent research initiatives.



Karolyi (1998) surveyed almost 70 contributions on the economic implications of the corporate decision to list shares on an overseas stock exchange. The focus was on the valuation and liquidity effects of the listing decision and on the impact of listing on the company's global risk exposure and its cost of equity capital. A bias was detected in this early survey in its almost exclusive focus on the phenomenon of the 1980s and 1990s, a period which saw rapid growth in the number of non-U.S. companies pursuing listings in the U.S. markets.

### 2.1.1 Share Price Reactions to Cross-listing Decisions

The majority of the empirical studies on international listings addressed the share price reactions around a firm's listing decision. Some of these event studies employed monthly returns using a two-year event window, while others studied daily returns using a more conventional two-month window. While some focused on listing dates, others evaluated on exchange-application, application-acceptance or regulatory-approval announcement dates. However, the most comprehensive studies featured were those of Miller (1999) and Foerster and Karolyi (1999). Miller's event study found a positive 1.15% average abnormal return for 183 ADR-initiating announcement dates between 1985 and 1995. His study concentrated on the 80 days around the event and included OTC listings, private placements, as well as exchange listings on the NYSE, AMEX and Nasdaq stock exchanges.

Two important auxiliary findings in Miller's study were that significantly higher announcement-day price reactions were obtained for emerging market firms (1.54%) and that these reactions were higher for exchange listings (2.63%). He interpreted this evidence as being consistent with the prevailing wisdom that the net benefits to cross-listing firms stem from their decision to overcome investment barriers. Foerster and Karolyi employed weekly abnormal returns for the two years around the listing dates for 183 ordinary and ADR listings. While they found pre-listing run-up of abnormal returns of 10% and an average post-listing decline of 9% surprisingly, they found that these longer-run share price reactions around listings were as dramatic for developed-market as



for emerging-market firms, and that listings associated with capital-raising (known as Level 3 ADRs) were associated with lower post-listing share-price declines. They proposed that prevailing explanations based on investment barriers and segmented markets were inadequate and offered several other possible explanations for these anomalous results with additional cross-sectional analysis of the cumulative abnormal returns. Ultimately, they related it to strategic market-timing decisions by the management and to other theories about diminished market incompleteness (Merton, 1987) as the firm's shares become more widely known following the cross-listing

### 2.1.2. Changing market risk exposures and the cost of capital

The theoretical developments inspired by the early and subsequent event-studies rationalized that cross-border listings of stocks are positively viewed by investors because the action taken by management circumvents many of the regulatory restrictions, costs and information problems that represent barriers to cross-border equity investing.

Stapleton and Subrahmanyam (1977) and Alexander et al. (1987), Eun and Janakiramanan (1986) and Errunza and Losq (1985) show how the cross-listing of shares across two markets that would be otherwise segmented by such barriers would lead to a higher equilibrium market price and a lower expected return. The revaluation arises from the elimination of a "super" risk premium (Errunza and Losq's term) that represents compensation to local investors for their inability to diversify their risks globally. An important implication of these models is that shares of a cross-listing firm may experience significant changes in its local and global market risk exposures and its cost of capital. Numerous empirical studies followed and were carefully separated into those that studied U.S. firms listing abroad and non-U.S. firms listing in the U.S. Once again, the results were distinctly different. Typically, these studies evaluated changes in total risk (ex post standard deviations of returns or ex ante implied volatilities from options) or systematic market risks (with different returns generating models) in event-time around the listing date.



For U.S. firms listing abroad (Howe and Madura, 1990; Varela and Lee, 1993b; Howe et al., 1994; and Lau et al., 1994), stock return volatilities changed very little and home market betas actually rose slightly. Fewer studies had examined changes in risks for non-U.S. firms listing in the U.S. (Foerster and Karolyi, 1993, 1999; Jayaraman et al., 1993), but those studies had either uncovered a significant decrease in local-market betas with no change in global- or U.S.-market betas or a significant increase in the latter with no change in the former. These results for non-U.S. companies were interpreted as consistent with a lower cost of capital after cross-listing given the typically-higher market risk premiums that arise in local markets relative to global markets and given the positive revaluations observed around listings, while acknowledging appropriate caveats on the difficulties of applying equilibrium models of returns, computed estimates of the decline in cost of capital which ranged from around 33 basis points for non-U.K. European companies to 207 basis points for Asian companies. A follow-up study by Errunza and Miller (2000) and a recent working paper by Hail and Leuz (2005) suggest that these early, rough estimates are actually quite reasonable. Errunza and Miller examine post-listing returns for 126 firms which cross-listed in the U.S. from 32 countries and uncover a 42% decline in the cost of capital, which, they assert, is driven by the ability of U.S. investors to span the foreign security prior to cross-listing.

### **2.1.3. Liquidity, Multi-market Trading, Price Discovery and Arbitrage**

Surveys of corporate managers that have initiated overseas listings for their firms (Mittoo, 1992b, Fanto and Karmel, 1997) often cite increased liquidity as a primary motivation. Bancel and Mittoo (2001) find that the importance of liquidity is still a critical factor. Their newest survey of 79 European managers measures the perceived net benefits of foreign stock listings on both U.S. and foreign exchanges and shows that it is significantly correlated with total trading volume after foreign listing. Several studies consider the liquidity impact of the listing decision itself. Noronha et al. (1996) show that no measurable difference in daily weighted average spreads exists for U.S. firms after listing in London or Tokyo; Foerster and Karolyi (1998) provide evidence of a 29%



increase in intra day volume and a 44 basis point decline in intra day effective spreads for 52 Canadian companies listing in the U.S. Domowitz, Glen and Madhavan (1998) examined weekly returns, volatility and volumes of 25 Mexican stocks cross-listing on U.S. markets and offer a more complex interpretation that is related to the degree of transparency between the markets competing for order flow. They show that higher volume and lower market impact costs arise for those firms with no foreign ownership restrictions.

For a sample of 128 NYSE-listed non-U.S. stocks, Smith and Sofianos (1996) measured an increase in the combined value of trading from \$240 million per stock per day to \$340 million, a 34% increase.

## 2.2 Process of going public and cross listing in Kenya

In most of the developed economies, firms wishing to issue shares to the public have to first apply for listing on the stock exchange. However, in East Africa and Kenya in particular, companies apply to the Capital Markets Authority, which is the Regulator-body. The regulator or each stock exchange has eligibility requirements which a company must fulfill before it can be listed. The application by the company has to be accepted and approved by the appropriate authority and then the company issues a prospectus, which provides information pertinent to it and to the issue and invites the public to subscribe to the issue. The flotation of a company's shares can be made through an underwriter who guarantees the issue while at other times the company may underwrite the issue directly. The shares approved for listing are sold to the public mainly through stockbrokers, investment banks and other financial institutions. Upon the shares having been sold to the public, and the company, having satisfied all the flotation requirements, the Company is formally listed on the stock exchange and its shares allowed to be traded in the secondary market.

Companies can list either on the Main Investment Market Segment (MIMS) or Alternative Investment Market Segment (AIMS) depending on whether they comply with the respective prescribed listing requirements. The more mature and profitable



companies normally list directly in the Main Investment Market Segment (MIMS), under which listing requirements are more demanding, whereas young and upcoming companies will tend to list under the AIMS as to begin with and then in the future seek listing under the MIMS upon establishing a track record.

The company's shares are bought and sold by those who acquired them during the primary issue or from others and those who might want to acquire the shares of the company, in the secondary market with the trade being determined by demand and supply forces in the market. Whereas a primary issue is used to raise funds for the company, the secondary market trade benefits the individual buyers and sellers of securities.

## 2.2.1 Benefits of going public and cross listing

There is a substantial literature on the reasons for cross-listing, among them is review of cross-listings by Karolyi (1998, 2004). Early theoretical and empirical work focused on the cross-listing benefits associated with market segmentation. Later, explanations based upon theories of asymmetric information were developed, including the awareness, liquidity, bonding, signaling, and market timing hypotheses. Recently, Sarkissian and Schill (2003) have identified a proximity preference in the cross-listing decision.

### 2.2.1.1 Capital Raising

As a benefit of cross-listing capital raising is the ability to raise external capital, either because credit constraints are relaxed, or because investor protection is increased due to a bonding effect. Consistent with the relaxing of credit constraints, Lins, Strickland, and Zenner (2003) find that the sensitivity of investments to free cash flow declines after cross-listing in the US. Reese and Weisbach (2002) find evidence consistent with an increase in capital raising as a results of the bonding hypothesis in that the cross-listing also increases the ability of a firm to raise capital in its own market. However, there may also be elements of market timing in the cross-listing decision. Assuming management



has inside knowledge on the value of the firm, they would choose to list when and where they are most able to capitalize on their firm's overvaluation.

Foerster and Karolyi (1999) find a pre-listing run-up in abnormal returns followed by a post-listing decline, consistent with the market-timing hypothesis. However, contrary to market timing, the post-listing decline is smaller for those firms that raise capital at the time of cross listing.

Mittoo (2003) looks at Canadian firms that cross-list in the US and finds that these stocks under-perform Canadian market indices by up to 30% in the three years after cross-listing.

Furthermore, King and Segal (2006) provide evidence that Tobin's q peaks at the time of cross-listing for Canadian firms, and then monotonically decreases afterwards.

