DECLINE IN RAISING FUNDS THROUGH COMMERCIAL PAPER IN KENYA

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A Research Project Report Submitted to the School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)
STUDENT’S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: _______________________________  Date: ______________

Caroline Ngotho (ID 621365)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: _______________________________  Date: ______________

Supervisor, Samuel Wainaina

Signed: _______________________________  Date: ______________

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ABSTRACT

The purpose of this study was to investigate the decline in the issue of Commercial Papers (CPs) in Kenya. A market assessment carried out showed that the total CP issued face value had declined from 8,150,000.00 in year 2000 to 1,360,000.00 in year 2011. The study was based on the three research questions: Why is there a decline in the use of commercial paper in Kenya? What is the role of commercial paper in corporate financing in Kenya? and what are the benefits of raising funds through commercial paper?

The study used a descriptive research design and studied the entire population of the 27 companies which have issued CPs at one point in time since the inception of the CP programme in Kenya in 1994 to year December 2011. The sampling frame consisted of all 27 companies that have issued CPs. No sampling was done as population was considered small. For collection of primary data, a close-ended questionnaire was developed. The questionnaires were administered to the finance managers of the sampled companies through the drop and pick method. Secondary data was collected from the published financial statements of the said companies between 1994 to 2011. Data was analyzed through descriptive and inferential statistics and presented in form of charts and graphs to elicit the findings based on the three research questions.

The results of the study showed that the factors affecting decline in usage of the CPs include non-transferability of CP and the requirement that the minimum capital of issuing firm be at least Kshs. 50 million for issue of CP. Further studies indicated that there was a strong positive relation between Debt to Equity ratio and Current ratio and issue of CPs. The study also indicated a weak negative relationship between Earning per Share ratio and issue of CPs.

The study revealed that the main role played CPs was as a cheap source of funds from the firms. CPs also played the role of financing inventories and financial obligations. This made CPs more attractive than other sources of short-term funds.
The study further revealed that low interest cost and low CP issuance costs as the two most important benefit of CPs. The respondents also cited low interest cost and low issuance costs as the main benefit of CPs over other short-term sources of funds.

The study recommends that CMA should educate the public on CPs and improve the CMA regulation and procedure on issue of CPs to improve the uptake of CPs. The study further recommends that the minimum CP issue be reduced to encourage uptake of CPs. The study also recommends licensing of more rating agencies dealing with issue of CPs.
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DEDICATION

This project is dedicated to my husband Jeff, who encouraged and supported me as I pursued my MBA. To my children Zanna, Zak and Zara, that you may have the zeal to pursue your education to the greatest heights possible. Finally to my parents Duncan and Susan for encouraging me to pursue my MBA and for believing in me.
ABBREVIATIONS

SEC  
Securities Exchange Commission

CP   
Commercial Paper

CMA  
Capital Markets Authority

USA  
United States of America

NSE  
Nairobi Securities Exchange

ABCP 
Asset-Backed Commercial Paper

CBK  
Central Bank of Kenya

CPFF 
Commercial Paper Funding Facility

IFRS 
International Financial Reporting Standards

IPA  
Issuing and Placement Agent
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the study

Hubbard (1994) describes financial Instruments as the tools by which financial markets channel funds from savers to borrowers and provide returns to savers. Financial markets instruments are divided into money market and capital market instruments. Money market is the market of short-term funds whose maturity is one year or less (Ross 2008). On the other hand, capital market is a market for securities (debt or equity), where business enterprises and governments can raise long-term funds with maturity exceeding one year (Sheffrin 2003).

The short maturity of money market assets does not allow much time for their prices to vary. Thus, these instruments are safe investments for short-term surpluses of households and firms. Money market instruments include treasury bills, commercial paper (CP), bankers’ acceptance, repurchase agreements and negotiable Bank certificates of deposit. This study covers one of the money market instruments namely CP. CP is a debt instrument with a maturity of less than one year and is evidence of a loan extended by a creditor to a corporation (CMA 1997). CPs are short-term unsecured promissory notes issued in the open market as an obligation of the issuing entity (Fabozzi 1997).

Kacperczyk and Schnabl (2009) defined three types of CP. First, asset-backed CP. These CPs are issued by off-balance sheet conduits of a large financial institution. However, the assets are under the control of the financial institution in the sense that the conduit is a shell company which is managed by the financial institution. Second, financial CPs which are issued by large financial institutions. In contrast to asset-backed CPs are issued by the institution directly and not via a conduit. Financial CPs are unsecured and the issuer does not pledge assets as collateral. The main issuers of financial paper are foreign financial institutions. Kacperczyk and Schnabl (2009). Third, corporate CPs which are issued by non-
financial businesses. Like financial CPs, corporate CPs are unsecured and only large, creditworthy firms with strong balance sheets can issue CP.

Calomiris, Himmelberg and Wachtel (1995) identifies three distinct stages in the history of the American CP Market following its emergence during the postbellum period. From the late nineteenth century until the 1920s, CPs grew rapidly as a source of corporate financing and then all but disappeared during the Depression. The second stage began after World War II and is characterized by very rapid growth in CP outstanding in the 1960s. This stage ended with the Penn-Central failure which severely shook the market and temporarily halted its growth. The third stage was after the Penn-Central failure and continues to the present.

According to Apte (2002), USA has the largest and long established dollar CP market. Rose and Marquis (2006) describes CP as one of the oldest of all money market instruments, dating back to the eighteenth century in USA. Mishkin (2006) indicates that CP has been one of the fastest growing money market instruments in USA having grown from $33 billion outstanding in 1970 to $1.6 trillion outstanding at the end of 2005. Mishkin attributed the growth to improvement of technology which has made it easier for investors to screen out bad from good risks, thus making it easier for corporations to issue debt securities. Development of money market funds has been another factor in the rapid growth of CPs because money markets need to hold liquid, high-quality short term assets such as CPs. At the beginning of 2007, CP was the largest U.S. short-term debt instrument with more than $1.97 trillion outstanding. Most of the CP was issued by the financial sector, which accounted for 92 percent of all CP outstanding.

In China, financial instruments CP is a settlement method, with China's reform and opening up officially entering the country, then after 30 years of development, from the initial stage of exploration, experience to promote the use of the system construction from 1999 rapid development stage. The end of 2011, the national the cumulative financial institutions issuing the commercial bills of 15.1 trillion yuan, the cumulative discounted 25 trillion, the end of 1999, growth by 30 times and 100 times, respectively. The country in recent years, the increase of cumulative financial institutions issuing and the amount of CP discounted is high.
Promissory balance of discounted overall has continued to rise, but discounted promissory balance in 2007 and 2010 with a significant decline, notes the size of the market has been shrinking (Guo and Fang (2012)).

In Kenya, the CP instrument debuted in 1994 and it was not until 1997 that activity increased. Prior to this, the Central Bank of Kenya limited the issuance to companies listed in the Nairobi Securities Exchange (NSE). In the absence of credit rating agencies in Kenya, the Central Bank of Kenya (CBK) undoubtedly reasoned that investors could access the creditworthiness of the issuers themselves as those listed published their financial statements periodically. Capital Markets Authority (CMA) issued revised rules in April 1997 that allowed a wider range of companies to issue commercial papers irrespective of their listing status subject to meeting rules and regulations laid out in the CMA guidelines. As a regulator, CMA prescribes the minimum conditions that are considered protective to investors in CP market. Issuers of CP in Kenya use dealers who are called placement agents or arrangers. There is no organized secondary market that has been developed for CP in Kenya (Musyoka, 2012).

Since 1994 to 2011, the numbers of companies that have issued CP are only 27 (Appendix I). Some of the companies in the following industries have used this form of debt instrument for raising funds: Motor Industry (General Motors, Ecta Kenya and CMC Holdings), Agriculture (Brooke Bond), Oil Industry (Caltex and Kenol-Kobil), Trade (Davis & Shirtliff) and Manufacturing (Crown Berger and Cooper Kenya). According to the CMA (2010), the main investors in CP consist of banks, insurance companies, fund managers investment companies and individuals. Several studies have been carried out in Kenya on CPs. Munywoki (2012) carried out a study on the factors affecting demand for CP as a short term source of finance for publicly quoted companies. This study was aimed at the identification of the factors critical to the development of the CP market and whether the companies issuing CP achieved the cost minimization strategy. Study results indicate that the company’s cash flow, interest on bank overdraft and the Treasury bill rate significantly affect the demand for CP. Bank overdraft rate was found to have a negative relationship with the demand of CP.
Musyoka (2012) looked at the relationship between CP financing and working capital components in Kenya. The objective of the study was to establish the relationship between CP financing and working capital components in Kenya. The findings indicated that in the majority of the companies there is a strong positive correlation between CP borrowings and working capital components. The study also showed that for a unit change in CP outstanding overall in all the companies, the working capital component that showed a huge variation is cash followed by accounts receivable and inventory respectively.

