LISTING REQUIREMENTS OF THE NAIROBI STOCK EXCHANGE: AN ATTITUDE SURVEY OF PRIVATE COMPANIES

BY
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A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTER OF INTERNATIONAL BUSINESS ADMINISTRATION WITH CONCENTRATION IN FINANCE.

United States International University
Africa........................................Library

DECEMBER 1995
DEDICATION

TO JOHN AND CHRISTINE NGONDE WHO WITHOUT THEIR SUPPORT, THIS PROJECT WOULD HAVE BEEN NOT POSSIBLE.
DECLARATION

THIS PROJECT IS MY ORIGINAL WORK AND IT HAS NOT BEEN PRESENTED FOR A DEGREE IN ANY OTHER UNIVERSITY.

Signed ____________________ Date 13/5/1996
Carolyne Ngonde

THIS PROJECT HAS BEEN SUBMITTED FOR EXAMINATION WITH MY APPROVAL AS UNIVERSITY SUPERVISOR

DR. K. MURAGU.
13 MAY, 1996.
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**DECLARATION**

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Thirdly, to my colleagues in USIU and friends who provided help and encouragement in the distribution of the questionnaires. Lastly to the Capital Markets Authority for allowing me to use their Library through which I was able to acquire the relevant information needed to make it a project.

Any errors of omission and commission are entirely mine.
ABSTRACT

Stock markets provide alternative choices for companies to raise capital other than using banks, lending houses and other forms of borrowing on the long term basis. In Kenya, the Nairobi Stock Exchange is such a market and was begun in 1954. Only 56 companies have listed on the exchange, though we would expect them to be more since the number of private companies registered in the country is greater than 5000. There is no research that has been done to provide evidence why these private companies do not use the stock exchange to raise capital.

This study presents the results of an investigation as to why there may be so few companies listed on the Nairobi Stock Exchange. It uses interviews and questionnaires as the method of research design.

The conclusion is that the Nairobi Stock Exchange has to do more than is currently the case to attract additional companies to list. It should lobby for enhancement of tax incentives for listed companies. The listing requirements such as a company has to have 5 years audited accounts are a barrier to new companies wishing to list. There is also the need of educating the general public on the reasons why they should use the stock exchange.
CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

A company needs financial support to meet its objectives and long term goals, which usually include meeting a target profit, or generating a certain amount of income in the profit making enterprises. An existing company requires capital to improve its activities to be able to compete with other firms, while new companies need capital to grow and expand their activities.

The support can come through debt financing or through equity financing. In debt financing, the company can acquire capital through borrowing to spend, and the percentage of interest charged depends on the lending house used. In using equity as a means of financing, a company sells part of its share holding either to the public to raise capital, or it is privately contributed by the owner(s). Raising of capital from the public takes place by a company listing on a stock exchange.

In the last decade, the development of stock markets has gained more recognition as an avenue which companies can raise capital to meet their financial requirements in the developing countries (Popiel, 1994). For example, Argentina in the 1990's was a country with a high rate of inflation (hyperinflation) that was over 4000%. Now the inflation is less than 10%. It has been able to reduce its inflation by developing its capital market which has experienced tremendous growth (Apertura, pg 18).
In Kenya, the culture of using the stock exchange to raise capital is underdeveloped. Out of approximately five thousand companies that are made aware to the public through the use of media, newspapers, directories, journals and other ways, only 56 companies use equity to raise capital by listing on the Nairobi Stock Exchange. In 1985 the listed companies were 53, which increased to 57 in 1993. Now in 1995, they have decreased to 56, with none that has been listed this year. (The listed companies are shown in Appendix C). On average only one company lists per year even though there are new companies that have been formed, while others have expanded their operations.

1.2 NEED FOR THE STUDY.

Here in Kenya, there is the Nairobi Stock Exchange on which a company can list. Started in 1954, it allows a company that has met the listing requirements to raise capital by selling part of their stock to investors. The selling and buying of the stockholding is done by stockbrokers, who earn a commission to do so.

The qualifications for listing on the Nairobi Stock Exchange for a company are as follows (NSE Manual, pg 13).

1. A company must have an issued capital of at least Kshs 2,000,000.

2. The Memorandum and Articles of Association of the company must comply with the requirements of the Nairobi Stock Exchange.
3. At least 20% of the issued equity capital for which quotation is being sought must be offered to the public, whose value must be at least Kshs. 2,000,000.

4. The Nairobi Stock Exchange requires that the spread of the shareholders existing at the close of an offer is sufficiently wide enough to justify the listing (approximately 150 shareholders is regarded as minimum).

5. The name, description, history of the company's interest and activities.

6. A report by the company auditors in respect of the last five completed financial years of the company, if the company has been in existence for 5 or more years.

7. Forecast earnings and dividends.

There are companies that can meet the qualifications for listing but they prefer not to list. A few examples include Citibank, Biashara Bank, Caltex Oil Co., Davies and Shirliff, Commercial Bank of Africa, etc.-some of which have been ranked top ten in profitability in Kenya (in Kenya Finance Insurance and Investment Directory 1994/1995 pg 14) while others have been top ten in capitalisation deposits and assets.
Ability to raise funds. A company can raise fresh capital both initially, by going public (primary issues) and subsequently through secondary issues (rights issues and placements of stocks).

A company that is listed is more noticed by the public, while the shareholders can keep track of their investments in the daily papers.

The stock market provides to savers and financial institutions with a further outlet for their funds. Hence it enables investors to select the portfolio with a risk return combination to their liking.

It is therefore interesting that given these attended benefits, so few companies are listed on the Nairobi Stock Exchange. This study examines why this might be so.

1.3 OBJECTIVES OF THE STUDY.

The study intends to reveal the reasons why companies that would be eligible for listing, have not done so.