### 2.2.1.2 Liquidity

Cross-listing reduces transactions costs through an improvement in market liquidity following the foreign listing (Karolyi 1998). A market is considered to be liquid if transactions can be executed rapidly and with little impact on prices. The relationship between liquidity and interlisting is largely attributed to the global competition for order flow (i.e., trading volume). This competition causes exchanges to continuously look for ways to improve their trading processes in order to enhance market quality and maintain or attract order flow. Improvements to trading processes relate, for example, to trade execution, disclosure of trading information, and to the presence and activities of market-makers. In theory, when a security trades on multiple markets, traders who do not have superior information regarding future returns will base their trading decisions largely on transactions costs. If one exchange has lower transactions costs than the other(s), order flow emanating from these so-called liquidity traders will gravitate towards that exchange. Other traders who wish to profit from information in their possession that has either not been disseminated to, or properly assimilated by, the whole trading community will then have incentives to trade on that market as well in order to better conceal their



trading intentions. This exchange would eventually reap most of the trading volume for the stock and dominate the market (Chowdhry and Nanda 1991; Huddart, Hughes, and Brunnermeier 1998).

In surveys of financial managers of cross-listing firms, Fanto and Karmel (1997) and Mittoo (1992) find that managers cross-list to increase the liquidity of their stock. The purpose of cross-listing in the liquidity hypothesis is to increase the liquidity of the company's shares. Empirically, several papers have found a positive liquidity effect after cross-listing in the US.

There may be several reasons why increased liquidity is important for managers. First, in a Kyle (1985) auction model, liquidity is related to the information environment as it depends on the interaction between a risk-neutral market maker, informed traders, and (uninformed) liquidity traders. Chowdhry and Nanda (1991) examine this model in a multi-market context and show that the increased competition among the market-makers in dually-listed stocks results in a lower bid-ask spread. Putting this result in the context of the Amihud and Mendelsson (1986) model, investors require a lower return for investing in securities with a lower bid-ask spread. The benefit of cross-listing comes as a reduction in the firm's bid-ask spread, resulting in an increase in firm valuation. A second benefit comes as this improved liquidity could attract more institutional investors. In essence, low liquidity acts as a barrier for these institutional traders as trading costs in low liquidity stocks can be prohibitive. This could be interpreted in the context of the market segmentation hypothesis, where the institutions are the restricted investors. Improving the liquidity turns these institutions into unrestricted investors, lowering the "super-risk premium" and resulting in a share price increase.

Third, Huddart, Hughes, and Brunnermeier (1998) show that insiders may prefer to list on a more liquid exchange to camouflage their trades. In their model, liquidity traders and insiders both choose to trade on the high disclosure exchange. The liquidity of the US and home-market shares is affected by the arbitrage ability of shares across markets. In a world without frictions, there should be parity in the prices of the two securities, and



deviations from parity should be quickly arbitrated away and should also be unrelated to any other factors. Frictions such as taxes, transactions costs, short-selling restrictions, and noise traders can impede this arbitrage process. Froot and Dabora (1999) examine price differences for a small sample of “Siamese twin” shares and find these deviations exhibit excess co-movements with the market index where more trading takes place, which is consistent with the presence of noise-traders as in the co-movement models of Barberis, Shleifer, and Wurgler (2002). Gagnon and Karolyi (2004) extend the work of Froot and Dabora by examining price differences in a much larger sample of 581 US / home markets pairs of cross-listed securities. They find that location of trading, illiquidity and a host of other impediments to arbitrage activity between the two markets are positively associated with the magnitude and the persistence of price differences across the two markets. Therefore, this lack of arbitrage ability could affect the success of the cross-listed securities, resulting in a migration of trading back to the home exchange and an eventual cross-delisting. This is consistent with the model of Chowdhry and Nanda (1991), in which one market establishes itself as the dominant exchange and attracts most of the trading. Baruch, Karolyi, and Lemmon (2005) develop a model to explain which exchange is most likely to attract the most trading in a cross-listed stock. In their model, market makers are able to update their information based on other assets traded on the same exchange. As a result, trading migrates to the exchange that has assets that are most correlated with the cross-listed asset. Halling, Pagano, Randl and Zechner (2004) examine the location of trading activity of European companies that are cross-listed and find results consistent with a “flow-back” of trading to the home exchange. After a typical cross listing, there is a rise in foreign trading activity, but this foreign trading quickly declines to very low levels.

### 2.2.1.3 Signaling

Under the signaling hypothesis, management chooses to cross-list in a foreign market to credibly convey their inside information to uninformed outsiders. Cantale (1996), and Moel (1999) show how the cross-listing choice can be explained as a signaling equilibrium. In their models, the cost of signaling includes listing costs as well as the



costs of additional regulation and disclosure requirements. The signaling hypothesis shares many empirical predictions with the bonding hypothesis. Firms from countries with less strict regulations and poorer disclosure would be more likely to cross-list and should experience higher abnormal returns around the cross-listing announcement.

Some authors believe that firms based in countries with poor standards may also benefit from the signaling effect of listing in a country with stricter requirements. According to them, cross-listing could signal a credible commitment to enhanced corporate governance. Firms would then try to list in countries with higher disclosure standards and a greater standard of enforcement than in their own jurisdiction (Coffee 2002). This so-called “bonding hypothesis” has been tested empirically with Canadian data. The results suggest that Canadian firms can increase their valuation by bonding themselves to the U.S. regulatory environment through cross listing (King and Segal 2003).

#### 2.2.1.4 Awareness or Investor Recognition

Another asymmetric information-related argument for cross listing is that firm’s cross-list to increase their visibility and shareholder base. This is often called the shareholder base hypothesis or Merton’s (1987) awareness hypothesis. According to this hypothesis, all of the shareholders that own the security are informed. The incomplete information in this equilibrium refers to a subset of investors that do not know about this security and hence do not hold it in their portfolio. In equilibrium, Merton (1987) shows that the smaller the firm’s investor base, the greater the discount relative to the complete information case. The benefit of cross-listing comes as the firm exposes itself to investors from a different country, raising its shareholder base and decreasing its discount. Chemmanur and Fulghieri (2003) examine a firm’s listing choice and show that a firm will choose to list in markets with more skilled analysts and investors. Foerster and Karolyi (1999) look at the changes in a firm’s shareholder base around the time of cross-listing. They find that, on average, the shareholder base of cross-listing firms increase by 29% following the US listing. Moreover, they find that the abnormal cross-listing return



is related to the change in the firm's shadow cost of market incompleteness. Baker, Nofsinger and Weaver (1998) look at changes in firm visibility for foreign firms cross-listing on the NYSE and LSE using two proxies for visibility: the firm's analyst following and media coverage. They find that an average of 6 more analysts follow the firm after an NYSE cross listing and an average of 3 more analysts follow the firm after an LSE cross-listing. On average, home market media coverage increases by 37% and -11% after NYSE and LSE cross-listings, respectively. They also find support for the hypothesis that the NYSE is associated with a greater change in visibility. Similarly, Lang, Lins and Miller (2002) also find an increase in analyst coverage and forecast accuracy around the time of cross-listing. Consistent with the awareness hypothesis, they find a positive correlation between the change in firm value around cross-listing and the change in analyst following and forecast accuracy. Bailey, Karolyi, and Salva (2005) find that return volatility and trading volume reactions to earnings announcements increase after a company cross-lists its shares in the US. This finding is surprising given that the richer disclosure and information environment should result in less information asymmetry among investors and lower volume following an earnings announcement.

#### 2.2.1.5 Bonding

Controlling shareholders and managers derive utility from both the overall value of their firm (through their equity stake) and from private benefits of control, which are expropriated to the detriment of the other minority shareholders. However, private benefits of control may hinder management's ability to increase firm value (i.e., through capital-raising) as minority investors will not invest if they are afraid that management will use the capital for personal use and not for increasing firm value. According to the bonding hypothesis, management bonds itself to a better governance regime by cross-listing in order to commit not to engage in expropriating activities and as a result, increases firm value (as they are able to then raise external capital). In this case, management receives a net utility gain as the increase in their utility from firm value outweighs the utility reduction from the loss of some private benefits of control. Coffee



(1999, 2002) and Stulz (1999) outline the bonding benefits that foreign companies receive by cross listing in the US. First, management is committing to increased monitoring by the SEC, auditors, analysts, US exchanges, institutional shareholders, debt-rating agencies, and better boards of directors. Second, management is lowering the net benefits of expropriation by subjecting themselves to penalties associated with SEC enforcement and increasing their risk of litigation.

A number of recent papers have tested the bonding hypothesis. Doidge, Karolyi, and Stulz (2004) build a model of bonding and show that management of firms with more growth opportunities should receive a higher benefit from cross-listing. They find that US cross-listed firms have a Tobin's q that is 17% higher than foreign firms that are not listed in the US. In addition, firms that list on a major US exchange have a Tobin's q that is 37% higher than these other firms. In another paper, Doidge (2004) tests the bonding hypothesis by examining voting premiums of firms with dual-class shares. He finds that foreign firms that cross-list in the US has voting premiums that are 43% lower than foreign firms that do not cross-list in the US. This is consistent with lower private benefits of control for majority shareholders that cross-list in the US.

Arguing against the bonding hypothesis, Licht (2003) suggests that the bonding role of US institutions has been exaggerated on a number of issues. First, the US regulatory regime is "watered down" for foreign issuers. Second, it is more difficult for the SEC to enforce its rules with foreign issuers and the SEC has not been very active in enforcing regulations with foreign issuers. Third, recent US corporate governance scandals such as those at Enron and Worldcom point to potential flaws in the US regulatory regime. In 2002, Broadgate Capital Advisors, The Value Alliance, and the Bank of New York conducted a survey of 143 ADR issuers regarding their views on corporate governance and Sarbanes Oxley. Almost half (46%) of these respondents felt that corporate governance standards in their home market were the same or more rigorous than in the US. A recent study by Siegel (2004) shows that cross-listing in the US did not prevent fraud and embezzlement among a sample of Mexican cross-listed firms. However, although bonding may not be as strong for foreign firms as it is for US firms, a US cross-



listing still may increase the protection of investors relative to the protections afforded to these investors based on the firm's home country rules.