Karimi (2012) carried out a study on the impact of CP on the Nairobi Securities Exchange. The study found that the number of CP issued, the approved amount of CP and the outstanding amount of CP are affected by the share volumes trades, equity turnover as well as the market capitalization. The study also found that most investors in the CP market purchase the paper at issuance and hold it until maturity hence little trading of CP in secondary markets.

Kinyua (2006) conducted a study on factors hindering CP market development in Kenya. A sample of 100 companies quoted and unquoted was picked. Included here were 24 companies that have issued CP as they were deemed to have more information given that they had experienced the issuing process. The results showed that factors hindering development of CP market in Kenya include: approval time by CMA and NSE, lack of information, competition from lenders, costs of issuance and management lack of enthusiasm. The conclusion of the study was that concerted efforts by the policy makers, NSE, CMA, stock broker’s investment advisors and commercial banks was the only solution to realize a vibrant CP market in Kenya.

Chirchir (2002) carried out a research on the Impact of CP launch on share. The study concluded that there is a relationship of issuance of debt instruments and stock prices. However, the resultant change due to issuance of debt instrument cannot be considered separately in making investment decisions, other factors need to be taken into account. Njogu (2003) conducted a study on Price impacts of CP issue announcements. The objectives of the study were to determine whether stock prices adjust to commercial paper issues
announcements and the direction of stock price adjustment. The justifications of the study were that because of the slow development of the market in Kenya, there was need to assess investor’s reactions to the market so that any company considering issuing the paper can predict the reaction of investors and its impact on its share prices.

Nganga (1999) conducted a study on CP as a source of Finance for Kenyan Companies. The findings indicated that volatility of interest rates has hindered deepening of the market in Kenya. The study also concluded that funds sourced from CP issuance have been mainly limited to the financing of working capital needs of firms. The study also determined that there is a demand for a secondary market for CP so as to offer flexibility to both lenders and borrowers.

1.2 Statement of the Problem

In the recent years there has been a decline in the use of CPs to raise funds in Kenya (Appendix II). Several studies have been conducted both globally and locally on CP as a short term source of financing and its main uses. Shen (2003) studied the decline in the total volume of nonfinancial CPs outstanding between 2000 and 2002 to find out why the CP market had shrunk. The findings indicated that factors affecting both supply and demand had contributed to the shrinkage of the market.

Kahl, Shvidasani and Wang (2010) studied why firms use CP and how its use is related to firms’ investment policies and their capital structure decisions. The findings indicated that firms’ participation in the CP market is driven by a trade-off between funding needs for investment and the rollover risk associated with CP financing. The study provided the first systematic evidence that CP is not limited to working capital financing but plays a much broader role in firms’ investment policies and financing decisions.

Musyoka (2012) looked at the relationship between CP financing and working capital components in Kenya and the findings indicated that there is a strong positive correlation between CP borrowings and working capital components. Kinyua (2006) looked at factors hindering CP market development in Kenya and found out that approval time by CMA and
NSE, lack of information, competition from lenders, costs of issuance and management lack of enthusiasm were the factors hindering development of the CP market.

Whereas Shen (2003), Kahl, Shivdasani and Wang (2010), Kinyua (2006) and, Musyoka (2012) have done the above studies on CPs, no known study been done on the decline in use of CPs in Kenya. CPs are expected to be a popular short-term source of finance because of their low issuance costs and low interest rates. However, the issue and uptake of CPs has been on a decline in Kenya. Musyoka (2012) in their findings noted that there is a decrease in the number of companies raising funds by way of CP. They recommended that further research can be done to find the reasons for the deterioration of the market in Kenya despite the CP being a cheap source of financing or to find out whether there are restrictions preventing companies from issuing CP in Kenya. This study therefore seeks to bridge the knowledge gap on the decline in the issue of CPs in Kenya.

1.3 Purpose of the Study

The purpose of the study was to establish why there has been a decline in the use of CPs to raise funds in Kenya.

1.4 Research Questions

The study was based on three research questions:

1.4.1 Why is there decline in the use of commercial paper in Kenya?

1.4.2 What is the role of commercial paper in corporate financing in Kenya?

1.4.3 What are the benefits of raising funds through commercial paper?

1.5 Importance of the Study

1.5.1 Borrowers of short-term funds

They will learn the practical advantages and disadvantages of raising funds through CP as well as the regulatory requirements of raising fund through CPs in Kenya. The borrowers
will also learn the role of CPs in corporate financing and factors that have led to decline in use of CPs in Kenya in the recent past.

1.5.2 Investors in commercial paper

The investors will be informed on CPs as an investment vehicle and determination of the return on investment. They will also learn the role played by funds invested in CPs and the uses of these funds for companies in the different sectors.

1.5.3 The government and regulatory authorities

The government and other stake holders will get feedback on the effect of the current regulation governing CP and the effect it has on use of CP to raise funds. They will also learn why there has been a decline in the use of CPs and the role of CPs in corporate financing. The paper will also reveal to government and regulatory authorities the benefits of raising funds through CPs for corporate in Kenya which will inform decision making concerning CPs regulation.

1.5.4 Scholars interested in the commercial paper market

The study will benefit scholars interested in the CP market add to the existing knowledge of CP in Kenya. It will enlighten them on why there has been a decline in CPs in Kenya in the recent past. The scholars will also get information on the role and benefits of CPs in raising funds in Kenya from the study.

1.6 Definition of terms

1.6.1 Commercial Paper

Commercial paper is a debt instrument with a maturity of less than one year and is evidence of a loan extended by a creditor to a corporation (CMA 1997)
1.6.2 CP ‘run’

The events in the unsecured commercial paper market surrounding the failure of Penn Central in 1970, during which it defaulted on about $80 million of unsecured commercial paper (Calomiris (1995)).

1.6.3 Bridge Financing

Financing or credit that an investment bank or venture capital firm extends until long-term financing can be arranged or an obligation is removed (Farlex Financial Dictionary, 2012).

1.6.4 Small, medium and large enterprises

In Kenya a business that employees 10-49 people and 50-99 is considered a small and a medium enterprise respectively. A business that employs over 100 people is considered a large enterprise (Kenya Revenue Authority, 2007).

1.7 Chapter Summary

Chapter one highlights the problem of study as the fact that use of the CPs is on the decline. The purpose of the study is to establish why there has been a decline in the use of CPs to raise funds in Kenya. The study will be of importance to borrowers, investors, the government and other stakeholders as well as scholars.

Chapter two will cover literature review on the topic of study and chapter three will cover the research methodology.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter reviews the literature that forms the basis of this study. It highlights the empirical literature where past studies by various scholars locally and globally on CP are discussed based on the research questions. A summary of literature wraps up the chapter by pointing out the gap in literature that the present study seeks to bridge.

2.2 Why is there decline in use of commercial paper in Kenya?

2.2.1 History of decline in Outstanding CP

There are three distinct stages in the history of the American CP market following its emergence during the postbellum period. From the late nineteenth century until the 1920s, CP grew rapidly as a source of corporate financing and then all but disappeared during the Depression. They note that the market all but disappeared by the end of the 1920s, even before the onset of the Depression. This was traced to the bank consolidation wave of the 1920s. Large city banks with growing deposit bases were better able to accommodate growing inter-regional flows of credit in the 1920s which made bank loans (including bankers’ acceptances) a cheaper source of credit than commercial paper. Another contributing factor was the Federal Reserve's policy of favoring bankers’ acceptances as collateral for discount lending, which was a conscious effort to increase the relative importance of acceptances and reduce the importance of CP. The second stage began after World War II and is characterized by very rapid growth in CP outstanding in the 1960s. This stage ended with the Penn-Central failure which severely shook the market and temporarily halted its growth. The third stage began after the Penn-Central failure and continues to the present (Calomiris, Himmelberg and Wachtel (1995))
Kacperczyk and Schnabl (2009) indicate that in the U.S.A, although the CPs generally a stable source of financing, periodically there have been large and sudden declines in its size. The most prominent example is the Penn Central’s failure. In June 1970, the transportation company, Penn Central, declared bankruptcy and as a result of its bankruptcy defaulted on its CP. Once Penn Central defaulted, investors lost confidence in other non-financial CP issuers and stopped refinancing maturing CP. Within three weeks of Penn Central’s bankruptcy, nonfinancial CP outstanding dropped by more than 9%, from $32 billion to $29 billion.