1.4 IMPORTANCE OF THE STUDY

The study can be of use to the following:-

1. The Nairobi Stock Exchange.

NSE can look into ways of encouraging companies to go public by analysing the problems that block companies seeking to list, and providing solutions to such problems.
2. Capital Markets Authority (CMA).

CMA being the regulatory body of the government is charged with the responsibility of developing the NSE, could look at what other emerging markets adopted that can work in our exchange such as relaxing the listing requirements.

3. Other researchers.

This project can be used by other researchers as a beginning to other reasons that can be researched on, on why companies have not been eager to list on NSE.

1.5 **OVERVIEW OF THE STUDY**

The rest of the study is in chapters. Chapter two presents the literature review on prior research findings in other countries that lead to companies avoiding to list on the stock exchanges, and how they have improved the situation. Chapter three details the methodology used in the study. This includes population chosen, data collection and the sample used.

Chapter four details the data analysis and findings of the study. Chapter Five summarises and discusses further suggestions for research.
CHAPTER TWO

LITERATURE REVIEW

In Kenya, the money markets have been more recognised in financing companies since they have been in existence longer than the capital markets. Banks and other financial have been the major source of short-term debt financing and provide capital for a shorter period of time, and many of them have been noted to have high credit ratings. They are highly liquid and people borrow and lend to the banks and similar organisations as frequently as possible. (CBK Report, pg 9).

Dominant banks used in the money markets include Central Bank which deals with foreign reserve deposits, Commercial banks like Kenya Commercial Bank, Standard Chartered and Barclays Bank. Some of these banks have subsidiary lending houses e.g. Barclays Merchant Finance Bank, Kenya Commercial Finance Ltd, etc. The non financial banks include Postbank, Diamond Trust, East African Building Society, Housing Finance Company of Kenya. Insurance companies such as American Life insurance Co. of Kenya, and the Kenya National Assurance are also included in the non-financial banks.

The instruments dealt in the money markets are certificates of deposits and debentures. Together with bank overdrafts, these instruments are a major way that companies use to finance their working capital. Letters of credit and bills of exchange are used in trade finance. Rhone Poulenc, Motormart and Brooke Bond, are companies that have issued a commercial paper to help them finance their activities. The commercial
paper recently introduced, is a short term paper which promises to repay to bondholders the specific amount plus a certain amount of interest within a fixed period of time. The time for maturity is usually from one month to one year.

In other developing countries many companies have now turned to equity to finance their companies through the use of stock exchanges. In the last decade, the development and sophistication of these stock exchanges have been used to distinguish whether a country is an emerging capital market or not. An emerging capital market refers to an economy of a capital market that is improved by the stock exchanges in the particular country going through a process of change, that is growing in size and technology and shows that it has a potential for development (IFC Factbook, 1995).

In Kenya, the Nairobi Stock Exchange can be considered as such a capital market. The performance has steadily increased in the last three years with the exception of this year. In all the public issues that have taken place, there has been full subscription of the shares. National Bank of Kenya in 1994 had 330% subscription, Barclays Bank in 1986 had 613% subscription, Firestone in 1994 had 101% subscription. This shows the Nairobi Stock Exchange has potential for development. (NSE Manual, 1994).

The securities that are dealt with in the Nairobi Stock Exchange include long-term government bonds, company loan stocks, treasury bonds and treasury bills issued by the Central Bank.

In the capital markets of developing countries you find the use of derivatives such as floating rate bonds, indexed bonds, futures and options. These have been developed to help countries, minimise risk against
foreign exchange fluctuations. Developing countries that have their companies listed in other foreign exchanges have benefited from these derivatives since they have reduced currency exposure which would be most felt in countries where currencies are constantly being devalued. (IFC Report, PG 11).

The trend in other emerging markets has been that of capital markets experiencing substantial progress in 1994. This has been attributed to advances made in carrying out transactions efficiently by automating their stock exchanges and improving investment saving techniques. This has resulted in markets surging in new listings. For example in 1994, India had 47 listings of nearly 36 billion dollars, China, had 35 listings raising nearly 24 billion dollars while Argentina, Brazil, Philippines and Korea had issues raising nearly one billion dollars. (Emerging markets, pg 24). Table one shows the number of listed companies in other stock exchanges in the rest of the world that are younger than the Nairobi Stock Exchange.

Although the Nairobi Stock Exchange is classified as an emerging market, the listed companies have not increased.

Below, table two shows how the activity at the Nairobi Stock Exchange compares with the number of listed companies.
Table Two

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of listed companies</td>
<td>54</td>
<td>53</td>
<td>57</td>
<td>56</td>
<td>56</td>
</tr>
<tr>
<td>Market cap. in Dollars</td>
<td>453</td>
<td>638</td>
<td>607</td>
<td>1418</td>
<td>3081</td>
</tr>
<tr>
<td>Market cap. in Kenya shillings</td>
<td>10,900</td>
<td>17,900</td>
<td>22,000</td>
<td>96,878</td>
<td>136,800</td>
</tr>
<tr>
<td>Turnover ratio</td>
<td>2.2</td>
<td>2.1</td>
<td>2.0</td>
<td>1.4</td>
<td>2.6</td>
</tr>
<tr>
<td>Trading value in shillings in US dollars</td>
<td>235</td>
<td>302</td>
<td>400</td>
<td>825</td>
<td>3080</td>
</tr>
<tr>
<td></td>
<td>10.3</td>
<td>11.0</td>
<td>12.4</td>
<td>14.2</td>
<td>62.2</td>
</tr>
<tr>
<td>NSE Index</td>
<td>915.3</td>
<td>958.3</td>
<td>1167.3</td>
<td>2513.7</td>
<td>4559.4</td>
</tr>
<tr>
<td>P.E. ratio</td>
<td>3.3</td>
<td>3.6</td>
<td>2.1</td>
<td>1.5</td>
<td>-</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>12.3</td>
<td>15.7</td>
<td>11.1</td>
<td>6.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>


The use of equity to finance companies is still very new to many people in Kenya, and that may be a reason why there has been no previous research or study done to investigate why many companies do not wish to finance their activities through listing on the Nairobi Stock Exchange.