#### 2.2.1.6 Market Segmentation

Models by Errunza and Losq (1985) and Alexander, Eun and Janikaramanan (1987) examine the effects of market segmentation on the pricing of securities. Errunza and Losq (1985) show that ineligible securities command a "super-risk premium" when a subset of investors is restricted from investing in those securities. Securities that are eligible (with no restrictions on investors) are priced as if there were no segmentation. By cross-listing, these ineligible securities become eligible and lose their "super-risk premium" and therefore command a higher price. The market segmentation hypothesis predicts that the benefits of cross-listing should be larger for firms from countries that are less integrated with the world markets.

#### 2.2.1.7 Informational considerations

Informational considerations are another source of market segmentation that can be overcome through cross-listing. These considerations relate mainly to the cost of acquiring and processing relevant information about foreign firms, and to the reliability of that information. Several authors argue that inter-listing reduces the cost of equity capital by making information on the listing firm more easily accessible. Cross-listing is believed to increase a firm's visibility as well as investor recognition, based on evidence that both media coverage and the number of analysts following the firm rise subsequent to the foreign listing. While there is evidence that analysts tend to be less optimistic about the prospects of foreign firms compared with domestically based firms, cross-listings tend to improve the accuracy of their earnings forecasts. Since investors have to incur a lower cost to follow a corporation's affairs, its investor base expands, and demand for its stock will rise (Lang, Lins, and Miller 2003; Baker, Nofsinger, and Weaver 2002)



### 2.2.1.8 Cultural Factors

Another strand of the cross-listing literature has found that cultural factors also play a role in the cross-listing decision. Pagano, Randl, Roell, and Zechner (2001) look at where European companies cross-list and find that companies are more likely to cross-list in countries from the same cultural group as their home country. Sarkissian and Schill (2003) look at the cross-listing choice for the entire universe of cross-listing firms and find that firms exhibit a proximity preference in their choice of cross-listing market. They suggest that this preference is similar in nature to the “home bias” observed in investor’s portfolios.

Specifically, they find that geographic proximity (distance between capital cities) is an important determinant of the cross-listing decision. Cultural proximity, proxied by similar language or colonial background, also positively affects the choice of listing destination. Also, firms are more likely to cross-list in a country with industrial and economic proximity to their home country and in equity markets that are correlated with their home equity market. From this perspective, we should expect voluntary cross-delists to be inversely related to the firm’s proximity to the cross-listed market.

An additional advantage of cross-listing is that, in the case of stocks trading on markets located in different time zones, it facilitates the process of assessing a stock’s value at the beginning of the trading session. At the opening of trading, prices are less volatile for shares that traded overnight on another exchange than for those that did not. Pricing errors are thus reduced (Yamori 1998; Lowengrub and Melvin 2002).

Also, according to survey results on why list abroad, Canadian corporate managers generally believe that access to a broader investor base and increased marketability of a firm’s securities are the main benefits of pursuing cross-listing, while compliance with foreign reporting requirements is cited as a major cost. The majority of survey respondents consider the net benefits of cross-listing to be positive, although not necessarily substantial. Whether benefits outweigh costs depends on whether total trading



volume increases subsequent to listing abroad (Mittoo 1992). Although some corporate managers may be partly motivated by such considerations as enhancing their firm's prestige or increasing the visibility of its products, the primary objective of cross-listing is the financial goal of reducing the cost of the firm's equity capital. Listing a company's stock abroad should have no impact on its price when domestic and foreign equity markets are fully integrated. If barriers exist, however, a firm's share value may be affected by the cross-listing announcement. Empirical evidence suggests that shares of cross-listed firms tend to experience abnormally high returns prior to their foreign listing and shortly thereafter. Longer-term performance varies greatly across companies. For many firms, the initial increase in performance dissipates over the next year.

## 2.2.2 Costs of going public and cross listing

Cross-listing offers many advantages for the listing firms, but there are also costs. These relate to enhanced disclosure requirements, registration costs with regulatory authorities, and listing fees (Karolyi 1998). To accommodate a wide variety of firms, exchanges have designed several different listing categories, each with a different set of requirements and, to the extent that investors are knowledgeable about this structure, varying potential benefits. At one end of the spectrum is the ordinary listing. This is the most prestigious type of listing, but also the one for which requirements are the most stringent. A firm seeking a listing must meet certain criteria set by the exchanges. These usually relate to minimum levels of market capitalization and of certain accounting variables, such as income. Firms must also satisfy the requirements of regulators, who usually demand that financial statements be restated according to the principles and standards mandated by the local accounting authority. They must also make arrangements for the clearing and settlement of trades in the foreign country in which they wish to list.

Other costs of going public include:



### 2.2.2.1 Adverse selection

Investors in general are less informed than the issuers about the true value of the companies going public. This informational asymmetry besides adversely affecting the average quality of the companies seeking a new listing and thus the price at which their shares can be sold (Leland and Pyle (1977)), also determines the magnitude of the underpricing needed to sell them (Rock et al. (1986)).

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

### 2.2.2.2 Administrative expenses and fees

Going public implies considerable direct costs: underwriting fees, registration fees and in addition to the initial expenses, there are the yearly fees of auditing, certification and dissemination of accounting information, stock exchange fees. Ritter (1987) estimated that in the United States the fixed costs equal approximately US\$250,000 and the variable costs are about 7% of the gross proceeds of an IPO.

### 2.2.2.3 Loss of confidentiality

Campbell (1979) was first to point to confidentiality as a deterrent from getting funding in public markets. Yosha (1995) has shown that in equilibrium those firms with more sensitive information are deterred from going public if the costs of a public offering are sufficiently high. The disclosures rules of stock exchanges force companies to unveil information whose secrecy may be crucial for the competitive advantage such as data about ongoing research and development projects or future marketing strategies. They also expose them to close scrutiny from tax authorities relative to private companies.



### 2.3 Brief history of the East African Stock Exchanges

The Nairobi Stock Exchange is licensed to provide stock exchange services in Kenya. It is a market that deals with the exchange of securities issued by quoted public companies mostly equities and bonds issued by both corporate and the government. Trading of financial securities in Kenya commenced in 1920s as a side line business conducted by accountants, lawyers, estate agents and auctioneers who met to exchange prices over a cup of tea. In 1954, the exchange was constituted as a voluntary association of stock brokers registered under the Societies Act after the London Stock Exchange agreed to recognize the NSE as an overseas stock exchange, trading moved to the “call over” system, with bids and offers being exchanged over the telephone (Jimnah Mbaru, 2006). The NSE ownership structure is organized in a form of a company limited by guarantee and incorporated under the Companies Act Cap 486 of the laws of Kenya. The exchange is licensed by the Capital Markets Authority and it is governed by its Memorandum and Articles of Association. It has rules and regulations that govern its activities with trading rights given only to member firms through membership to the NSE.

Activity in the NSE was low in the 1960s and the 1970s, as the market remained a members club where stocks were traded over a cup of tea at the New Stanley Hotel using the “call over” system.

In the 1980s, and in order to boost economic development the government acknowledged the need for having an efficient and stable financial system. In 1991 the exchange was registered under the Companies Act with the full secretariat and the “call over” system was phased out and more open and transparent floor based “open out cry” system was adopted and has been applicable until 2005.

Planning for automation of the exchange started in 1995 when the government opened the market to foreign investors. Turnover growth as well as the highest index in the exchange was attained during this year and this brought to light limitations of the open



out cry system leading to the decision to automate the exchange (Kibaki, 2006). The Automated Trading System (ATS) with the capacity of processing in excess of 10,000 trades per hour was implemented in October 2006 and has brought about more transparency and efficiency to the bourse. Prior to this in November 2004, the markets implemented the CDS, automating the settlement of equity trades executed at the exchange facilitating faster and easier processing of securities, shares and bonds transactions.

Today trading at the exchange is divided into three segments, the Main Investment Market (MIMS), the Alternative Investment Markets Segment (AIMS) and the Fixed Income Investment Market (FISMS). Listed are 78 Government of Kenya Treasury Bonds, 7 Corporate Bonds and 48 Equities.

The Standard – FS (Financial Standard) of 19/6/07 report by KPMG on demutualization on the NSE stated that- ‘It is now ranked as “the most organized and active stock market in the region”. The NSE is also ranked as the Number 9 largest stock exchange among Africa’s 17 stock exchanges in terms of market capitalization and 5<sup>th</sup> in terms of liquidity. Market capitalization reached a peak of Sh.824 billion at the end of January 2007 before an all time high of over Sh.1 trillion this year, and the number of registered investors in the central depository system rose to over 600,000 from 75,000 investors.

The exchange is therefore poised to play an increasingly prominent role in the Kenyan economy, in privatization of state owned enterprises and its growth should reflect changes taking place in the economy.

The Dar es Salaam Stock Exchange (DSE) was incorporated in September 1996 and trading started in April 1998. There are currently 9 listed companies and of which 2 of these namely; East African Breweries and Kenya Airways are cross-listed at the Uganda Securities Exchange and the NSE.



The Uganda Securities Exchange (USE) is Uganda's principal stock exchange and was founded in June 1997. The USE is operated under the jurisdiction of Uganda's Capital Markets Authority, which in turn reports to Uganda's Central Bank, the Bank of Uganda. The exchange's trading started in January 1998 – with one listing, a bond issued by the East African Development Bank.