2.2.3 Commercial paper ‘runs’

The term ‘run’ to describe the events in the unsecured CP market surrounding the failure of Penn Central in 1970, during which it defaulted on about $80 million of unsecured CP (Calomiris (1995)). The Penn Central’s financial condition deteriorated during the recession of 1969-70. Penn Central was a major issuer of CP, with more than $84 million outstanding, much of which came due in June, July and August of 1970. As Penn Central’s cash flow declined, its debt holders and their agents appealed to the federal government for financial assistance which the government supported. The Nixon administration proposed a $200 million loan guarantee to a syndicate of some 70 banks, which were to provide a two-year loan in that amount. The Penn Central plan was rejected by Congress. The administration then asked the Federal Reserve Board to make a loan to Penn Central to help it meet immediate obligations. The New York Fed recommended against the loan, and it was denied. Thus news Penn Central’s bankruptcy on Sunday, June 21 (Calomiris (1993)).

Rettl, D. A. (2011) indicates that the Enron crisis in 2001 represents a relatively recent adverse shock to liquidity in the corporate CP market. The bankruptcy called into question the accuracy of corporate financial statements, and consequently, many investors exited the market. By that time, investors had already been alerted by the defaults of two large Californian utility companies in early 2001, contributing to an accelerated withdrawal of funds from the CP market after the Enron collapse. As a result, total volume outstanding dropped by almost 33 percent from year-end 2001 to year-end 2002.
Shen (2003) analyzed the reason why the non-financial CPs had shrunk. The total volume of nonfinancial CP outstanding in the U.S.A peaked in the fall of 2000 and has declined rapidly ever since. By September 2002, the market had shrunk more than 50 percent. Relative to historical patterns, both the magnitude and the timing of the decline were unusual. The factors that may have contributed to the recent shrinkage were separated into two groups: those affecting the supply of credit in the commercial paper market and those affecting the demand for credit in the market. On the supply side, an unusually widespread deterioration of credit quality and investors’ decreased tolerance for risk have reduced the supply of credit to the market. These supply factors have shown few signs of abating. On the demand side, the aggressive inventory reduction and the widespread practice of replacing CP with longer term corporate bonds have reduced the demand for credit in the commercial paper market. The study concluded that the demand factors appeared to be winding down. Therefore, in the near term, the study projected that the market was likely to remain at current low levels or even shrink further, but the pace of the shrinkage may moderate somewhat.

During the financial crisis of 2007-2009 two events lead to the decline of the issued CP in the USA Market. The first event was on July 31, 2007, when two Bear Stearns’ hedge funds that had invested in subprime mortgages filed for bankruptcy. This lead to the total value of asset-backed CP outstanding falling by 37 percent, from $1.18 trillion in August 2007 to $745 billion in August 2008. Financial and corporate CPs remained stable during this period. The second event occurred on September 16, 2008, when the Reserve Primary Fund—a large money market fund would provide deposit insurance to investments in money market funds. Even though the announcement halted the run on money market funds, most funds nonetheless reduced their holdings of all types of CP because they deemed them too risky. Within one month after the Reserve Fund’s announcement, the total value of commercial paper outstanding fell by 15 percent, from $1.76 trillion to $1.43 trillion. To stop the sudden decline in CP, the Federal Reserve decided for the first time in its history—to purchase CP directly. By early January 2009, the Federal Reserve was the single largest purchaser of commercial paper and owned paper worth $357 billion, or 22.4% of the market, through a
variety of lending facilities. Throughout the year 2009, the Federal Reserve steadily reduced its holdings and in October 2009 it held $40 billion of commercial paper accounting for 3.4% of the market (Kacperczyk and Schnabl (2009)).

In July 2007, amid widespread concern about how to value structured products and an erosion of confidence in the reliability of ratings, the market for short-term asset-backed CP began to dry up. IKB, a small German bank, was the first European victim of the subprime crisis. In July 2007, its conduit was unable to roll over asset-backed CP and IKB proved unable to provide the promised credit line. After hectic negotiations, a €3.5 billion rescue package involving public and private banks was announced. On July 31, American Home Mortgage Investment Corporation announced its inability to fund lending obligations, and it subsequently declared bankruptcy on August 6. On August 9, 2007, the French bank BNP Paribas froze redemptions for three investment funds, citing its inability to value structured products (Brunnermeier (2008)).

Gao and Yun (2009) used firm-level data to examine the interplay between the use of lines of credit and CP which reveals the real effects of the recent financial crisis on nonfinancial firms. They found that aggregate CP borrowing declined 15% after the collapse of Lehman Brothers, but the effect was concentrated among firms with high default risk.

Covitz, Liang, and Suarez (2009) in their paper ‘The evolution of a financial crisis: Panic in the asset-backed commercial paper market’ indicated that the U.S. Asset-Backed Commercial Paper (ABCP) market erupted in late summer of 2007 and played a pivotal role in the global financial crisis that would become increasingly severe. In the ABCP market, where investors expect to be able to access their funds on demand at par value, even limited concerns about risk can instigate flight from the market. Mounting delinquencies of subprime mortgages triggering a decline in investor confidence in mortgage financial intermediaries and ratings downgrades of structured mortgage securities. Reflecting these concerns, investors became reluctant to roll over ABCP, yields on new issues of ABCP soared and outstanding ABCP plummeted $190 billion, almost 20 percent, in August, and fell by an additional $160 billion by the end of the year. The steep contraction in ABCP, in turn,
sparked concerns about whether banking institutions that explicitly provided program back-up liquidity support or implicitly provided liquidity as sponsors would be able to meet their obligations. As a result, banking institutions began to hoard their cash and became extremely hesitant to lend in inter-bank funding markets, and risk spreads for interbank funds even at overnight terms widened sharply. In addition, demand from ABCP programs for AAA-rated tranches of mortgage backed securities (MBS) declined, which made it difficult to structure new securitizations of mortgages. Thus the events in the ABCP market had far reaching and long-lasting consequences for the broader financial markets and the economy.

2.2.4 Decline in outstanding CP in Kenya

According to CMA there has been a decline in the amount of fund raised through CPs. Figure 2.1 below show the trends in outstanding CP from year 2000 to 2011.

![Graph showing outstanding CP amounts in KSHS. Millions from 2000 to 2011]

**Figure 2.1 Outstanding Commercial Paper from 2000 to 2011**

**Source:** Capital Markets Authority
A few studies have been carried out in Kenya on factors affecting growth/decline of CP. Munywoki (2012) studied the factors affecting demand for CP as a short term source of finance. This study was aimed at the identification of the factors critical to the development of the CP market and whether the companies issuing CP achieved the cost minimization strategy. Study results indicate that company’s cash flow, interest on bank overdraft and the treasury bill rate significantly affect the demand for CP. The bank overdraft rate was found to have a negative relationship with the demand of CP. The researcher also indicates that the cost of borrowing of all companies studied decreased after borrowing through CP. The treasury bill rate was found to affect the CP interest rate. In light of the research findings, which reveal that CP is a low cost borrowing instruments, it was suggested that companies with a good credit rating or companies with a strong financial base should engage it to reduce the level of its domestic borrowing (which indirectly makes credit expensive) in order to allow companies access to cheap credit from banks and stop the private sector crowding out.

Kinyua (2006) conducted a study on factors hindering CP market development in Kenya. A sample of 100 companies quoted and unquoted was picked. Included here were 24 companies that have issued CP as they were deemed to have more information given that they had experienced the issuing process. The results showed that factors hindering development of CP market in Kenya include: approval time by CMA and NSE, lack of information, competition from lenders, costs of issuance and management lack of enthusiasm. The conclusion of the study was that concerted efforts by the policy makers, NSE, CMA, stock broker’s investment advisors and commercial banks was the only solution to realize a vibrant CP market in Kenya.

Nganga (1999) conducted a study that explored the use of CP as a source of finance for Kenyan companies, judging by its increased use by the corporate sector especially in 1999. The study attempts to find, inter alia, if there has emerged a pattern among the issuing companies that would show existence of any similarities as regards size, ownership and industrial class. It also sought to find out the reasons that bring companies to source funds from the CP market. The numbers of companies that have borrowed funds using CP then were relatively few. This was partly attributed to policy and infrastructural limitations within
the capital markets framework. More CP issues were expected after the resolution of these limitations by the CMA by the end of year 1999. The study has determined that there was a significant rise in the use of CP as a source of finance in 1999. The findings indicated that volatility of interest rates has hindered deepening of the market in Kenya and that use of funds sourced from CP issuance had been mainly limited to the financing of working capital needs. The study findings also showed that there was a demand for a secondary market for CPS so as to offer flexibility to both the lenders and borrowers.