However, there have been some studies that have been done on other developing markets that could be used to refer to the situation here, since the stages of development in these other markets compared to our market are similar.

In many developing and developed countries, there are not major differences in the listing requirements of their various stock exchanges. These are specified together with the trading rules in each particular exchange. They usually include regulations on disclosure, the need to provide relevant information to the investor about the issuer, the business operations of the company, the financial status of the company, etc.

The purpose of disclosure is to give investors information that is useful to them to make informed decisions as to whether they should
invest in a company or not, which is considered as material information. This usually requires the preparation of a prospectus to contain all this.

The requirements for listing also include part of the company to be held by the public to be approximately 20% of the company, and on average a minimum of 150 to 200 shareholders to participate. The minimum amount of capitalisation of a company varies depending on the stock exchange which it is listed on. The similarity of the listing requirements is seen in the stock exchanges of Mauritius, Korea, Philippines, Singapore, Poland, Zimbabwe, Ghana, Botswana, South Africa, and Kenya Stock exchanges. They also require five years previous accounts to determine its credibility. (Global investor, pg 6).

The buying and selling of shares of a listed company are facilitated by the use of stockbrokers and dealers who buy and sell on behalf of the investors. There are about 20 brokerage companies that are registered to do so. When a company does well there are dividends payable to the shareholders who are on register at a particular date. The size and payments of dividends depends on the trading class of shares (NSE Manual pg 4). The companies that are listed are required to prepare annual reports ad to up-date them.

Proper listing requirements are necessary to ensure that companies seeking a public listing have "bonfide" business activities and do not obtain funds from the public through deceptions and mis-representation (Nse Handout pg 6). Here in Kenya companies are taxed at 35%. Listed companies deposits had with-holding tax of 15%, which was reduced to 10%, while on dividends it is 10%.
In some countries, the listing requirements have been found to hinder companies from listing, and some countries have modified them to improve the situation so that more companies can be encouraged to list.

In the Mauritius Stock Exchange, tax incentives have been introduced to encourage companies to list. A listed company enjoys a tax relief of 30% and exemptions in the registration duty of 13.2% on the transfer of shares. Investors in addition to tax-free dividends, they obtain generous tax credits for investments in new shares. In order to get more investors to participate which will encourage demand for companies to list, the Mauritius Stock Exchange provides information to the public, and makes investors aware of the importance of their investment to the market. This it has done putting special emphasis on investment promotion and in providing information and any other information useful to the investor. This includes preparing investment brochures, annual young investors award competition, a weekly radio programme and country side shows, which have been used as promotional campaigns. The securities exchange of Mauritius has been fairly successful in creating a new investment culture sustaining the confidence of the investors. (Review of the Emerging Markets, pg 18).

In the securities market of Korea, the tax for listed companies was lowered from 35% to 20%. There is also the mandatory registration of the companies that eligible for listing on stock exchange. They encourage companies to list by giving preferential tax treatment for those that are already listed and their minority shareholders while promoting employee stock ownership. So according to law, the regulatory body of the stock exchange in Korea, the Societies Exchange Commission of Korea, is
empowered to select eligible companies and induce them to go public. (Review of emerging markets, pg 21).

In South Africa, the Johannesburg Stock Exchange has recognised that it is impossible for new and expanding companies to adhere to the rule of submitting 5 years accounts so as to list. To encourage companies to list, those new companies that show good growth aspects, the prompt and full disclosure of the company takes place when it is in the best interest of the company. (Topic, pg 6). There is also the presence of a junior board where companies can raise capital, and the listing requirements are less strict than those of the main stock exchange.

In Poland (the Polish equity market), the companies owned by the state are forcefully privatised by publicly offering shares. This encourages other companies to be privatised through listings. In addition there is no interest charged on capital gains.

In Turkey, foreigners have been allowed to acquire up to 49% shareholding in a company that is listed. In Jordan, foreigners can participate up to 40%. (Emerging markets, pg 25)

In Argentina, the days for a company application for a listing to go through has been reduced from 4 months to 20 days so as to speed up the process for those that would wish to list, hence reducing delays in listings.

In Kenya, there was a related study that identified a problem on peoples attitudes towards investing in shares. In a study done by Coopers and Lyband that was commissioned by the Capital Markets Authority in 1992 to study on the attitude of the public towards buying and selling shares, very few people would consider investing in the Nairobi Stock exchange. Most preferred saving in the bank accounts or investing in assets like land.
This shows there is a need to develop a public awareness campaign on the general investor attitude. With more investors participating, the prices of the shares a company are bound to go up when driven by the increasing demand, and therefore generating more liquidity at the Nairobi Stock Exchange. When the prices of the securities go up, more companies are encouraged to list.

The Kenyan government is trying to increase investor participation and increase activity at the Nairobi Stock Exchange. In the 1994/1995 and 1995/1996 Budget, foreign investors were allowed to participate in buying and selling of shares in publicly quoted companies at the Nairobi Stock Exchange. In 1994 foreigners were allowed to hold up to 20% of a company which was later increased to 40% this year. (Kenya Gazette Supplement, 6th January).