The USE currently trades 9 listed local and East African Companies and has started the trading of Fixed Income instruments. The stock exchange is open 5 days a week and operates in close association with the DSE and NSE. {Market Listing: - Bank of Baroda, Uganda; BAT Uganda; DFCU Group; EABL; Jubilee Holdings; Kenya Airways, New Vision Printing and Publishing, Stanbic Bank; Uganda Clays.

#### 2.4 Policy incentives to promote cross listing

The Dar-es-Salaam Stock Exchange, the Nairobi Stock Exchange and the Uganda Securities Exchange have held meetings under the auspices of the East African Securities Exchanges Association (EASEA) in trying to pursue the objectives of promoting; the growth and development of capital markets in the East African Community; market integration in the East African Community and; cross border listing and development of infrastructure that facilitates and promotes cross border trading, delivery and settlement.

Despite identifying the cross listing of already listed securities in the three markets as a key milestone, and agreeing to provide incentives to listed companies to encourage cross listing, also proposing to reduce the costs associated with cross listing, and setting up a cross listing subcommittee to work out the modalities of cross listing within the region, no progress seems to have been made as the policy efforts have not yielded increased cross listing activity.



## 2.5 Recent studies on cross-listing trends and Review of listing at NSE

The pace of international cross-listings around the world has decelerated dramatically during the last few years. This structural break is, of course, coincident with a combination of global macroeconomic, political, regulatory and institutional factors, so it would be difficult to attribute this outcome to any one of them. The aim in this section is to provide a snapshot of the market today and to reassess the perspectives of long-term developments in these markets.

The past several years have witnessed a significant slowdown in the pace of new international cross-listings and in the fraction of global trading on overseas exchanges. Consider that, as at the end of 2002, the number of internationally cross-listed stocks had retreated to 2,300 from its 1997 high of 4,700, a decline of over 50%. Concomitantly, there have been dozens of new academic studies of the benefits and costs of listings that depart from the conventional wisdom of previous studies and that seek to rationalize the changing and now more complex world of cross-listings. These studies acknowledge the opportunities that the globalization of equity issuance and trading affords, but they also explore new risk factors due to globalization that relate to agency conflicts among controlling shareholders, management and public investors, information-asymmetry problems among market agents, complexities of multi-market trading for liquidity, price discovery and arbitrage, and a host of other transparency and corporate governance issues

### **Growth of NSE (Number of new listings and cross listings).**

The growth of the NSE in terms of the number of companies listed, new listings, delistings and the number of companies cross listed over the period 1994 and 2006 shows that between 1994 and 2000, total listed companies ranged between 56 and 57. In this period and before, there were no companies cross listed, although there were three new listings in 1994, two each in 1996 and 1997, and one company in 2000. On the other hand, delisted companies were four, one in 1996, two in 1997 and one in 1999.



In 2001, the first regional cross listing from the NSE took place when the East African Breweries listed shares in both the Uganda Securities Exchange and the Dar es Salaam Stock Exchange. This was followed by Kenya Airways in 2002 and then Jubilee Insurance Company in 2006. New listings were of two companies in 2001, and four in 2006 while 11 companies were delisted with the highest number being five in 2001, four in 2002 and then two companies in 2003. Total listed companies at the NSE dropped to 52 in 2006, and the number of companies at the NSE's Main Investment Market Segment cross listed remains insignificant hence the desire to carryout this study to establish the reasons behind this state.

## 2.6 Why companies delist

Firms may voluntary delist if the expected increase in shareholder base does not materialize, or if this increase is short-lived. For example, at the time of its cross-listing in November 2001, Fisher and Paykel Healthcare had issued 5 million ADRs. Near the time of its delisting in February 2003, the number of ADRs had declined to less than 140,000. There has been a decrease in the number of cross-listed foreign firms in the US with 150 net delistings between 2002 and 2003 [Karolyi (2004)]. Analysis by Jonathan Witmer shows that some of this decline is a result of an increase in the number of firms voluntarily cross-delisting during this period. With a stricter US regulatory regime in 2002 and 2003 under Sarbanes-Oxley, we would expect cross-listing in the US to provide more bonding benefits. However, this stricter regulatory regime also imposes many additional costs on cross-listed firms. The cause of these foreign companies to delist from the US exchanges and other questions were addressed by examining a sample of 140 foreign firms that delisted from US exchanges and 72 foreign firms that voluntarily deregistered from the US regulatory environment during the period from January 1990 through December 2003. First, on the characteristics of firms that voluntarily delist, findings were that smaller firms with a lower percentage of turnover in the US were more likely to delist. Also, Witmer J. (2006) found that Nasdaq-listed firms and firms with fewer growth opportunities are more likely to delist. Firms are also more likely to cross-delist in the post-2001 (Post-Sarbanes-Oxley) period or if they are from countries with



poorer or weaker investor protection. These findings are suggestive that the costs of complying with Sarbanes-Oxley (including any loss in private benefits of control) outweigh any of its bonding benefits. They suggest that the added costs of US regulations seem to deter these firms from maintaining a US listing.

Also, cross-listed stocks that delist in the US, consistent with the bonding, liquidity, and awareness hypotheses, findings are that firms with a lower percentage of turnover in the US are more likely to voluntarily delist. These results are consistent with cross-listing costs outweighing bonding benefits. It is found that an average negative return of approximately 5% around the cross-delisting announcement exists, which is mitigated if the stock has a low proportion of turnover in the US.

## 2.7 Alternative theories

There is a growing academic literature about an alternative motivation for cross listing, the so-called “bonding” explanation (that has been recently advanced) bonding is the costs or liabilities an agent or entrepreneur incurs in order to assure investors that he will perform as promised. According to this view, cross-listings towards the US act as a bonding mechanism used by firms that are incorporated in a jurisdiction with poor investor protection and enforcement systems to commit themselves voluntarily to higher standards of corporate governance. In this way, firms attract investors who would otherwise be reluctant to invest.

This premium existed definitely until recently, since a US listing reduced the extent to which controlling shareholders could engage an expropriation and thereby increases the firm’s ability to take advantage of growth opportunities. Interestingly, this premium was higher for companies domiciled in countries with relative weak investor protection, suggesting that controlling shareholders from countries with poorer minority shareholders rights give up more when they commit themselves to the high corporate governance standards in the US than controlling shareholders from countries with shareholder protection closer to the US standards. Also notable is the finding that the premium was



more than twice as large for companies listed at official US stock exchanges than for the over-the-counter listings and private placements.

Very recent evidence shows that the listing premium for cross-listing has evaporated, due to new US regulations and competition from other exchanges.

An emerging stream of the literature on cross-listings is concerned with analyzing the fluctuations in the price of a stock on different markets. If equity markets were fully integrated, price gaps would be minimized when prices were converted into the same currency. In addition, all markets would incorporate new information almost simultaneously. Integration of market prices should favour market efficiency and liquidity by ensuring that orders are matched with the best off-setting orders from all trading venues. Informational links between markets, however, are rarely strong enough for perfect market integration to take place and for concurrent price discovery to occur on multiple markets. Informational asymmetries and transactions costs cause a certain degree of market segmentation, allowing one market to become from time to time a price leader for a given stock. While arbitrage forces necessarily drive prices on other markets to adjust so as to maintain an equilibrium of no arbitrage, the exchange acting as a price leader could attract a substantial portion of order flow if the adjustment takes time. This type of misalignment is expected to arise, for example, when trading hours do not overlap. In such an environment, an advantage is gained by the firm's domestic equity market, since firm-specific news relevant to prices is likely to be produced in its home country during regular business hours. Another example of an informational asymmetry that may cause market segmentation occurs with firms that may be classified as "blue chip" in their home markets, because they have a relatively large investor base and analyst following, but have less visibility abroad. In these cases, it is reasonable to assume that price discovery will tend to occur primarily on the firm's national exchange. However, it could also be argued that price discovery will occur on the foreign exchange if its market quality is superior. Does price discovery on the firm's home market lead that in exchanges from abroad, or is the opposite true? Empirical evidence suggests that prices on Canadian and U.S. exchanges are mutually adjusting for Canadian-based cross-listed stocks. The contribution of each market varies greatly across stocks. The extent to



which the foreign market will act as a leader is related to its share of total trading volume, its relative advantage in terms of liquidity, and the economic ties between the listing firm and the country in which the exchange is located (Eun and Sabherwal 2003).

Studies as to why companies cross list and also on the benefits accruing from cross listing have been done mostly in the developed countries, namely in America, Canada, Europe and also some have been carried out on markets in Asia and South America. However, scanty reliable empirical evidence exists on the challenges encountered by public companies in cross listing in most emerging economies, Kenya included. This study therefore aims to find out the challenges influencing cross listing from the Nairobi Stock Exchange to the East African Exchanges and, the benefits to the companies cross listing.

#### Population

As a census study where the entire population of eligible companies for cross listing has been studied. The population of the study consists of all eligible companies at Nairobi Stock Exchange and licensed by the CMA as at 31 December 2006. The therefore covers all the 44 companies quoted at the NSE as at 31 December 2006 listed under the Main Investment Market Segment, which is further categorized as following different sectors:

1. Agricultural Market Sector

2. Commercial and Services Sector

3. Finance and Investment Sector

4. Industrial and Allied Sector

All firms are eligible for cross listing as they satisfy the basic requirement that a firm must be listed under the Main Investment Market segment before other cross listing requirements are considered, in order to be eligible for cross listing.