2.3 What is the role of commercial paper in corporate financing in Kenya?

2.3.1 Role of funds raised through CP

The CP market is a major source of bank and firm funding. It is a relatively cheap form of funding for firms that consists of a secured and an unsecured market. The instruments in the secured market are called asset-backed commercial papers (ABCP). They are usually backed by a pool of mortgages or other loans as collateral (Suutala (2009)). CP provides institutions direct access to the money market. In traditional bank-intermediated financial systems, borrowing institutions obtain loans from commercial banks, which are, in turn, primarily funded by deposits. Since the early 1980’s, however, the U.S. financial system has undergone a major transformation as an ever increasing fraction of credit intermediation migrated from banks to financial markets (Adrian, Kimbrough and Marchioni (2010)).

Firms use CP to finance inventories, to provide bridge financing in connection with various transactions, and for day-to-day cash management (Downing and Oliner (2007)). Anderson and Gascon (2009) notes that in the U.S.A., the CP market was originated by firms seeking short-term funds at interest rates and terms more favorable than bank loans. The rise of bank advised, multiseller ABCP conduits during the 1990s extended the market’s purpose such that it became focused on asset securitization and risk diffusion, typically with significant off-balance sheet support. The funds raised through CP issuance have a variety of uses, including payroll and inventory finance. CP is important for investors as well. Larger investors, including institutions, directly purchase CP as a short-term, low-risk investment.
For smaller investors, money market mutual funds (MMMFs) intermediate between larger denomination CP and the liquid, smaller denomination shares that they issue to the public.

Kahl, Shivdasani and Wang (2010) finds that firms are likely to enter the CP market to finance high investment needs. Using a difference in difference approach that compares CP issuers to firms with similar financial characteristics, they find that investment expenditures increase after firms enter the CP market. Firms also experience a large decrease in their cash holdings prior to entering the CP market, suggesting that CP serves as a substitute for cash. Other findings suggested that firms use CP to fund new investment outlays when they have insufficient internal funds. They found that after firms exit the CP market, investment expenditures drop sharply. At the same time, exiting firms increase their cash holdings substantially. The study argues that CP can be an attractive mechanism for financing new investment because of its low issuance costs and ability to finance investments quickly. However, rollover risk and mismatch in the maturity of assets and liabilities makes it undesirable to permanently fund long-term investment with CP. This suggests that CP may be particularly attractive as a bridge to long-term financing. Under the bridge financing view, a firm can refinance CP using long-term financing once a cost-efficient issuance size is reached. The findings indicate that CP serves as a valuable tool for funding new long-term investment opportunities, which is often refinanced with longer-term debt to mitigate the rollover risk associated with CP.

Liu (2007) indicates that proceeds from CP issues can be used to finance "current transactions", which include operating expenses and the funding of current assets such as receivables and inventories. Proceeds cannot be used to finance fixed assets, such as plant and equipment, on a permanent basis. Lin further argues that CP is issued by a wide variety of domestic and foreign firms, including financial companies, banks and industrial firms. Finance companies are the biggest issuers. They provide consumers with home loans, unsecured personal loans and retail automobile loans. They provide businesses with a variety of short- and medium-term loans including secured loans to finance purchases of equipment for resale. Some are wholly owned subsidiaries of industrial firms that provide financing for purchases of the parent firm's products. For example, a major activity of General Motors
Acceptance Corporation (GMAC) is the financing of purchases and leases of General Motor's vehicles by dealers and consumers. General Electric Capital, and Ford Motor Credit are two other big issuers.

Financial issuers also include securities firms and insurers. Securities firms issue CP as a low-cost alternative to other short-term borrowings such as repurchase agreements and bank loans, and they use CP proceeds to finance a variety of security broker and investment banking activities. Insurance companies use it to finance premium receivables and operating expenses. Commercial bank holding companies issue CP to finance operating expenses and various non-bank activities. Due to declines in the perceived credit worthiness of many major domestic bank issuers, bank holding companies have recently (Lin (2007)).

The CP market is where companies go to raise money for such short-term uses as inventory investment, funding credit cards, and for payrolls. Without CP issuance, $1.7 trillion of short-term credit would dry up, imperiling the ability of companies to produce goods and services, and resulting in big job losses from both a direct and indirect hit Crescenzi (2008).

Kahl, Shivdasani and Wang (2008) in their paper “Do firms use Commercial Paper to enhance financial flexibility?” found firms use CP to finance long-term investment. The finding indicates that CP borrowings are positively correlated with long-term investment but negatively correlated with cash holdings. Non-CP debt does not display these correlations. This suggests that CP plays a special role in firms’ capital structures in that firms use CP to finance fluctuations in the funding needs for investment. The paper argued that firms use CP to enhance their financial flexibility. CP represents a flexible source of financing because it allows firms to borrow only if good investment opportunities or a shortage of internal cash flow arise. At the same time, it allows firms to avoid financing costs if there are no good investment opportunities or they have enough internal cash. Other findings indicate that CP is used as bridge financing for investment and refinanced later by other debt and, in particular, by issuing bonds. Moreover, firms also use CP to (bridge) finance acquisitions, which we view as an example of a less predictable investment project. This indicates both that firms
choose to access the CP market in anticipation of changes in investment opportunities and that CP market access affects investment behavior.

Zuckerman (2002) also found out that, the CP had served as the corporate world’s automated teller machine, spitting out a seemingly endless supply of cash for businesses at super-low interest rates. But amid financial jitters caused by Enron Corp.’s collapse, that machine is sputtering, sent a surprising number of companies of all sizes scrambling to find money for their most basic needs, from paying salaries to buying office supplies. Some companies paid higher interest rates so they can keep selling paper. But others, after getting the cold shoulder from CP turned to raising debt by other, costlier means.

Because CP has a short-term maturity, it is usually viewed as a short-term liability of the issuer, but this does not mean that issuers use paper only to finance short-term needs. Firms in the financial sector tend to roll over their CPs continuously. Similarly, nonfinancial firms often use CP as financing for capital expenditures and roll it over continuously or until alternative financing is found. Thus, it is often correct to view CP as long-term financing with variable terms tied to short-term rates (Calomiris (1995))

Hahn (1993) indicates that CPs are issued by a wide variety of domestic and foreign firms, including financial companies, banks, and industrial firms. Finance companies provide consumers with home loans, retail automobile loans, and unsecured personal loans. They provide businesses a variety of short- and medium-term loans including secured loans to finance purchases of equipment for resale. Some finance companies are wholly owned subsidiaries of industrial firms that provide financing for purchases of the parent firm’s products. The financial issuer category also includes insurance firms and securities firms. Insurance companies issue CP to finance premium receivables and operating expenses. Securities firms issue CP as a low-cost alternative to other short-term borrowings such as repurchase agreements and bank loans, and they use CP proceeds to finance a variety of security broker and investment banking activities. Commercial bank holding companies issue CP to finance operating expenses and various nonbank activities. Nonfinancial issuers include public utilities, industrial and service companies. Industrial and service companies
use CP to finance working capital (accounts receivable and inventory) on a permanent or seasonal basis, to fund operating expenses, and to finance, on a temporary basis, construction projects. Public utilities also use CP to fund nuclear fuels and construction.

Handal (1972) notes that CP is issued primarily to reduce borrowing costs; it serves as a relatively low-cost alternative to bank loans and as a flexible financial instrument that can be sold with little difficulty in the amounts and maturities required. In addition, by having its notes offered, the corporation receives exposure to the financial community, which is an important benefit in securing further financing.

Selden (1963) indicates that though most corporate borrowers make little or no use of CP, this form of debt is nevertheless important to one class of borrower, finance companies. Since finance companies are major providers of consumer credit, the CP market is a significant channel through which funds flow to households. CP has significance as a liquid asset. Holdings of CP serve in some measure as a substitute for money; accordingly, they permit higher ratios of spending to cash (i.e., higher velocity of circulation of money) than would otherwise exist.