The number of brokers increased in 1994 to be 20, though previously they had been only six. The brokerage commissions were reduced from 5% to 2.5%. The effects of the implementation of this has not been felt since much of this was implemented two months ago.

In the Global Investment Guide, there is analysis that was done on the developing markets to research on the discriminating tendencies that make their companies prefer debt financing rather than equity financing. The countries included were from Asia and Africa and these were some of the conclusions: (Samuel’s and Yacouts, pg 153).

1. The tax environment in developing countries is biased against capital market development. One common impediment to an increased supply of securities is the tax advantage in debt financing as opposed to equity financing. Interest on debt is tax deductible,
while dividends are not tax deductible and are taxed twice, once at company level and what the shareholder obtains upon the sale of securities is subject to excessive taxation.

2. The fixing of brokerage and underwriting commissions is high. (Here in Kenya when it was 5%, it was one of the highest ever in developing countries before it was made negotiable in this year's budget).

3. Companies that plan public offerings are subject to waiting since the listing have to be in priority of government policies and not market priorities.

4. There is a lack of proper publicity to improve the companies that have listed their corporate image and public awareness of the company. The publicity should be generated by the stock exchange where a company has listed.

5. There are excessive limitations on foreigners holding investments in the listed companies, though now many countries have now liberalised their companies to allow foreigners to participate.

6. The prices at which securities can be bought and sold at the stock exchange should be determined by market principles on stock exchange. In the developed countries, it is determined by the investors perceptions of the future earnings and capital appreciation. (On the Nairobi Stock Exchange, the initial offer price is determined
by the public organisation rather than basis of supply and demand - Nse Manual pp 21). Fixing of issue price is a major impediment to public issues, since it is an arbitrary determination by the authorities of the price which an issue can be offered to the market.

7. The costs associated with the listing process are exemplary high. Here in Kenya, the company pays 0.3% the par value of the total being issued as the listing fee (C.M.A. Act). The cost of going public is heavy if the issue includes an issuing house or an underwriter, sponsoring brokers fee, money for property valuation auditors fees, printing and legal costs and extraordinary expenses which amounts to approximately 10% of the capital raised.

In summary, these are some of the problems that contribute to discouraging companies to list on the Nairobi Stock Exchange, and some of these problems could be facing the Nairobi Stock Exchange. Through the use of a questionnaire to the various companies who should list but have not done so, the literature review can justify on what can be done or implemented in our market to make more companies to prefer equity financing.
CHAPTER THREE

RESEARCH DESIGN

This chapter details out the research design to achieve the objective stated above.

3.1 POPULATION AND PERIOD OF STUDY

The population is all those companies that have not listed on the Nairobi Stock Exchange. So far only 56 companies are listed on the exchange, but they would be expected to be more because of the benefits that are associated with a company that is listed.

3.2 SAMPLE

In the Kenya, Finance, and Investment Directory of 1994/1995, companies are ranked in the following categories:

1. Profitability.
2. Capitalisation.
3. Deposits.

The first top ten in each category and which are not listed on the Nairobi Stock Exchange formed the sample for this study.
3.3 DATA COLLECTION

This study relied on primary data which was collected through questionnaires and interview sessions. The questionnaire used is shown Appendix A, and the companies that gave their responses are listed in Appendix B.

3.4 DATA ANALYSIS

The data is analysed by formulating tables on the various responses given to various questions, to establish if any conclusions can be made.
CHAPTER FOUR

DATA ANALYSIS AND FINDINGS.

4.1 INTRODUCTION

In this section the findings of the study are presented. The results of this study were taken randomly from companies in Nairobi to represent companies in Kenya, since most of the companies are concentrated in the capital city. The answers were sought through the use of interviews and questionnaires to the managers of the companies.

4.2 COVERAGE

Thirty out of forty-five companies responded to the questionnaires that were sent out. The study period taken, and unavailability of the data from some of the companies made up for the companies not included in the research. The researcher considers the above sample to be sufficient enough to enable meaningful valid conclusions to be reached on investigating why few companies are listed on the Nairobi Stock Exchange.

The responses provided the following industrial groupings:

<table>
<thead>
<tr>
<th>Industry</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance and investments</td>
<td>11</td>
</tr>
<tr>
<td>Industrial and allied</td>
<td>9</td>
</tr>
<tr>
<td>Commerce and services</td>
<td>8</td>
</tr>
<tr>
<td>Agricultural</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>30</td>
</tr>
</tbody>
</table>
(The companies which responded in the study are shown in Appendix B).

The approach to the study used various question surveys carried out and they are analysed below.

4.3 **SURVEY SUMMARIES.**

4.3.1 **Nature of shareholding.**

As seen from the table 1 below, majority of the respondents, (37%) had foreign shareholding. Their companies all have shareholders that are less than 10. In the opinion of these companies if there were more foreign owned companies in the Nairobi Stock Exchange, there would be more foreign investors who would be willing to buy and sell shares.

**TABLE 1: NATURE OF SHAREHOLDING**

<table>
<thead>
<tr>
<th>HOLDING</th>
<th>NO</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>FOREIGN</td>
<td>11</td>
<td>36.7</td>
</tr>
<tr>
<td>LOCAL</td>
<td>8</td>
<td>26.0</td>
</tr>
<tr>
<td>FOREIGN/LOCAL</td>
<td>5</td>
<td>16.7</td>
</tr>
<tr>
<td>FAMILY</td>
<td>5</td>
<td>16.7</td>
</tr>
<tr>
<td>OTHER</td>
<td>1</td>
<td>3.3</td>
</tr>
</tbody>
</table>

4.3.2 **No. of Shareholders.**

63.3% of the companies had less than four shareholders. 80% of the sample had shareholders less than 10. Comparing the number of shareholders to the nature of holding in the companies, the following results emerged, (see Table 2, overleaf).
TABLE 2: S/HOLDING V/S S/HOLDERS