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## CHAPTER THREE

### 3.0 RESEARCH METHODOLOGY

#### 3.1 Research Design

The research has been carried out through a survey that seeks to establish the challenges Kenyan companies encounter in cross-listing at the East African Exchanges and the benefits associated with cross-listing. A survey is desirable where respondents are uniquely qualified to provide the desired information. In this study the researcher investigates the challenges that influence cross-listing from the NSE to the other two regional exchanges and the benefits realized, in view of the fact that there are also costs associated with cross-listing and for firms to incur such costs there are likely related benefits.

#### 3.2 Population

This was a census study where the entire population of eligible companies for cross-listing has been studied. The population of the study consists of all eligible companies listed at Nairobi Stock Exchange and licensed by the CMA as at 31 December 2006. The study therefore covers all the 44 companies quoted at the NSE as at 31 December 2006 and licensed under the Main Investment Market Segment, which is further categorized into the following different sectors:

- i. Agricultural Market Sector
- ii. Commercial and Services Sector
- iii. Finance and Investment Sector
- iv. Industrial and Allied Sector

These 44 firms are eligible for cross-listing as they satisfy the basic requirement that a company must be listed under the Main Investment Market segment before other cross-listing requirements are considered, in order for it to cross-list at the Uganda Securities Exchange and/or the Dar es Salaam exchange.



In determining the benefits that accrue to companies that cross list at the regional exchanges, which is the second objective of the study, the population as in above, covers all companies listed in the Main Investment Market Segment of the NSE, as at 31 December 2006.

### 3.3 Sample description

The study focused on firms listed as at 31 December 2006 because firms licensed and listed subsequent to this date are still new listings at the NSE, and would likely require more time before contemplating cross listing. Four companies under suspension from the NSE namely; Hutchings Biemer Ltd., Uchumi Supermarkets Ltd., Carbacid Investment Ltd., and BOC Kenya Ltd., have been excluded from the survey because their eligibility in being considered for cross listing would first require their re-admission to the NSE trading floor. The sample of 40 companies in the four sectors of the NSE Main Investment Market Segment, which excludes the Alternative Investment Market Segment, is considered representative enough.

### 3.4 Data collection

The study used primary data, which is data collected for the first time to address the research problem outlined in this survey. In the survey, primary data was collected using a structured questionnaire (See Appendix 3). A structured questionnaire was used because it is easy to administer, analyze and economical. Each item in the questionnaire is developed to address the research problem and objective. The questionnaire comprises both open and closed ended questions and was administered through drop and pick later method. The questionnaires were addressed to the Managing Directors and Finance Directors of the companies. An introduction letter (See Appendix 1) was obtained from the University to enable the researcher to administer the questionnaires to the respondents during official working hours.



### 3.5 Data analysis

The data collected has been analyzed using descriptive statistics such as mean, percentages and tables. The descriptive statistics enables the researcher to describe the challenges in cross listing and to reduce the information to an understandable form. The data analysis has been tied to the objective of the study in order to arrive at reliable conclusions.

Also, to obtain a relative assessment of the extent of the different aspects of the cross listing challenges and benefits, the questionnaires has been subjected to a statistical analysis of frequency.

Factor analysis has also been used to rank challenges considered in order of importance, this is a mathematical tool used to examine a wide range of data sets.

TYPE	DISTRIBUTION	RESPONSE	PERCENTAGE
Individual	4	2	50%
Commercial	2	1	50%
Individual and commercial	12	6	50%
Commercial and individual	16	8	50%
Total	40	24	60%

The questionnaire comprised of two main parts with the first part addressing the challenges to regional cross listing while the second part was on the benefits accruing or deriving from regional cross listing. Other supplementary sections to the first part of questionnaire were sections B and C that sought to find out what the respondents perceived as being the main inhibiting factors to cross listing.

In considering the first part of the questionnaire the researcher used the principal component analysis to rank the possible inhibiting factors to cross listing.

Means or measures in the data analysis were used for ranking variables and it is assumed that the greater the mean, the higher the importance of the particular factor (K



## CHAPTER FOUR

### 4.0 DATA ANALYSIS AND FINDINGS

#### 4.1 Response Rate

The questionnaires were administered to all eligible listed companies at the Nairobi Stock Exchange's Main investment market segment as at 31 December 2006. The response rate was 60% per cent with the market sector composition of the firms as shown in the table below.

**Table 4.1:** Response Rate

SECTOR	DISTRIBUTION	RESPONSE	PERCENTAGE
Agricultural	4	2	50%
Commercial and Services	8	7	88%
Finance and Investments	12	6	50%
Industrial and Allied	16	9	56%
<b>Total</b>	<b>40</b>	<b>24</b>	<b>60%</b>

The questionnaire comprised of two main parts with the first part addressing the challenges to regional cross listing while the second part was on the benefits accruing or realizable from regional cross listing. Other supplementary sections to the first part of the questionnaire were sections B and C that sought to find out what the respondents considered as being the main inhibiting factors to cross listing.

Also considered in this first part of the questionnaire was the eligible NSE listed companies' rankings of the possible inhibiting factors to cross listing.

The Means as measures in the data analysis have been used for ranking variables and it is assumed that the greater the mean, the higher the importance of the particular factor or variable.



The responses were coded (see Appendix 4), frequency of responses cumulated, tables designed and inferences made based on the data analysis findings.

#### 4.2 Challenges and factors that influence the decision to cross list.

In analyzing the data, means were computed and used as a summary statistic. The computed means were also ranked accordingly in interpreting the results of data for the respective sections of the questionnaire.

Respondents' opinions relating to the challenges and considerations that influence the decision to cross list were evaluated on a five point scale with interpretation of the responses as follows:

Mean Range	Label
1 – 1.49	NI = Not important
1.5 – 2.49	LI = Less important
2.5 – 3.49	FI = Fairly important
3.5 – 4.49	I = Important
4.5 – 5.00	EI = Extremely important

A summary of the challenges and factors in regional cross listing that have impacted the scope of cross listing by companies listed at the NSE that are eligible by their virtue of being licensed in the main investment market segment of the Kenyan Exchange as derived from the coded data in appendix 4, is presented in the table below.



**Table 4.2**

Frequency Table:

Challenges and Factors that influence the decision to cross list

	Mean	Mean	N	1	2	3	4	5	Total
		Ranking	Responses	NI %	LI %	FI %	I %	EI %	%
To finance growth and development (AFGD)	3.79	2	24	4.17	4.17	37.50	16.67	37.50	100
To increase the company's visibility (AICV)	4.00	1	24	4.17	8.33	16.67	25.00	45.83	100
To balance the debt/equity level (ABDEL)	2.63	8	24	25.00	29.17	20.83	8.33	16.67	100
To improve the company's image and raise its status (AICIRS)	3.75	3	24	8.33	8.33	16.67	33.33	33.33	100
To increase the liquidity of company shares (AILCS)	3.58	4	24	12.50	4.17	16.67	45.83	20.83	100
To enjoy tax benefits (AETB)	2.38	9	24	29.17	37.50	12.50	8.33	12.50	100
To infuse professional management of the company (AIPM)	2.63	8	24	29.17	20.83	20.83	16.67	12.50	100
To involve new people in the governance (AINPG)	2.67	7	24	29.17	16.67	25.00	16.67	12.50	100
To help the development of strategic alliances (ADSA)	3.33	5	24	8.33	25.00	16.67	25.00	25.00	100
Having to meet requirements for shareholding (AMRS)	2.71	6	24	25.00	16.67	33.33	12.50	12.50	100

From the table, the respondents rate highest the need by firms to increase their visibility as an important factor with the highest mean score of 4.0. In cross listing firms expect to attain more market visibility through analysts reports and publicity, the listed NSE firms eligible for cross listing face challenges due to comparatively less developed regional stock markets which may not offer the desired visibility. The financing of growth and development also ranked as important, is the next highly rated factor and challenge with a mean score of 3.79 that influences firms decision to cross list. Also important is the need to improve firm's image and status, and increasing the liquidity of company shares whose mean scores were 3.75 and 3.58 respectively. The realization of tax benefits as a factor



influencing cross listing or tax incentives as a challenge was rated the least with a mean score of 2.38. Firms listed in the NSE main investment market segment are least influenced in their decision to list regionally by the existing tax regimes possibly because the Ugandan and Tanzanian tax policies provide no added value with corporate tax rates and incentives being almost similar in many ways to what these firms operate under locally. This also explains the low ranking of this variable with only 8% of the respondents rating it as important and 12.5% as extremely important.

In addition, the table shows that about 46% and 38% of the respondents view increasing a firm's visibility (AICV) and, financing firm's growth and development (AFCD) respectively as extremely important challenges that impact on cross listing decisions. Increasing liquidity of company shares (AILCS) is considered by 66% of the respondents as both important as well as an extremely important factor in cross listing. Similarly, improving a company's image, raising its status (AICIRS) had the same frequency of 66% of the respondents.

Other challenges and factors impacting cross listing decisions namely the need to meet shareholding requirements (AMRS); involving new people in governance (AINPG); balancing of debt/equity levels (ABDEL) and enhancing professional management (AIPM) were rated by between 41% to 54% of the respondents as either not important or of less importance. The mean scores for these variables were 2.71, 2.67, and 2.63 respectively.

The table below (**Table 4.2.1**) summarizes the data from the respondent's rankings of the possible inhibiting factors or challenges to cross listing.

To interpret the responses, a ranking scale of 1 to 10 was used whereby a ranking of 1 represents the greatest inhibiting factor and in a descending order a possible ranking of 10 representing the least weighting or ranking of a factor.