2.4 What are the benefits of raising funds through commercial paper?

2.4.1 Benefits of Commercial Paper

2.4.1.1 Low interest rates

Firms seem to issue CP to benefit from low interest rates as a result of low default risk, and low issuance costs (Rettl (2011)). Kahl, Shivdasani and Wang (2010) indicates that one reason why firms may employ CP is because it is a very cheap source of financing for highly rated issuers, as indicated by the low spreads over Treasury bills. In addition, firms may use CP because it is potentially a cost-efficient source of start-up funding for new investment. Madura (1999) highlights that a well-known finance company can issue CP through direct placement and thus avoid a transaction fee, lowering the cost of funds. In practice, the interest rate on CP is a bit higher CP.
In practice, the interest rate on CP is a bit higher than the interest rate on Treasury bills of the same maturity and a bit lower than than the interest rate on Treasury bills of the same maturity and a bit lower than the interest rate on loans of the same maturity such as LIBOR (London Interbank Offered Rate), the benchmark interest rate paid on short-term lending among Offered Rate, the benchmark interest rate paid on short-term lending among large banks (Kacperczyk and Schnabl (2009)).

2.4.1.2 Flexibility

Interest rates on raising funds through commercial paper are often more flexible than banks and finance company loans. A company in need of money can raise money more quickly through either dealer or direct paper. Dealers maintain close contact with the market and generally know where funds may be found. Frequently, notes can be issued and funds raised the same day (Apte (2002)). CP can be well suited for financing of smaller projects or ongoing investment needs where the size of the required financing is not sufficient to warrant costs associated with long-term bond issuance. Since bond issuance entails a fixed underwriting cost, issuing bonds is more cost effective for larger issue sizes (Yasuda (2005)). Goacher (2003) indicates that borrowing through CP provides a flexible term for the borrowing since CPs can be issued with original maturities of seven days upwards. CP issuers are flexible in adjusting their outstanding balances every time the roll over their paper, which occurs multiple times per year (Rettl (2011)).

2.4.1.3 Convenience

Larger amounts of fund may be borrowed more conveniently through that paper market than from other sources, particularly bank loans. This situation arises due to banking regulations that limit the amount of money that a bank can lead to a single borrower (Apte (2002)). For many large, creditworthy issuers, CP is a low-cost alternative to bank loans. Issuers are able to efficiently raise large amounts of funds quickly and without expensive Securities and Exchange Commission (SEC) registration by selling paper, either directly or through independent dealers, to a large and varied pool of institutional buyers. Investors in CP earn
competitive, market-determined yields in notes whose maturity and amounts can be tailored to their specific needs (Hahn (1993)).

2.4.1.4 Increased scope of borrowing

The ability to issue commercial paper gives a corporation considerable leverage when negotiating with banks and other lenders. For example, a banker who knows that a customer can draw on the paper market for fund is more likely to offer advantageous terms on a loan and be more receptive to future customer credit needs (Apte (2002)).

2.4.1.5 Low investment risk

The increasing attractiveness of commercial paper is explained in part by the fact that it is considered to be a low-risk investment carry-placing a somewhat higher yield than other money market instruments. Although there is no secondary market in CP, liquidity is provided by the wide range of maturities available to satisfy investors (Handal (1972)). Due to its short maturity, CP is considered a very safe investment and is therefore cheaper as other debt instruments with longer terms to maturity (Rettl (2011)).

2.4.1.6 Low issuance costs

CPs are exempt from expensive regulatory reporting and issued to only a limited group of institutional investors, issuance costs are relatively low (Rettl (2011)). Companies issue CP as a low-cost alternative to bank loans, as it is exempt from Securities and Exchange Commission (SEC) registration (Anderson and Gascon (2009)). Hahn (1993) informs that to a significant extent, the advantage of CP issuance is cost: high-quality issuers have generally found borrowing in the CP to be cheaper than bank loans. The cost of CP programs, including the cost of distribution, agent fees, rating fees, and fees for backup credit lines, are small, amounting to perhaps 15 basis points in a large program. A large creditworthy issuer will generally find it cheaper to bypass the bank and raise funds directly in the credit market.
2.4.1.7 **Liquidity**

From the lender's, or commercial paper holder's, perspective, CP is a highly liquid, low-risk asset. CP is considered a liquid asset—one that can be converted to cash easily with little loss of value—because, as noted, the typical issue matures in less than seven weeks (Stojanovic & Vaughan (1998)).

2.4.1.8 **Low risk**

CP is also a low-risk asset—one that carries little risk of default—because the typical issue has such a short maturity and is the liability of a high-quality firm. In addition CP issuers reduce "rollover risk" by securing backup lines of credit from banks. These backup lines, which are also called liquidity enhancements, give paper-issuing firms access to bank credit in exchange for a fee. Usually, CP issuers maintain 100 percent backing, though some large issues have less than full backing (Stojanovic & Vaughan (1998)). Financial CP is considered a low-risk asset because of its short maturity and the fact that its issuers are large institutions with strong balance sheets. If the balance sheet of an issuer deteriorates, investors usually become reluctant to roll over maturing commercial paper and the issuer has to exit the CP market (Kacperczyk and Schnabl (2009)).

2.4.1.9 **Exempt from registration under the Securities Act of 1933**

From the perspective of a CP issuer, one benefit of CP is that the issuer can avoid registration under the Securities Act of 1933, which is the set of rules that requires any firm issuing securities to provide a description of the company's properties and business, of the security itself, and of corporate management, along with financial statements. Registration is generally considered an expensive and lengthy process. The exemption from registration for CP is usually based on Section 3(a)(3) of the 1933 Securities Act, which requires CP issuers to satisfy three criteria. First, the maturity of CP must not be more than 270 days. In practice, CP typically has far shorter maturities—between 1 and 45 days—with an average maturity of about 30 days. Second, CP must not be targeted towards the general public. Hence, issuers of CP cater to institutional investors; usually offering large denominations of $100,000 or more. Third, issuers of CP must only use their proceeds from issuing CP to finance current assets.
such as receivables or inventory. In practice, this requirement implies that firms need to demonstrate that they have sufficient scale of current transactions to justify the size of their commercial paper programs (Kacperczyk and Schnabl (2009)).

2.4.1.9 Provision of funds for transactional needs
CP matures within 270 days, but most matures within 30 to 45 days, making it vital for companies to tap the market for money quite often. Commercial paper is sold for "transactions purposes" only, SEC rules state, which for example includes inventory investment. Without commercial paper issuance, $1.7 trillion of short-term credit would dry up, imperiling the ability of companies to produce goods and services, and resulting in big job losses from both a direct and indirect hit (Crescenzi (2008)).

2.4.1.10 Ease of rolling over debt
CP is issued at short maturities to minimize interest expense, many issuers roll over CP by selling new paper to pay off maturing paper (Anderson and Gascon (2009)). There is little trading of CP in secondary markets. Instead, many investors continuously roll over maturing CP, which means that they purchase newly, issued CP from the same issuer once their holdings of CP mature. As a result, issuers usually refinance the repayment of maturing CP with newly issued CP (Kacperczyk and Schnabl (2009)).

2.4.1.10 Direct access to money market
CP provides institutions direct access to the money market. In traditional bank-intermediated financial systems, borrowing institutions obtain loans from commercial banks, which are, in turn, primarily funded by deposits (Adrian, Kimbrough and Marchioni (2010)). In Kenya the main investors in CP consist of banks, insurance companies, fund managers investment companies and individuals. Fund Managers are the main investors in CP. Figure 2.2 below shows the investors in CP in Kenya from the year 2005 to 2010.
Figure 2.2: Commercial Paper investors per class from 2005 to 2010
Source: Capital Markets Authority

2.5 Chapter Summary

The literature review show that most of the studies carried out concern the developed world. The local studies have not adequately addressed why there is a decline in the use of CPs in Kenya. This study therefore seeks to bridge this gap in literature in knowledge in the commercial paper market in Kenya.

Chapter three will cover research methodology and describes the methods and procedures used to carry out the study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research methodology that was used to carry out the research. It describes the research design, population, sampling design, data collection methods, research procedures, data analysis and data presentation.

3.2 Research Design

This study adopted a descriptive research design. A descriptive study tries to answer the questions who, what, when, where, why and sometimes how questions (Cooper and Schindler (2003)). In descriptive research the problem is structured and well understood (Ghauri and Gronhaug, 2002). A descriptive research portrays and accurate profile of a person’s events or situations (Robson (2002)). Descriptive research was the most appropriate design for this study because the study was answering the why there is a decline in use of CPs.