<table>
<thead>
<tr>
<th>NATURE OF HOLDING</th>
<th>NO OF SHAREHOLDERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0-10</td>
</tr>
<tr>
<td>FAMILY</td>
<td>5</td>
</tr>
<tr>
<td>FOREIGN</td>
<td>11</td>
</tr>
<tr>
<td>FOREIGN/LOCAL</td>
<td>4</td>
</tr>
<tr>
<td>LOCAL</td>
<td>2</td>
</tr>
<tr>
<td>OTHER</td>
<td>1</td>
</tr>
</tbody>
</table>

All the companies that were foreign and family held, had shareholders that were less than 10. The companies that were locally held had majority of the shareholders being more than 20. Those companies that had both local and foreign shareholding 80% of the sample had less than 10 shareholders.

The fact that the sample companies have few shareholders would influence the results of the findings. For example, for the family held companies, it shows they are closely knit and wish to restrict the shareholding to themselves to avoid loss of control. The decision for them to list in the NSE is not their first choice. Likewise for the foreign subsidiaries who have less than 10 shareholders, they do not expand by using NSE and would rather be funded by their parent companies. As seen from Table 3 overleaf, the more popular type of funding used by companies (30)% was bank loan. The reasons given for using bank loan was that it was faster and cheaper to obtain than having to go through the process of listing which takes time and is costly.
4.3.3 NATURE OF FUNDING

TABLE 3: TYPE OF FUNDING USED

<table>
<thead>
<tr>
<th>nature of funding</th>
<th>NO</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loan</td>
<td>9</td>
<td>30</td>
</tr>
<tr>
<td>Private placements</td>
<td>8</td>
<td>26.67</td>
</tr>
<tr>
<td>shareholders equity</td>
<td>7</td>
<td>23.33</td>
</tr>
<tr>
<td>private borrowing</td>
<td>7</td>
<td>23.33</td>
</tr>
<tr>
<td>profits from operations</td>
<td>6</td>
<td>20</td>
</tr>
<tr>
<td>investment companies</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td>others</td>
<td>2</td>
<td>6.67</td>
</tr>
</tbody>
</table>

This is interesting because according to the Nairobi Stock Exchange report on the benefits of listing, the single main reason for going public is usually to increase the equity base of a company thus allowing for future expansion and growth. (Going Public on NSE, pg 4). Companies with favourable growth potential would have high share prices and would be able to generate more capital from the market. The expectation therefore is that equity would be the first source of funding.

4.3.4 Nature of funding v/s the type of holding

When the nature of shareholding was compared to the nature of funding, the following results followed, (as seen on table 4 overleaf)
<table>
<thead>
<tr>
<th></th>
<th>family</th>
<th>foreign</th>
<th>local/foreign</th>
<th>local</th>
</tr>
</thead>
<tbody>
<tr>
<td>bank loan</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>private placements</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>investment companies</td>
<td>-</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>shareholders</td>
<td>1</td>
<td>4</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>others</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>profit from operations.</td>
<td>-</td>
<td>4</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>private borrowing</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
</tbody>
</table>

- Those in family shareholding preferred bank loan which can probably be attributed to the companies not wishing to dilute their control of ownership.
- However these companies may use the factor of control theory to show why they prefer to use bank loan other than the stock exchange to raise capital. The control theory argues that some corporations expand only to the extent of their internal earnings. This policy is defended on the ground that raising funds by additional common stock dilutes the control of the dominant group of that company of fluctuating earnings to the present owners of the company (Weston and Brigham, pg 165).
- Local companies could not fund themselves from their operations and preferred private placements, where they sell shares to specific people.
They would be more likely to head towards a listing than family and foreign held companies.

- Majority of the companies in foreign shareholding funded themselves from shareholders and the profits from their operations, since they generated enough capital to support themselves.

4.3.5 **Attitudes towards Listing.**

There private sector companies expressed little interest in getting listed on the Nairobi Stock Exchange.

Only three companies from the sample expressed interest on listing on the Nairobi Stock Exchange. One company had already applied for listing and was waiting for their application to be processed. The other two were restructuring their activities to meet the requirements to list.

The other companies were not interested in the activities of the stock exchange. Those especially with pure family and foreign holding did not wish to list their companies since they wanted to restrict the ownership to the existent shareholders.

5 companies (20%) did not wish to list since they would have to subject the affairs of their company to public scrutiny, and also experience the cost of disclosure. The costs included in disclosure are for the collection and processing of financial data, which can be reasonably large since the preparation of the data has to withstand hostile scrutiny. Inexpensively prepared reports would not be presentable. (Foster, 1994)
3 companies (10%), felt that those companies that were listed paid higher taxes but none wished to validate their reasons. It maybe the companies that were not listed had ways of evading the original tax they are meant to pay.

Those companies that are multinationals and had branches in other stock exchanges felt that listing at the NSE would only be impressive for political reasons, since the activity at the exchange is too minimal for them to expand their enterprises and they would not be able to raise adequate capital for their activities.