**TABLE 4.2.1**  
**FREQUENCY TABLE:**  
**CHALLENGES, FACTORS INHIBITING CROSS**  
**LISTING**

	Mean	Mean Ranking	N Responses	1	2	3	4	5	6	7	8	9	10	Total
				Ranking frequencies										
				%	%	%	%	%	%	%	%	%	%	
Lack awareness/understanding of entry requirements (BLAEPI)	4.41	1	22	27.27	13.64	0.00	4.55	22.73	9.09	4.55	4.55	4.55	9.09	100
Too stringent entry requirements (BSER)	4.77	4	22	9.09	9.09	22.73	18.18	0.00	4.55	13.64	18.18	4.55	0.00	100
Too many entry requirements (BMER)	5.09	5	22	4.55	9.09	18.18	0.00	22.73	13.64	18.18	13.64	0.00	0.00	100
Too stringent continuous cross listing requirements (BSCLR)	6.55	9	22	4.55	0.00	4.55	18.18	13.64	13.64	0.00	4.55	31.82	9.09	100
Too many continuous cross listing requirements (BMCLR)	6.18	8	22	0.00	9.09	0.00	18.18	13.64	18.18	13.64	4.55	9.09	13.64	100
Absence of new investment opportunities (BAIO)	5.68	6	22	18.18	9.09	4.55	4.55	0.00	13.64	13.64	13.64	13.64	9.09	100
Unrealistic and unachievable policy incentives (BUPI)	6.91	10	22	0.00	0.00	13.64	4.55	13.64	9.09	18.18	9.09	9.09	22.73	100
Availability of listing benefits when not cross listed (BALB)	5.77	7	22	13.64	18.18	0.00	13.64	4.55	4.55	0.00	9.09	13.64	22.73	100
High costs associated with cross listing (BHCLC)	4.55	2	22	4.55	27.27	9.09	13.64	9.09	9.09	9.09	13.64	4.55	0.00	100
Liquidity, status of the regional capital markets (BLSRM)	4.73	3	22	18.18	9.09	27.27	4.55	0.00	4.55	9.09	9.09	9.09	9.09	100



The respondents rank the lack of awareness and understanding of entry requirements and policy incentives (BIAEPI) as the greatest inhibitor to cross listing. In a scale of 1 to 10, 27.8% and 14% of the respondents consider this factor as 1 (the greatest) and as scale 2 respectively. The costs associated with cross listing (BHCLC) is the second greatest challenge or inhibiting factor with 31.8% of respondents ranking this variable thus. The third greatest inhibiting factor or challenge is the liquidity and status of the regional capital markets (BLSRM) in terms of development which had 18% of the respondents ranking it as 1 and 40% between 2 to 4. This factor is closely followed in ranking by stringent entry requirements (BSER).

The least inhibiting factor is the policy incentives (BUPI) as these were considered by the respondents as either achievable even without having to cross list or having no challenge. This together with the availability of listing benefits (BALB) even when a Kenyan company is not cross listed regionally had a frequency rating by respondents at 23% each.

The ranking of the other inhibiting factors to cross listing in a descending order of their importance was; the absence of new investment opportunities in the region (BAIO), many and stringent continuous listing requirements (BMCLR), and (BSCLR) respectively.



### 4.3 Benefits of cross listing regionally

The second objective of the study was to establish the extent to which benefits can be realized or have been realized by the eligible firms in the sample of study, upon cross listing. The table below summarizes the research findings.

**Table 4.3**  
**Frequency Table:**  
**Benefits of cross listing**

	Mean	Mean	N	1	2	3	Total
		Ranking		Responses	NA	SR	
				%	%	%	%
Access to wider capital base across region (EAWCB)	2.54	3	24	16.67	12.50	70.83	100.00
Reduction in firm's cost of capital (ERFCC)	2.00	9	24	37.50	25.00	37.50	100.00
Acceptance and recognition company brand across region (EARCB)	2.63	2	24	12.50	12.50	75.00	100.00
Higher efficiency of the governance of mechanisms (EHEG)	2.04	8	24	29.17	37.50	33.33	100.00
Incentives to improve performance (EIIP)	2.04	8	24	25.00	45.83	29.17	100.00
Improved relationship with clients (EIRC)	2.17	7	24	20.83	37.50	41.67	100.00
Easier management of relationship among shareholders (EEMRS)	1.88	10	24	37.50	37.50	25.00	100.00
Improved relationship with suppliers (EIRS)	1.83	11	24	33.33	50.00	16.67	100.00
Incentives to refine tools and procedures of planning and accounting (EIPPA)	1.75	12	24	41.67	41.67	16.67	100.00
Employee pride in the company (EEPIC)	2.46	5	24	4.17	45.83	50.00	100.00
Access to strategic alliances (EASA)	2.50	4	24	4.17	41.67	54.17	100.00
Improved corporate image, prestige of regional listing (EICIP)	2.67	1	24	8.33	16.67	75.00	100.00
Increased liquidity of company securities (EILCS)	2.38	6	24	12.50	37.50	50.00	100.00

The responses on benefits that can be realized or are realized from cross listing were interpreted using a three point scale as follows:



Mean Range	Label
1.0 – 1.49	NA = Not at all
1.5 – 2.49	SR = Some how realized/realizable
2.5 – 3.00	VM = Very much realized/realizable

The Means as measures in the data analysis have been used for ranking variables and it is assumed that the greater the mean, the higher the importance of the particular factor Or variable.

The results show that after cross listing regionally, companies benefit or can benefit from an improved corporate image and prestige (EICIP). The respondents ranked the acceptance and recognition of company brand across the region (EARCB) as the second highest benefit and thirdly, having access to a wider capital base (EAWCB), those variables had mean scores of 2.67, 2.63 and 2.54 respectively. The fourth ranked benefit was having access to strategic alliances (EASA) whose mean was 2.50.

From the table, the frequency for each category shows that 75% of respondents realized or would expect to realize very much an improved corporate image and prestige. This is the same percentage as in gaining acceptance and recognition of company brands(s). 70% of respondents realize or expect to realize the benefit of access to wider capital base (EAWCB) very much.

The other benefits in their order of importance in realizing them are; employee pride in company, increased liquidity of company shares both with means of 2.46 and 2.38 respectively and 50% of respondents realizing the benefits very much. These are followed by benefits in improved relationships with clients and at the same ranking; governance (EHEG) and incentive to improved performance (EIIP).

The least ranked benefit is the incentive to refine planning and accounting procedures (EIPPA) with 41.7% of the respondents not considering this as realizable. This position can be attributable to the fact that planning, accounting and reporting standards are substantially high and bench marked to international standards in the case of Kenya.



This is followed by improved relationship with suppliers (EIRS), easier management of relationship among shareholders (EEMRS) and, the reduction in firm's cost of capital (ERFCC), in order of importance.

Additional comments on the benefits accruing to cross listing regionally by some of the respondents cite the need for enhanced goodwill and the potential markets growth in size and stature.

#### 4.4 Existing Legal and regulatory requirement for cross listing

The respondents rating of the legal regulatory requirements are summarized in the table below.

**Table 4.4**  
**Frequency Table:**  
**Legal, regulatory requirements**

	Mean	Mean	N	1	2	3	4	Total
	Ranking	Responses	TS	S	R	LS		
				%	%	%	%	%
Initial listing and Cross listing entry requirements (CILCL)	1.39	1	23	65.22	30.43	4.35	0.00	100.00
Continuous reporting obligations (CCRO)	2.43	2	23	17.39	26.09	52.17	4.35	100.00
Quantity and quality of disclosures (CQD)	2.65	4	23	13.04	26.09	43.48	17.39	100.00
Initial and continuous cross listing fees (CICCLF)	2.52	3	23	17.39	26.09	39.13	17.39	100.00
Number of profitable years track record (CNPY)	3.00	4	23	4.35	17.39	47.83	30.43	100.00

These and other costs related to cross listing were ranked on a scale of 1 to 4 as; "Too stringent" (1), "Stringent" (2), "Reasonable" (3) and "Less stringent" (4).

The respondents rank the initial listing and cross listing entry requirements as the most stringent aspect to cross listing. The respondents considered the other items in their order of stringency as; continuous reporting obligations, initial and continuous cross listing fees, the quantity and quality of disclosure and past profitability record.



The initial listing and cross listing entry requirement (CILCL) was rated by 65% of the respondents as too stringent while 43.5 % rated equally fees associated with listing (CICCLF) and continuous reporting obligations (CCRO) as stringent and too stringent.

#### 4.5 Other Factors

The other inhibiting factors to regional cross listing include for instance in the case of some banks their status as subsidiaries of overseas parent companies that own 100% subsidiaries in both Kenya and Uganda and therefore cross listing is untenable. Restrictive domestic laws in Tanzania that do not allow free movement of investors and, dividend payments on a uniform currency as well as cross listing not being prioritized in firm's strategic plans, are the other challenges.



## CHAPTER FIVE

### 5.0 SUMMARY AND CONCLUSIONS

#### 5.1 Summary and Conclusions

The results of the study are in agreement that challenges exist in the process of cross listing and therefore account for the present low level of cross listing by eligible Kenyan Companies listed at the Nairobi Stock Exchange. The expectations are that the exchange having been in existence since 1954 and the first cross listing having taken place in 2001, the number of companies cross listing regionally ought to have been more than the present three companies. This is in view of studies carried out in the developed world that have shown that, in cases where firms cross listed, net benefits were realized. This finding is also supported by this study in that, the results to the second objective of the study show that a number of benefits are very much realized or realizable according to the opinions of the respondents, once a firm cross lists. Despite this, no significant number of companies has cross listed regionally into the Uganda securities exchange and the Dar es Salaam stock exchange.