3.3 Population and Sampling Design

3.3.1 Population

Castillo (2009) defines a research population as a large collection of individuals or objects that is the main focus of a scientific query. It is for the benefit of the population that researches are done. All individuals or objects within a certain population usually have a common, binding characteristic or trait. The population of interest in this study consists of the 27 companies that issued CPs in Kenya between 1994 and 2011 (Appendix 1). These were companies which had experience in issuing of CPs. As such, they were found to be best suited to explain reasons that contribute to decline out of own experience irrespective of the market they operate at, whether listed or not.
3.3.2 Sampling Design and Frame

3.3.2.1 Sampling Frame

Sampling frame is a list of elements from which a sample is actually drawn (Cooper and Schindler, 2001). In this study the sampling frame was the whole population of 27 companies which have issued CPs in Kenya between 1994 and 2011 (Appendix I).

3.3.2.2 Sampling Technique

In this study the researcher carried out a census of the whole population of the 27 companies that have issued CPs in Kenya from 1994 to December 2011. The population was not large enough to warrant sampling. Also, since the entire population is located in Nairobi, the cost and time to collect data was not prohibitive to seek sampling. This study was a census survey hence no sampling technique was used.

3.3.2.3 Sampling Size

Where time and resources allow, a researcher should take as big sample as possible (Mugenda, 2003). The researcher considered the whole population of 27 companies which have issued since inception in 1994 to 2011. These companies had the relevant information having issued CP and experienced the issuing process. There was no need to sample because it was practical to survey the entire population. The efficiency of using the whole sample was high since the results were obtained quickly.

3.4 Data Collection Methods

A questionnaire was developed (Appendix III) based on the three research questions. Primary data was collected by use of questionnaire. The advantage of primary data is that it is reliable and consists of current data required for the study (Denscombe (1998)). Primary data are sought for their proximity to the truth and control over error (Cooper and Schindler (2001)). The questionnaire contained semi-structured questions. It was divided into three sections. Likert scales were used in the questionnaire to scale responses. The questionnaires
were administered through the drop and pick method. Secondary data was collected from financial statements of 27 companies for the period start 1994 to 2011.

3.5 Research Procedures

For collection of primary data, a close-ended, semi-structured questionnaire was developed. The questions were structured on a Likert scale. Prior to using the questionnaire in the field it was pilot tested in three investment firms. The purpose of this was to refine the questionnaire and also ensure that the respondents understood the questions. The questionnaires were administered through the drop and pick method. The research assistant dropped the questionnaire to the finance managers of the sampled firms and explained the purpose of the study. The respondents were asked to complete the questionnaire which were collected after one week. Prompting of questionnaire completion was done through telephone follow-up reminders. The collected data was examined for completeness, reliability and consistency.

3.6 Data Analysis Methods

Data analysis involves reducing accumulated data to a manageable size, developing summaries, looking for patterns and applying statistical techniques (Cooper and Schindler (2001)). Descriptive statistics were used to summarize the data in a meaningful way that patterns in the data could emerge. Anderson (1996), defines inferential statistics as a process of using data obtained from a sample to make estimates or test claims about the characteristics of a population. Correlation analyses were carried out to determine the relationship between earnings per share ratio, current ratio and debt to equity ratio with the issue of CPs. Collis and Hussey (2003) proposes that data presentation in a descriptive study can be done through frequencies such as cross tabulations. Data was analyzed through frequencies and presented in form of charts, tables and graphs to elicit the findings based on the three research questions and to give a clear picture of the findings at a glance.
3.7 Chapter Summary

This chapter outlines that the study was a descriptive study. The population used in the study consisted of all the 27 companies that have issued CPs in Kenya. The 27 companies were the sampling frame. Primary data was collected using a close-ended questionnaire. Both descriptive and inferential statistics were used to analyze the data. Chapter 4 presents the findings of the research.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This section represents the data presentation, analysis and findings of the study. The study had a response rate of 78%. The chapter commences with descriptive statistics. Frequencies were used to analyze responses from the 21 respondents on the three research questions. This enabled the researcher make an overall conclusion on the factors that have led to a decline in use of CPs in Kenya.

4.2 Demographic analysis

Table 4.1 analyses the industry in which the 21 respondents fall under. 33% were in the commercial and services sector, 33% fell under the manufacturing sector, 24% were in the energy and petroleum sector while 5% were in the insurance/investment sector and 5% were in the banking sector. It is likely that the manufacturing sector and the commercial and services sector use CPs because they deal with huge amounts of inventory. CPs in this case are used to fund the inventory.

Table 4.1: Analysis of the companies by industry

<table>
<thead>
<tr>
<th>Sector</th>
<th>Respondent companies (Percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial &amp; Services</td>
<td>33</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>33</td>
</tr>
<tr>
<td>Energy &amp; Petroleum</td>
<td>24</td>
</tr>
<tr>
<td>Insurance or Investment</td>
<td>5</td>
</tr>
<tr>
<td>Banking</td>
<td>5</td>
</tr>
</tbody>
</table>

29
From Figure 4.1 76% of the companies that have issued CPs are large enterprises and 24% are medium enterprises. No small enterprises have issue CP. In Kenya a business that employees 10-49 people and 50-99 is considered a small and a medium enterprise respectively. A business that employs over 100 people is considered a large enterprise (Kenya Revenue Authority, 2007). These findings are consistent with the requirement that companies issuing CPs in Kenya should have a minimum capital of Kshs. 50 million. This regulation thus excludes small enterprises from issuing CPs.

Figure 4.1: Analysis of the companies by size

Figure 4.2 indicates that 90% of the firms that have issued CPs have been in operation over 5 years and 10% of those companies have been in operation for 4-5 years. No company which has been in operation under 4 years has issued CPs. This is because the requirements of issue in CP in Kenya require that a firm should have made profit in 2 of the last 3 years when the company is applying for CP.
Figure 4.2: Analysis of the number of years the company has been in operation

4.3 Decline in use of commercial paper

4.3.1 Sources of short-term finances

In figure 4.3, bank overdrafts were the most popular source of short term funds accounting. 80% of the respondents source their short term funds from bank overdrafts. 40% of the respondents used CP as a source of short term finances as shown in figure 4.4 below. CP seem not to be a popular short-term source of finance as compared to most of the other sources of short-term finances.
Figure 4.3: Sources of short-term finances

4.3.2 Requirements for issue of CPs

From Figure 4.4, 65% strongly agreed that the Kshs 50 million minimum capital requirements for issue of CP discouraged uptake of CP. 30% agreed and 5% disagreed. This response that the minimum capital requirement discourages uptake of CPs.
Figure 4.4: Requirement that the minimum capital of issuing firm be at least 50 million

In Figure 4.5, 14% of the respondents strongly agreed that the requirement that a company must have made profit in the two of the three preceding years before issue of CP discouraged uptake of CPs. 52% agreed, 29% disagreed and 5% agreed. Despite the fact that the respondents felt that this requirement discouraged uptake of CPs, this is requirement secures the CPs investors because CPs are non-secured. The investors can only count on the financial stability of the borrowing company for assurance that their funds will be paid back.

Figure 4.5: Requirement that the issuing company should have made profit for two of the last three years preceding application
4.3.3 Regulation of CPs by CMA

From figure 4.6, 19% of the respondents strongly agreed that non-transferability of CPs discouraged uptake of CPs. 52% agreed, 24% disagreed and 5% agreed. Non-transferability of CPs may limit the pool of investors providing to CPs issuer by locking out the investors whose preferred investment period is shorter than the duration of the CP issued.

![Pie chart showing responses to non-transferability of CPs](chart.png)

Figure 4.6: Non-transferability of commercial paper

Figure 4.7 shows that 30% of the respondents strongly agree that the minimum CP issue amount of Kshs. 1 million discourages use of CP. 50% agreed, 20% disagreed. No respondent strongly disagreed that the minimum CP issue amount discourages use of CP. This may result in firms requiring an amount lower than Kshs. 1 million at a specific time opting for other sources of short-term funds thus affecting uptake of CPs.
Figure 4.7: Minimum commercial paper issue amount of Kshs 1 million

From figure 4.8, 33% strongly agree CMA regulation and procedure on issue of CP affect uptake of CP. 48% agree and 19% disagree. The CMA regulation is requires time and it may be costly when raising small amounts of funds eg. Kshs.1 million as compared to alternatives like bank overdraft.

Figure 4.8: CMA regulation and procedure on issue of commercial paper
Figure 4.9 below shows that 43% of the respondents strongly agreed that the approval process of issue of CP by CMA discouraged uptake of CP. 43% agreed and 14% disagreed. No respondents strongly disagreed indicating that the approval process discouraged uptake of CPs.