4.3.6 Attitudes towards listing requirements.

When the listing requirements were analysed to establish whether they were related to their decision to list, the following results emerged as shown in table 5;

(The following requirements for listing were found to discourage companies from listing).
Table 5: Attitudes to Listing Requirements

<table>
<thead>
<tr>
<th>Requirement</th>
<th>No</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum 150 shareholders</td>
<td>16</td>
<td>57.1</td>
</tr>
<tr>
<td>Full disclosure of material info.</td>
<td>9</td>
<td>32.1</td>
</tr>
<tr>
<td>20% in public hands</td>
<td>8</td>
<td>28.5</td>
</tr>
<tr>
<td>5 yrs. audited accounts</td>
<td>6</td>
<td>21.4</td>
</tr>
<tr>
<td>Details of holding &amp; structure</td>
<td>3</td>
<td>10.7</td>
</tr>
<tr>
<td>Issued capital of 2 million</td>
<td>2</td>
<td>7.1</td>
</tr>
</tbody>
</table>

- 30% of the companies were of the opinion that companies should not disclose all their activities.
- Other diverse reasons limiting the companies to list were
- that 5 years audited accounts were not practical. Many reasoned that new companies seeking venture capital to expand their activity, could not meet this requirement.
- thought having 20% of the company in public hands was restrictive.
- This is because most wished to limit the ownership to shareholders.
- Some companies were of the opinion that a company could be bought out by corporate raiders.

4.3.7 Rating of the Performance at the NSE

The activity at the Nairobi Stock Exchange was rated as shown in Table 6.
TABLE 6: PERFORMANCE AT THE NSE

<table>
<thead>
<tr>
<th>Rating of performance</th>
<th>No.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>excellent</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>good</td>
<td>5</td>
<td>16</td>
</tr>
<tr>
<td>fair</td>
<td>14</td>
<td>46.67</td>
</tr>
<tr>
<td>poor</td>
<td>8</td>
<td>26.67</td>
</tr>
<tr>
<td>v. poor</td>
<td>1</td>
<td>10</td>
</tr>
</tbody>
</table>

The rating was skewed towards the poorer side.

**Excellent**
Nobody rated the performance as excellent.

**Good:**
Those who rated it as good, it was because the number of brokers had increased in the last year, and the government was in the process of adopting liberalisation tendencies.

**Fair:**
Those who rated it as fair, it was because the stock exchange can do much better than it is currently is, that is it should try and initiate changes that would be positive to its growth. Some suggestions given on how it would improve were that since Uganda and Tanzania have not developed their stock exchanges, their companies can be allowed to list here. That would boost the activity at the mart here.
There are also cases of certificates getting lost or being misplaced. Some people practice insider trading, whereby they have knowledge of the company results beforehand.

Majority of the shares held are by institutional investors who can control the market, if they decide to do so. There is a shortage of quality stocks at the Nairobi Stock Exchange which is attributed to the fact that there are few companies quoted at the NSE.

**Poor:**
Those who rated it as poor (26.6%), it was because the exchange suffered from poor publicity, had poor market liquidity and the brokers were incompetent.

This they explained using the following reasons;
- The stock brokers do not add value to what they trade. The commissions they charge are high, yet the shares have been slumping.
- There are few brokers therefore there is no real competition among them to do a better job. Foul brokers should be punished.
- The activity at the exchange slackened in 1995.
- Few companies are listed on the exchange including none that was listed this year.
- Many people do not know about the activities at the NSE and holding of shares.
- Share prices are controlled by a few individuals with high capital which could lead to cases of corporate raiding.
4.3.8 Possible problems facing NSE

There are problems that face other developing stock exchanges in the developing countries and were found to be similar to those facing the Nairobi Stock Exchange. When the respondents were interviewed on the problems that are likely to face NSE, the following was found (as shown in Table 7 overleaf);

**TABLE 7: POSSIBLE PROBLEMS FACING NSE**

<table>
<thead>
<tr>
<th>problems facing NSE</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>poor publicity</td>
<td>16</td>
</tr>
<tr>
<td>market liquidity</td>
<td>13</td>
</tr>
<tr>
<td>choice of people valuing shares</td>
<td>5</td>
</tr>
<tr>
<td>inappropriate govt policy</td>
<td>5</td>
</tr>
<tr>
<td>undervaluation of shares of the co.</td>
<td>4</td>
</tr>
<tr>
<td>other reasons</td>
<td>4</td>
</tr>
</tbody>
</table>

Majority of the respondents (57.7%) were of the opinion that the exchange suffered from poor publicity. As shown in table 7, when the publicity was analysed further, it was established that many felt that there was the widespread lack of knowledge by many people in both the rural and urban towns on how they can raise capital through a stock exchange and the types of securities that are used to trade on the Nairobi Stock Exchange.

Over 70% thought that the publicity adopted by the NSE is inadequate (refer to table 8).
TABLE 8: OPINION OF THE CURRENT PUBLICITY

<table>
<thead>
<tr>
<th>Ranking of publicity</th>
<th>NO</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>inadequate</td>
<td>20</td>
<td>71.4</td>
</tr>
<tr>
<td>adequate</td>
<td>5</td>
<td>17.8</td>
</tr>
<tr>
<td>better to advertise independently</td>
<td>3</td>
<td>10.7</td>
</tr>
</tbody>
</table>

Their expectations for adequate publicity were

- promotion of public awareness through CMA and NSE by educating schools, colleges, and dissemination of information in rural areas.
- increase more publicity, have more programmes and documentaries on the use of capital markets. In the local television information about NSE is too complex for many to understand.
- promote and educate brokers to be more competent at their job introduce a central depository system.

46.2% recognised the lack of liquidity.

This they attributed to the settlement of transactions taking too long.

There is also the culture of people buying shares to keep for long and wait for dividends only.

The lack of quality stock shortages at the NSE was seen as a result of the presence of few companies that are listed.

4.3.9 VIEWS ON FOREIGNERS PARTICIPATING

Before 1994, foreigners were not allowed to buy and sell shares in the companies that are listed. Later that year, they were allowed to participate up to 20%, which was later increased to 40%.
The views on foreigners participating unto 40% in a company and reduction of brokerage commissions were seen as positive. (98% of the sample thought so). Foreign investors were seen to be a major source of foreign direct investment.