Having to satisfy firms needs to achieve more and desired market visibility in the region is considered as a challenge and an objective cross listing is faced with. The process of cross listing despite giving some firms some level of publicity appears not to meet fully their expectations. This would suggest that the financial analysts following and also increased media coverage of the firms is seen as inadequate, whereas this aspect in cross listing is extremely important.

The ability to finance growth and development, attaining an improved firm's image and status, and having increased liquidity in company shares are challenges that not only influence the decision to cross list but also the current status of the regional markets faces. The capacity, size and stature of the regional markets are not that well developed.



These markets where Kenyan firms would cross list are not as developed as other stock markets outside the region that have more liquidity and this would meet the need to raise funding for growth and development easily and at lower transaction costs. This state therefore encourages firms to seek development funding from borrowings and internally generated funds. The liquidity of company shares may also not improve significantly once cross listed as the regional markets are still small and require growth and advancement.

This suggests the need for the Association of the Stock Exchanges of East Africa not only to carry out aggressive campaigns targeting eligible firms for cross listing but also working in liaison and in conjunction with their respective governments to see more development of the regional exchanges so that they attain the status that addresses the challenges in regional cross listing.

Policy incentives, inadequate awareness and costs associated with entry and cross listing requirement are the key impediments that face companies that are eligible for cross listing regionally. Those legal, regulatory requirements are considered not only stringent but also too stringent. There is need for a continued review of the regulatory framework in order to address the needs of companies eligible for regional cross listing. This is in line with Aggrwal (2001) who states that a strong legal and regulatory framework is essential for capital markets to function well but it does not suffice without enforcement.

There is little doubt that cross listing does bring about benefits and in particular an improved corporate image for the firm, brand recognition and acceptance, having a wider capital base and lowering firm's cost of capital in addition to increased liquidity of company shares. In order to encourage regional cross listing, more policy incentives by the government and CMA and also by the regional stakeholders need to be introduced. The stock exchanges should also play a more educational role and the other regulatory agencies should be more proactive and supportive in their roles in facilitating more developed, vibrant and integrated regional markets. This would also see the capital



markets in the region effectively play their intended roles in economic growth in the region.

## 5.2 Limitations of Study

Although the study was successful, there were limitations:

- There were officials of some of the companies who considered the information sought in the questionnaire as confidential and therefore declined to give their company responses to the questionnaire, in one of the instances it was said to be company policy not to provide any research information.
- The questionnaire targeted Chief Executive Officers and Finance Directors of the listed companies that are eligible for cross listing, it was however difficult in some of the companies to get the senior executives to complete the questionnaire. There was some delegation in who else was to fill the answers to the questionnaire and in the process some of the questionnaires got misplaced resulting in repeat delivery of the same or completion by some officials who were not too sure they were giving answers representative of their companies' position on a particular issue.
- Some of the companies had not before at any time thought about the possibility of cross listing regionally, this posed a challenge in responding to the questionnaire.
- Literature review material relevant to the region and or emerging or developing markets was limited.

## 5.3 Recommendations

- Studies in the developed world and in some of the emerging markets have shown that there are net benefits realized from cross listing. The NSE listed companies



eligible for cross listing should reappraise their positions on cross listing and consider it as one of their possible business strategies. This would lead to the companies benefiting from improved corporate image, the increasing acceptance and recognition of their brands and, the benefit of having the access to a wider capital base.

- More drive in awareness creation of the benefits in cross listing should be undertaken by the regulatory and licensing authorities in Kenya namely, the Capital Markets Authority and the Nairobi Stock Exchange and similarly by the regional securities exchanges in Uganda and Dar es Salaam. The objective being to have more eligible listed companies cross list.

#### 5.4 **Suggestions for further study**

A study on the following research areas could contribute further to the understanding of the challenges that account for the dismal cross listing of companies at the regional Uganda securities exchange and the Dar es Salaam stock exchange, and the benefits realizable from cross listing.

The study focused on NSE listed companies licensed under the main investment market segment, this study can be extended further to cover all listed companies after 30 December 2006, and other unlisted key companies.

The study can also be carried out to understand better why listed companies in the regional markets have not cross listed or not seeking a listing at the Nairobi Stock exchange.



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7.0 **APPENDICES**

7.1 **INTRODUCTION LETTER**

UNIVERSITY OF NAIROBI  
FACULTY OF COMMERCE  
MBA PROGRAM  
LOWER KABETE CAMPUS

22 August, 2008

**TO WHOM IT MAY CONCERN:**

The bearer of this letter: **PETER MUMO, M.**

Registration Number: **D6/P8885/04**

Is a Masters of Business Administration (MBA) student at the University of Nairobi

He is required to submit as part of his coursework assessment a research project report on some management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would therefore appreciate it if you could assist him to collect data in your organization for the research.

The results of the report will be used solely for academic purpose and a copy of the same will be availed to the interviewed organization on request.

Thank you

**CO-ORDINATOR MBA PROGRAM**



7.2 **List of Companies Quoted on the NSE main investment market segment, as at 31st December 2006.**

**NAIROBI STOCK EXCHANGE**

**THE MAIN INVESTMENT MARKET SEGMENT (MIMS)**

**AGRICULTURE**

- 1 Unilever Tea Kenya Limited
- 2 Kakuzi Limited
- 3 Rea Vipingo Plantations Ltd
- 4 Sasini Tea and Coffee Limited

**COMMERCIAL AND SERVICES**

- 5 Car and General (Kenya) Limited
- 6 CMC Holdings Limited
- 7 Hutchings Biemer Limited-
- 8 Kenya Airways Limited
- 9 Marshalls (East Africa) Limited
- 10 Nation Media Group Limited
- 11 Tourism Promotion Services (Serena) Limited
- 12 Uchumi Supermarkets Limited
- 13 Standard Group Limited
- 14 ScanGroup Limited

**FINANCE AND INVESTMENT**

- 15 Barclays Bank of Kenya Limited
- 16 CFC Bank limited
- 17 Diamond Trust Bank (Kenya) Limited
- 18 Housing Finance Company Limited

- 19 ICDC Investment Company Limited
- 20 Jubilee Insurance Company Limited
- 21 Kenya Commercial Bank Limited
- 22 National Bank of Kenya Limited
- 23 NIC Bank Limited
- 24 Pan Africa Insurance Holdings Co. Limited
- 25 Standard Chartered Bank Kenya Limited
- 26 Equity Bank

## **INDUSTRIAL AND ALLIED**

- 27 Athi-River Mining Limited
- 28 Bamburi Cement Company Limited
- 29 British American Tobacco Kenya Limited
- 30 BOC Kenya Limited
- 31 Carbacid Investments Limited
- 32 Crown-Berger Kenya Limited
- 33 Olympic Capital Holdings Limited – Formerly Dunlop Kenya
- 34 East African Cables Limited
- 35 East African Portland Cement Company
- 36 East African Breweries Limited
- 37 Sameer Africa Limited (formerly- Firestone East Africa (1969) Limited)
- 38 Kenya Oil Company Limited
- 39 Mumias Sugar Company Ltd
- 40 Kenya Power and Lighting Company Limited
- 41 Total Kenya Limited
- 42 Unga Group Limited
- 43 Kengen Limited
- 44 Eveready East Africa Limited



7.3 APPENDIX 3 QUESTIONNAIRE  
 SURVEY OF REGIONAL CROSS LISTING CHALLENGES AND  
 BENEFITS.

COMPANY NAME:.....

POSTAL ADDRESS: .....

NAME OF MD/FINANCE DIRECTOR .....

YEAR OF FIRST ISSUE OF SHARES AT NSE: .....

SHARES ISSUED ON THE FIRST PUBLIC ISSUE: .....

A. **How important are the following aspects, challenges on the decision to cross list?**

Express your agreement on a 1 to 5 scale, where 1=Not important, 2=Less important, 3=Fairly important, 4=Important and 5=Extremely important.

- |  | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| 1. To finance growth and development                   | — | — | — | — | — |
| 2. To increase the company's visibility                | — | — | — | — | — |
| 3. To balance the debt/equity level                    | — | — | — | — | — |
| 4. To improve the company's image and raise its status | — | — | — | — | — |
| 5. To increase the liquidity of company shares         | — | — | — | — | — |
| 6. To enjoy tax benefits                               | — | — | — | — | — |
| 7. To infuse professional management of the company    | — | — | — | — | — |
| 8. To involve new people in the governance             | — | — | — | — | — |
| 9. To help the development of strategic alliances      | — | — | — | — | — |
| 10. Having to meet requirements for shareholding       | — | — | — | — | — |

B. In your own opinion what are the challenges or factors inhibiting cross-listings at the E.A exchanges? Please rank them in a descending order from the greatest inhibitor (as=1) to the least.

	Rank
(i) Lack of awareness/understanding of the entry requirements, and policy incentives by the eligible listed companies .....	.....
(ii) Too stringent entry requirements .....	.....
(iii) Too many entry requirements .....	.....
(iv) Too stringent continuous cross listing requirements .....	.....
(v) Too many continuous cross listing requirements .....	.....
(vi) Absence of new investment opportunities to warrant seeking cross listing at the stock exchanges .....	.....
(vii) Unrealistic and unachievable policy incentives .....	.....
(viii) Availability of listing benefits even when not cross listed .....	.....
(ix) High costs associated with cross listing .....	.....
(x) Liquidity and status of the regional capital markets .....	.....
(xi) Others. Please list them .....	.....
.....	.....
.....	.....

C. In your opinion which of the following are the most stringent aspects and challenges to cross listing if any? (Please indicate them in order of stringency.