Figure 4.9 : Approval process of issue of commercial paper by CMA

In Figure 4.10, 5% of the respondents strongly agreed that the placing arrangements by CMA discouraged uptake of CP. 86% agreed and 10% disagreed. This shows that placing arrangements requirements negatively affect uptake of CPs.

Figure 4.10 : Placing arrangements requirements
Uses for which funds raised through CPs were put into did not discourage uptake of CPs. From Figure 4.11 above, 5% strongly agreed that uses for which funds raised through CP are authorized to be put in discouraged use of CP. 33% agreed, 57% disagreed and 5% strongly disagreed.

Figure 4.11: Uses for which funds raised through commercial paper are authorized

4.3.4 Other factors affecting uptake of CPs

From Figure 4.12, no respondents strongly disagreed that fluctuation in market interest rates discourage use of CP. 17% strongly agreed, 44% agreed and 39% disagreed. This shows that fluctuation in market interest rates negatively affect uptake of CPs.

Figure 4.12: Fluctuations in the market interest rates
In figure 4.13 85% of the respondents would reduce uptake of CP because of fluctuation in the market rates. 65% would reduce uptake of CP because placing requirements, 50% because of CMA procedure on regulation and issue of CP. 40% of the respondents would reduce their CP intake due to profit requirements, 40% due to non-transferability of CP. 65% would reduce their CP intake due to the minimum CP size, 35% due to the authorized uses of CP funds and 30% due to the CMA approval process.

![Bar chart showing factors affecting CP uptake](image-url)

**Figure 4.13: Factors that would make (have made) organizations reduce the amount of funds they raise through commercial paper.**

Market rate fluctuation was found to be the lead factor that discouraged uptake of CPs in the manufacturing and the commercial and services sector. The energy sector cited placing requirements as the main factor discouraging uptake of CPs. In the insurance/ investment sector authorization of use of funds, minimum CP issue amount, profit requirement and fluctuation of market interest rates influenced were mentioned as factors that would make firms reduce their CPs uptake. The finance sector is highly regulated in terms of the investment vehicles the hold their funds therefore they are sensitive to the authorization of
use of CP funds. Since they mainly buy CPs for trading, market interest rate fluctuations is important to them because it affects their profits.

Table 4.2: Factors that would make (have made) organizations reduce the amount of funds they raise through commercial paper per sector.

<table>
<thead>
<tr>
<th>Industry Category</th>
<th>Total</th>
<th>Commercial &amp; Services</th>
<th>Insurance or Investment</th>
<th>Energy &amp; Petroleum</th>
<th>Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market rates fluctuation</td>
<td>85%</td>
<td>100%</td>
<td>100%</td>
<td>60%</td>
<td>86%</td>
</tr>
<tr>
<td>Placing arrangements requirements</td>
<td>65%</td>
<td>57%</td>
<td>0%</td>
<td>100%</td>
<td>57%</td>
</tr>
<tr>
<td>CMA regulation and procedure on issue of CP</td>
<td>50%</td>
<td>57%</td>
<td>0%</td>
<td>60%</td>
<td>43%</td>
</tr>
<tr>
<td>CMA approval process</td>
<td>50%</td>
<td>43%</td>
<td>0%</td>
<td>80%</td>
<td>43%</td>
</tr>
<tr>
<td>Profit Requirements</td>
<td>40%</td>
<td>14%</td>
<td>100%</td>
<td>60%</td>
<td>43%</td>
</tr>
<tr>
<td>Non-transferability of CPs</td>
<td>40%</td>
<td>43%</td>
<td>0%</td>
<td>60%</td>
<td>29%</td>
</tr>
<tr>
<td>Minimum CP issue amount of Kshs 1 million</td>
<td>35%</td>
<td>29%</td>
<td>100%</td>
<td>20%</td>
<td>43%</td>
</tr>
<tr>
<td>Authorization of uses of funds raised through CP</td>
<td>35%</td>
<td>14%</td>
<td>100%</td>
<td>40%</td>
<td>43%</td>
</tr>
</tbody>
</table>

Figure 4.14 indicates that there is a relationship between the size of the company and the decline in the CP uptake. 75% of the factors that resulted in reduction of CP uptake were more pronounced in large enterprises as compared to medium enterprises. This is probably because the larger companies generally would raise higher amounts through CPs than small enterprises.
Figure 4.14: Analysis of factors that would make (have made) organizations reduce the amount of funds they raise through commercial paper against the size of the company

From Figure 4.15, 0% indicated that they have never wanted to re-issue / rollover CP but did not do due to regulatory requirements. 100% indicated that they have never wanted to re-issue / rollover CP but did not do due to regulatory requirements.

Figure 4.15: Has your company ever wanted to roll over/ re-issue a commercial paper but did not due to the requirements that had to be met?
The researcher further computed a Pearson product-moment correlation co-efficient was to assess the relationship between Earnings per Share (E.P.S) and issue of CP. The E.P.S for 11 of the 21 respondent companies whose financial statements were available was calculated before and after the issue of CP and after issue of a CP using the following formula

\[
E.P.S = \frac{\text{Earnings attributable to share holders}}{\text{Number of issued shares}}
\]

The results of the E.P.S calculation before and after CP issues are summarized in figure 4.16 below.

![Figure 4.16: Earnings per share ratio before and after CP issue.](image)

A correlation was thereafter calculated using excel. The results indicated a weak positive correlation between the two variables, \( r = -0.12, n=11, p=0.05 \).
4.4 Roles of commercial paper

4.4.1 Role of commercial paper

From figure 4.17 52% of the respondent companies used CPs for bridge financing, 48% to finance inventories and 48% to reduce borrowing costs. 48% of the respondent companies used CPS to finance maturing obligations, 38% as a substitute for cash holdings or credit lines and 19% of the firms used the funds for other uses. Inventory financing is one of the traditional uses of CP and hence the large percentage of use of funds raised through CP.

![Figure 4.17: Role of commercial paper](image)

From table 4.3 the companies in the insurance industry mainly CPS for bridge financing and other uses. Banks use all their CPs proceeds for bridge financing. The companies in the energy sector use most of their CPs proceed to reduce borrowing costs. The manufacturing sector companies use their CP proceeds to finance maturing obligations and as a substitute
Figure 4.18: Role of commercial paper in corporate financing

In Figure 4.19, 70% of the respondents indicated that CP plays the role of cheap funds in the firm. 60% financing of inventories, 50% financing of maturing obligations. 35% indicated that CPs were used for bridge financing, 20% of day to day cash management and 10% for payroll financing. Due to the fact that CPs are issued by financial stable companies, CPs continue to play the cheap source of finance role in this companies probably because the amount per issue is large enough to accommodate the issue costs.
Figure 4.19: Role of commercial paper in the respondents firm

In Figure 4.20, 76% of the firms interviewed have not considered substitutes other substitutes to CP because it is a source of cheap short-term funds. 76% indicated financial flexibility, 47% indicated it is a bridge to long-term financing, 47% indicated it is cheaper than other alternatives. 35% preferred CPs to finance maturing obligations, 24% to finance acquisitions, 24% to finance investments and 6% for payroll financing.
Figure 4.20: Why firms have not considered the other alternatives to substitute commercial paper in its role.

4.5 Benefits of commercial paper

4.5.1 Benefits of commercial paper in respondent firms

In Figure 4.21, 95% of the respondents indicated the low issuance cost as a benefit of raising funds through CP. 86% sighted low interest rates on CP, 62% benefited from flexibility in terms of amounts that can be borrowed. 52% indicated they benefited from convenience in borrowing large amounts, 52% flexibility in the period of borrowing and 33% benefited from increased scope of borrowing. This is consistent with the findings on the role CP plays in the respondent firms.
Figure 4.21: Benefits of raising funds through commercial paper

4.5.2 Benefits of commercial paper over other short-term sources of finance

From Figure 4.22, 90% of the respondents indicated that low interest rate was an advantage of CP over other short-term finances. 57% indicated low issuance costs, 52% flexibility over amounts that can be bought while 52% indicated rolling over of debt as the main advantage of CP. 43% indicated flexibility in terms of period of borrowing and 43% the increased scope of borrowing.
Figure 4.22: Advantages of commercial paper as compared to other forms of short term financing.

Figure 4.23 shows that 67% of the respondents strongly agreed that low interest was a benefit if raising funds through CP. 33% agreed that CP had the advantage of raising funds through CP. This shows that interest rate is a major advantage of raising funds through CP.