Other comments were:
- By attracting foreign investors liquidity at the mart would increase.
- Initially brokerage commissions were too high and can be liberalised further since the high commissions discourage local and foreign investors from holding shares.
- Brokers should be market specialists. This will help generate liquidity. Foreigners are hesitant to participate in the listed companies as investors since they know nothing of our companies.
CHAPTER 5

SUMMARY, CONCLUSION, LIMITATIONS AND SUGGESTIONS FOR FURTHER RESEARCH.

5.1 SUMMARY AND CONCLUSION

The Nairobi Stock Exchange, which can be used to raise equity capital, presently has few listed companies. Private companies prefer to use bank loans and private placements to finance their activities. The study was possible through the use of surveys conducted by the use of questionnaires and interviews directed to the companies that have not listed. It was evident that even though positive moves have been implemented by the government in the wake of liberalisation activities, such as increasing the participation limits for foreigners in the quoted companies and reducing the brokerage fees, there are still problems that have hindered companies from listing.

Major findings include that some of the requirements needed for a company to list are stringent. For a company to list, a minimum of 5 years audited accounts does not augur well for newly established companies who would wish to raise finance through the stock exchange.

The Nairobi stock exchange is lacking enough liquidity to enhance performance. There is need to create enthusiasm to list such as giving incentives to the private companies to list. To those that are already quoted, benefits should be given to them that are not available for the
private companies, like for example taxing them less. It was felt that if a lower corporate tax was instituted for listed companies, it would certainly prod companies into seeking capital through equity than loan financing.

The current publicity adopted by the Nairobi Stock Exchange is not yet satisfactory. There is need to step up campaign to promote the public awareness of shares to the individuals. Few individuals hold shares, majority are held by institutional investors who hold them in such large quantities such that they can manipulate the market in their favour. There is the need for new instruments like mutual funds and unit trusts so that individuals with little experience in holding stocks can participate in the market. The shortage of securities is a limitation to market liquidity.

Another finding is that some of the brokers are not technically equipped in their field, in the sense that they do not advise their clients wisely hence they do not justify the commissions they charge. Their commissions are also on the higher side. Some people felt that if the brokers were allowed to be market makers (i.e. trade on their own account no matter which way the market is headed) they would enhance liquidity. Fraudulent brokers need to be punished by the Capital Markets Authority, since they contribute to the people’s lack of trust in holding shares. Exchange to raise capital since they see that their stake in ownership will be diluted. Those subsidiaries that are listed on other foreign stock exchanges find our market too small to meet their capital requirement.

From the findings, it seems that some rules should be suited to the local conditions to allow more companies to list.
The findings above are some of the factors that can explain why there are only 56 companies listed on the Nairobi Stock Exchange.

5.2 LIMITATION TO THE STUDY

One of the limitations of the study was the unavailability of data from some of the companies. Some thought that the questionnaire required privileged information in asking such questions as the number of shareholders, source of funding, and why they have never considered listing on the NSE.

The period of the study did not allow for time to approach companies which are outside of Nairobi.

The other limitation was that in some of the companies the directors and the managers could not find time to discuss what can be done to improve the stock exchange in detail.

The fourth limitation was that in some companies, the board of directors had to decide whether to answer the questionnaire or not, and before the decision could be met required a period of time.

5.3 SUGGESTIONS FOR FURTHER RESEARCH

The following suggested research areas could be useful if the conclusions made in this study are to be validated or generalised in the Kenyan context.
The first suggestions is for a similar study to be done using a much larger sample from the unquoted companies. Also a different method of research design can be used to sample the companies.

The second suggestion is to include companies outside of Nairobi which include even other companies with activities that have not been in the exchange e.g. fisheries and hotels.

LETTER USED TO SEND OUT QUESTIONNAIRE IN APPENDIX A.

AN INVESTIGATION AS TO WHY FEW COMPANIES ARE LISTED ON THE NAIROBI STOCK EXCHANGE

We are conducting a study to find out why many companies do not raise funds by listing on the Nairobi Stock Exchange.

In other developing countries, their stock exchanges assist their companies to raise capital through equity rather than debt, and in the process the number of listed companies has increased including activity in their marts.

A company that is quoted on the stock exchange can offer its shares for sale to the public to expand its capital base and to boost its activities.

In the following pages we have questions and statements which we would be pleased if you would respond for us. Your honest answers are sought.

Thanks for your time and co-operation.

THE RESEARCHER.
QUESTIONNAIRE

1. Name of Company

2. Nature of company ( ) tick as appropriate)
   a) All family shareholding
   b) Foreign shareholding
   c) Foreign/Local
   d) Other

3. When was your company founded?

4. Number of shareholders in your company.

5. What are the sources of your capital fund? ( )
   a) Bank Loan
   b) Private borrowing
   c) Investment companies
   d) Private placements
   e) Others
      (specify)___________________________________________

42
6. Has your company ever considered applying to list on the Nairobi Stock Exchange? ( )
   a) Yes
   b) No

7. What are the reasons why you have not listed? (N.B. can tick more than one option as applicable)
   a) The company want to limit ownership to existing owners only.
   b) It is faster to borrow from the bank or elsewhere rather than the Stock Exchange.
   c) The company does not wish to subject its affairs to public scrutiny.
   d) The application was rejected.
   e) The share prices are usually too low.
   f) There is inactivity after the company has gone public caused by lack of demand by investors.
   g) It is cheaper to obtain capital elsewhere.
   h) The costs associated with going public are high.
   i) Any other reasons ____________________________

8. If you have applied for listing and your application rejected, tick ( ) reasons for this.
   a) Non satisfaction of listing requirements.
   b) Other reasons (specify).
9. Which of the following requirements for listing on the Nairobi Stock Exchange do you find discourage companies from getting listed? ( ).

a) 5 years audited accounts.
b) 20% of the company is in public hands.
c) A minimum of 150 shareholders.
d) A company must have an issued capital of Kshs. 2,000,000.
e) Full disclosure of all material information about the company.
f) Details of the share capital structure. Loan capital and borrowing powers of the company.