Key: 1. Too stringent 2. Stringent 3. Reasonable 4. Least stringent.)

	1	2	3	4
i). Initial listing and Cross listing entry requirements	[ ]	[ ]	[ ]	[ ]
ii). Continuous reporting obligations	[ ]	[ ]	[ ]	[ ]
iii). Quantity and quality of disclosures	[ ]	[ ]	[ ]	[ ]
iv). Initial and continuous cross listing fees	[ ]	[ ]	[ ]	[ ]
v). Number of profitable years track record	[ ]	[ ]	[ ]	[ ]
vi). Others. Please list them .....				
.....				



D. Do you think if some of the requirements were relaxed this would attract more companies to seek cross listing at the regional securities exchanges?

Certainly      Possibly      No  
 { }              { }              { }

**APPENDIX 3 QUESTIONNAIRE (CONTINUED)**

**SURVEY OF BENEFITS ACCRUING TO NSE COMPANIES CROSS LISTED AT THE EAST AFRICAN EXCHANGES**

E. **To what extent do you believe your company can realize/has realized these benefits from cross listings?**

Express your agreement on a 1 to 3 scale, where 1=not at all and 3=very much

	1	2	3
1. Access to wider capital base across region	-	-	-
2. Reduction in firm's cost of capital	-	-	-
3. Acceptance and recognition of company brand across region	-	-	-
4. Higher efficiency of the governance mechanisms	-	-	-
5. Incentives to improve performance	-	-	-
6. Improved relationship with clients	-	-	-
7. Easier management of relationship among shareholders	-	-	-
8. Improved relationship with suppliers	-	-	-
9. Incentives to refine tools and procedures of planning and Accounting	-	-	-
10. Employee pride in the company	-	-	-
11. Access to strategic alliances	-	-	-
12. Improved corporate image, prestige of regional listing	-	-	-
13. Increased liquidity of company securities	-	-	-

F. **Please provide any other additional comments that you may have on the benefits accruing to listed NSE companies cross-listing at the East African Exchanges.**

Company Name and Sector	AFGD	AICV	ABDEL	AICIRS	AILCS	AETB	AIPM	AINPG	ADSA	AMRS	BLAERI	BSER	BMER	BSCLR	BMCLR	BAIO	BUPI	BALB	BHCLC	BLSRM
<b>Agriculture</b>																				
Rea Vipingo Plantations Limited	3	3	2	1	1	1	1	1	2	1	6	8	7	9	10	1	5	4	2	3
Sasini Tea and Coffee Limited	3	4	2	4	4	2	3	1	2	1	1	4	3	5	6	7	10	8	2	9
<b>Commercial and Services</b>																				
Car and General (Kenya) Limited	3	4	2	2	4	2	3	4	2	5	1	3	2	5	4	7	6	10	9	8
CMC Holdings Limited	4	4	1	4	3	1	2	2	1	1	10	8	6	9	7	1	5	4	2	3
Kenya Airways Limited	3	5	2	4	5	1	1	1	2	4	2	3	5	6	4	7	8	9	1	10
Nation Media Group Limited	5	5	3	4	4	2	3	3	4	3	8	2	5	4	6	9	7	10	3	1
TPS. H. Africa (Serena) Limited	3	2	2	3	3	2	4	3	4	1	5	4	7	9	6	10	3	8	2	1
Standard Group Limited	1	3	1	3	3	1	1	1	3	3	1	3	5	9	10	6	8	2	7	4
ScanGroup Limited	4	5	1	5	5	5	5	5	5	1	1	3	6	4	7	2	10	5	8	9
<b>Finance and Investment</b>																				
Barclays Bank of Kenya Limited	4	1	1	1	1	2	1	1	1	4										
Diamond Trust Bank (Kenya) Limited	5	3	3	4	4	2	5	5	5	3	2	1	3	10	4	8	7	9	5	6
Kenya Commercial Bank Limited	3	5	2	5	4	2	2	3	4	3	9	3	1	4	2	8	5	10	6	7
NIC Bank Limited	5	4	5	4	5	2	4	4	4	2	5	4	3	1	2	9	10	6	8	7
Pan Africa Insurance Holdings Co. Limited	5	5	5	5	4	4	5	5	5	5	10	8	7	6	5	3	9	2	4	1
Standard Chartered Bank Kenya Limited	5	2	5	2	3	3	2	3	2	2	5	1	2	3	4	6	9	10	7	8
<b>Industrial and Allied</b>																				
Athi-River Mining Limited	5	5	4	5	4	2	4	4	4	3	1	4	5	6	7	9	10	2	8	3
Bamburi Cement Company Limited	4	3	3	3	4	5	1	2	3	2	4	9	8	5	6	1	7	10	2	3
Crown-Berger Kenya Limited	5	5	4	4	4	1	2	4	4	3	5	7	6	8	9	1	10	2	4	3
East African Cables Limited	5	5	5	5	5	4	4	3	5	4	7	6	5	9	8	10	4	1	3	2
East African Breweries Limited	2	5	1	5	1	1	1	1	5	5										
Sameer Africa Limited	3	4	1	5	5	1	3	3	3	3	6	7	8	9	5	4	3	1	2	10
Mumias Sugar Company Ltd	3	5	3	4	4	3	3	2	3	2	2	2	3	4	5	8	7	9	6	1
Kenya Power and Lighting Company Ltd	3	4	3	3	4	3	1	1	2	1	1	7	8	9	10	6	3	4	5	2
Kengen Limited	5	5	2	5	2	5	2	2	5	3	5	8	7	10	9	2	6	1	4	3
TOTAL	91	96	63	90	86	57	63	64	80	65	97	105	112	144	136	125	152	127	100	104
Mean	3.79	4.00	2.63	3.75	3.58	2.36	2.63	2.67	3.33	2.71	4.41	4.77	5.09	6.55	6.18	5.68	6.91	5.77	4.55	4.73



## Data analysis

## Coded Questionnaire - Benefits of Cross listing

## - Regulatory and Legal Requirements inhibiting/challenges to cross listing

Company Name and Sector	EAWCB	ERFCC	EARCB	EHEG	EIIP	EICR	EESRM	EISR	EIPPA	ECEP	EASA	EICIP	EILCS	CILCL	CCRO	CQQD	CICCLF	GNPY
<b>Agriculture</b>																		
Rea Vipingo Plantations Limited	1	1	1	1	1	1	1	1	1	2	1	1	1	1	3	4	2	4
Sasini Tea and Coffee Limited	3	3	2	2	1	2	1	1	1	2	2	3	3	2	3	2	1	2
<b>Commercial and Services</b>																		
Car and General (Kenya) Limited	2	2	3	3	2	3	3	3	3	3	2	3	3	1	1	2	4	4
CMC Holdings Limited	3	1	3	2	3	2	1	2	2	2	2	3	2	1	2	3	1	4
Kenya Airways Limited	3	1	3	1	1	3	1	1	1	2	2	3	3	2	2	2	3	3
Nation Media Group Limited	3	3	3	2	2	3	2	2	2	3	3	3	3	2	2	1	3	3
TPS East Africa (Serena) Limited	1	1	2	1	2	2	3	2	1	2	2	3	3	2	3	3	2	3
Standard Group Limited	3	1	3	3	3	3	1	1	2	3	3	3	2	2	3	4	4	4
ScanGroup Limited	3	3	3	1	1	2	1	2	1	3	3	3	3	1	3	3	1	3
<b>Finance and Investment</b>																		
Barclays Bank of Kenya Limited	3	3	1	1	2	2	2	2	1	2	2	2	2					
Diamond Trust Bank (Kenya) Limited	3	2	3	3	2	2	2	2	2	2	3	3	3	1	3	3	2	2
Kenya Commercial Bank Limited	2	1	3	2	2	3	2	1	2	3	3	3	2	1	3	4	2	4
NIC Bank Limited	3	3	2	3	3	2	2	2	2	2	2	2	2	1	1	1	2	2
Pan Africa Insurance Holdings Co. Limited	3	2	3	2	3	3	3	3	3	3	3	3	2	1	3	3	3	1
Standard Chartered Bank Kenya Limited	3	3	3	2	2	2	2	1	1	2	2	2	2	1	1	2	3	3
<b>Industrial and Allied</b>																		
Athi-River Mining Limited	3	3	3	2	2	2	2	2	2	2	3	3	3	1	3	2	3	3
Bamburi Cement Company Limited	3	2	3	3	2	3	3	3	2	3	3	3	3	1	2	1	3	3
Crown-Berger Kenya Limited	3	3	1	1	1	1	3	3	2	3	3	1	3	2	1	3	3	3
East African Cables Limited	3	3	3	2	2	3	2	2	3	3	3	3	2	2	3	3	3	3
East African Breweries Limited	1	1	3	3	3	3	3	2	1	3	3	3	1	1	4	4	4	4
Sameer Africa Limited	3	1	3	3	3	1	1	1	2	3	3	3	1	1	2	3	4	3
Mumias Sugar Company Ltd	2	1	3	2	3	2	1	2	1	1	2	2	3	1	2	3	2	2
Kenya Power and Lighting Company Ltd	3	2	3	3	2	1	1	2	3	3	3	3	3	1	3	2	1	3
KenGen Limited	1	2	3	1	1	1	2	1	1	2	2	3	2	3	3	3	3	4
TOTAL	61	48	63	49	49	52	45	44	42	59	60	64	57	32	56	61	59	70
Mean	2.54	2.00	2.63	2.04	2.04	2.17	1.88	1.83	1.75	2.46	2.50	2.67	2.38	1.39	2.43	2.65	2.57	3.04