10. What amendments would you like to have in the listing requirements? Explain briefly ____________________________

______________________________________________________

______________________________________________________

______________________________________________________


a) Excellent
b) Good.
c) Fair.
d) Poor.
e) Very poor.

12. Can you justify your rating in a few words and how it affects your decision to list

13. What do you consider to be the problem facing the Nairobi Stock Exchange ( ) as applicable.
   a) Inappropriate government policy.
   b) High listing requirements.
   c) Undervaluation of shares of the company seeking listing.
   d) Poor publicity.
   e) Market liquidity.
   f) The choice of people valuing the shares.
   g) Other reasons ___________________________
      ___________________________

   a) Adequate.
   b) Inadequate.
   c) It is much better for a company to advertise independently in the media.
15. Which of the following is required for the Nairobi Stock Exchange to improve listing? ( )

a) Lower listing requirement.

b) Create more branches.

c) Promotion of public awareness.

d) Increase publicity.

e) Any other suggestions ________________________________

16. What is your view on:-

a) Foreigners being allowed to participate in Stockholding (upto 40%).

b) Commissions charged to brokers in less (5% - 2 1/2%) (How will this influence activities at NSE)
APPENDIX B
LIST OF QUOTED ON THE NAIROBI STOCK EXCHANGE

Africa Hotels and Tours
A. Baumann $ Co. Ltd
Publishers
B.A.T. Kenya Ltd
Ltd
Bamburi Portland Cement Ltd
Barclays Bank of (K) Ltd
Brooke Bond Kenya Ltd
Car & General
Carbacid Investments Ltd
City Trust Ltd
Chancery Investments
C.M.C. Holdings Ltd
Credit Finance Cor. Ltd
Crown Berger Ltd
Diamond Trust Bank (K) Ltd
Dunlop Kenya Ltd
Eaagads Ltd
E.A. Cables
BOC Kenya Ltd
E. A. Packaging Industries Ltd
E.A. Portland Cement
Express
Firestone East Africa Ltd
George Williamson (k) Ltd
Housing Finance C. of (K) Ltd
Hutchings Biemer Ltd
I.C.D.C. Investments Ltd.
Jubilee Insurance Co. Ltd
Kakuzi Ltd
Kapchorua Tea Ltd
Kenstock Ltd
Kenya Breweries Ltd
Kenya Commercial Bank
Kenya Finance Bank
Kenya Hotel Ltd
Kenya National Mills Ltd
Kenya Oil Co. Ltd
Kenya Orchards Ltd
K.P.C.U. Ltd
Kenya Power and Lighting Ltd
Limuru Tea Co. Ltd
Marshalls (E. A) Ltd
Motor Mart Building
National bank of Kenya Ltd
Nation Printers &
National Industrial Credit
Ol Pejeta Ranching Ltd
Pan African Insurance
Pearl Dry Cleaners
Phillips International Ltd
Sasini Tea Ltd
Stanndard Chartered Bank
Standard Newspapers
Total Kenya Ltd
Theta Group
Unga Group
Uchumi Supermarkets
APPENDIX C

COMPANIES WHOSE RESPONSES TO THE QUESTIONNAIRE WERE USED IN THE PROJECT

1. ABN AMRO BANK
2. AIR ZIMBABWE
3. ALICO (K) LTD
4. AMIRAN (K) LTD
5. AVON RUBBER CO (k) LTD
6. BIASHARA BANK
7. BUSINESS MACHINES (K) LTD
8. CALTEX OIL KENYA LIMITED
9. CIBA GEIGY
10. CITIBANK
11. COLGATE PALMOLIVE (K) LTD
12. COMMERCIAL BANK OF AFRICA
13. CO-OPERATIVE BANK OF KENYA
14. DAVIS & SHIRTLIFF
15. DHL (K) LTD
16. ELSTAR LIMITED
17. ESSO KENYA LTD
18. EUROFINANCE
19. FIRST AMERICAN BANK
20. GLAXO EAST AFRICA
21. GESTETNER LIMITED
22. MITCOFAX INTERNATIONAL
23. PRIME CAPITAL AND CREDIT
24. SCHINDLER LTD
25. SAVINGS AND LOANS
26. SKYNET
27. SHELL DEVELOPMENTS
28. STANBIC BANK
29. SUNTRA STOCKS
30. TETRAPAK
**TABLE ONE.**

**THE NUMBER OF VARIOUS LISTED COMPANIES IN OTHER STOCK EXCHANGES**

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>NUMBER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentine</td>
<td>156</td>
</tr>
<tr>
<td>Greece</td>
<td>216</td>
</tr>
<tr>
<td>Indonesia</td>
<td>216</td>
</tr>
<tr>
<td>Jordan</td>
<td>95</td>
</tr>
<tr>
<td>Korea</td>
<td>699</td>
</tr>
<tr>
<td>Nigeria</td>
<td>177</td>
</tr>
<tr>
<td>Philippines</td>
<td>189</td>
</tr>
<tr>
<td>Poland</td>
<td>44</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>215</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>64</td>
</tr>
<tr>
<td>Jamaica</td>
<td>50</td>
</tr>
<tr>
<td>Kuwait</td>
<td>48</td>
</tr>
<tr>
<td>Morocco</td>
<td>61</td>
</tr>
<tr>
<td>Oman</td>
<td>100</td>
</tr>
</tbody>
</table>
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