Figure 4.23 Low interest rates of commercial paper as an advantage of issuing CP
Figure 4.24 shows that firms that had been in operation between 4-5 years disagreed that CPs are convenient for borrowing large amounts as compared to other sources of funds. However, firms over 5 years thought CPs to be more convenient for borrowing short-term funds.

Figure 4.24: Convenience in borrowing large amounts as compared to other sources of funds

4.6 Regulatory framework recommendations

Figure 4.25 indicates that 95% of the respondents believed that educating the public on CP would improve the uptake of CPs. 90% of respondent indicated improvement of CMA regulations and procedure to make them easier to use, 76% voted for reduction of minimum CP issue amount while 57% indicated that licensing of more rating agencies that deal with CP issue would improve the uptake of CPs. Lack of information is a main factor hindering uptake of CPs.
Figure 4.25: Recommendations to CMA do to encourage uptake of commercial paper.

4.7 Chapter Summary

The researcher used descriptive statistics and found out the factors affecting decline in usage of the CPs include non-transferability of shares and the requirement that the minimum capital of issuing firm be at least Kshs. 50 million for issue of CP usage. Placing arrangements requirements by CMA, the minimum CP issue amount of at least Kshs. 1 million and CMA regulation and procedure on approval and issue of CP also emerged as factors discouraging uptake of CPs. Further studies indicated that there was a strong positive relation between Debt to Equity ratio and Current ratio and issue of CPs. The study also indicated a weak negative relationship between Earning per Share ratio.

The study revealed that the main role played CPs was as a cheap source of funds from the firms. CPs also played the role of financing inventories and financial obligations. This made CPs more attractive than other sources of short-term funds. The study further revealed that low interest cost and low CP issuance costs as the two most important benefit of CPs. The
respondents also cited low interest cost and low issuance costs as the main benefit of CPs over other short-term sources of funds
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents discussions, conclusions and recommendations of the study. The chapter was divided into four sections. The first section presented the summary of important elements of the study. The second section presented a discussion of the study structured according to the research questions. The third section presented the major conclusions drawn from the research findings. The final section presented recommendations for improvements and further studies.

5.2 Summary

The purpose of this study was to investigate the decline in the issue of Commercial Papers (CPs) to finance a firm’s operation. A market assessment carried out showed the total CP issued had decline from Kshs. 8.15 million in year 2000 to 1.36 million in year 2011. The study was based on the three research questions: Why is there decline in use of commercial paper in Kenya? What is the role of commercial paper in corporate financing in Kenya? and what are the benefits of raising funds through commercial paper?

The study used a descriptive research design and studied the entire population of the 27 companies which have issued CPs at one point in time since the inception of the CP programme in 1994 to year December 2011. The sampling frame consisted all 27 companies that have issued CPs. No sampling was done as population was considered small. For collection of primary data, a close-ended questionnaire was developed. The questionnaires were administered to the finance managers of the sampled companies through the drop and pick method. Secondary data was collected from the financial statements of the said companies between 1994 to 2011. Data was analyzed through descriptive and inferential statistics and presented in form of charts and graphs to elicit the findings based on the three research questions.
The results of the study showed that the factors affecting decline in usage of the CPs include non-transferability of CP and the requirement that the minimum capital of issuing firm be at least Kshs. 50 million for issue of CP. The study also indicated a weak negative relationship between Earning per Share ratio and issue of CP.

The study revealed that the main role played CPs was as a cheap source of funds from the firms. CPs also played the role of financing inventories and financial obligations. This made CPs more attractive than other sources of short-term funds.

The study further revealed that low interest cost and low CP issuance costs as the two most important benefit of CPs. The respondents also cited low interest cost and low issuance costs as the main benefit of CPs over other short-term sources of funds.

The study recommends that CMA should educate the public on CPs and improve the CMA regulation and procedure on issue of CPs to improve the uptake of CPs. The study further recommends that the minimum CP issue be reduced to encourage uptake of CPs. The study also recommends licensing of more rating agencies dealing with issue of CPs.

5.3 Discussion

5.3.1 Decline in use of commercial paper in Kenya.

From the study there has been a decline in the outstanding CPs from year 2000 to year 2011 in Kenya. This is in contrast with the trend in China where the CP market has been growing (Guo and Fang (2012)). Unlike in the U.S.A where declines in outstanding CP was marked by certain events, for example failure of Penn Central in 1970 (Calomiris (1995)), the Enron crisis in 2001 (Rettl, D. A. (2011)) and the financial crisis of 2007-2009 (Kacmanczyk and Schnabl (2009)), the decline in outstanding CPs in Kenya for the period under study could not be linked to any event.

Non-transferability of CPs emerged as one of the factors resulting to the reduced uptake of CPs. 52% of the respondents agreed that non-transferability of CPs discouraged uptake of CPs. 19% of the respondents strongly agreed that non-transferability of CPs affects its
uptake. These findings are consistent with the findings in Nganga (1999) which indicated that there is a demand of a secondary market for CPs in Kenya.

The study revealed that the requirement that the minimum capital of issuing firm be at least 50 million for issue of CP discouraged issue of CP. Only 5% of the respondents disagreed that the minimum capital discouraged the issue of CPs. Placing arrangement requirements was also noted as a factor that discourages uptake of CPs. Only 10% of the respondents disagreed that placing arrangements affected the uptake of CPs.

The findings also showed that placing arrangements requirements was a factor that would reduce uptake of CPs for a firm that had already raised funds through CPs. CMA regulation and procedure on issue of CP as well as the approval process of issue of commercial paper by CMA were also marked as factors that would reduce uptake of CP.

The minimum CP issue amount was also noted as one of the factors that discouraged the issue of CPs. 50% of the respondents agreed that the minimum issue amount discourages issue of CP 30% of the respondents also strongly agreed that the minimum issue amount affects the uptake of CPs. The uses for which funds raised through CP are authorized to be put into did not discourage uptake of CP from the findings of the study.

The findings also revealed that CMA regulation and procedure on approval and issue of CP. These findings are consistent with Kinyua (2006) who conducted a study on factors hindering CP market development in Kenya. The results showed that factors hindering development of CP market in Kenya include: approval time by CMA and NSE, lack of information, competition from lenders, costs of issuance and management lack of enthusiasm.

Findings on the factors that would make a firm reduce the amount of funds they raise through CP, fluctuation in the market interest rates emerged as the major factor. 85% of the respondents indicated that they would reduce uptake of CP because of fluctuation in the market rates. The market fluctuations emerged to affect the companies in the banking and insurance sectors more than the other companies. These findings are in line with Nganga
(1999) whose findings indicated that that volatility of interest rates have hindered deepening of the market in Kenya.

The decision to re-issue/rollover of CP was found not to be affected by the regulatory requirements indicating that once a company has been able to issue CP, the regulatory requirements cease to discourage uptake of CPs.

All the above findings on decline of CPs were consistent with the recommendations by the respondents to CMA to ensure that uptake of CPs increased. 95% of the respondents believed that educating the public on CP would improve the uptake of CPs. This ties up with the findings that of the firms that had issued CPs, none of the firms found the regulation governing issue of CPs a hindrance to the uptake of CPs. 90% indicated that improvement of CMA regulations and procedure to make them easier to use would increase uptake of CPs. 76% voted for reduction of minimum CP issue amount and 57% indicated that licensing of more rating agencies that deal with CP issue would improve the uptake of CPs.

5.3.2 Role of commercial paper in corporate financing in Kenya.

More than half of the respondent firms indicated that they used CPs for bridge financing. This finding ties with the findings of Kahl, Shivdasani and Wang (2010) who indicated that CP may be particularly attractive as a bridge to long-term financing. Under the bridge financing view, a firm can refinance CP using long-term financing once a cost-efficient issuance size is reached.

Kahl, Shivdasani and Wang (2010) also indicates that firms may use CP because it is potentially a cost-efficient source of start-up funding for new investment. This is consistent with the findings of this study on the role of CPs where 81% of the respondents indicated that the role of CP in corporate financing is a cheap source of funds. 57% indicated the role of CP as financing investment, 57% as a bridge to long-term finance, 52% financing inventories and 48% financing of maturing obligations. Financial flexibility was sighted by 33%, 24% indicated financing acquisitions, 5% day to day cash management and 5% payroll financing.
The findings indicated that the main role played CPs was as a cheap source of funds from the firms. 48% of the respondents indicated that they use CPs to finance inventories. On response to the question on the role CPs should play in corporate financing, 85% of the respondents indicated that CPs play the role of a cheap source of funds. The importance of this role was also seen in the individual respondents firms where 70% of the respondents indicated that CP plays the role of cheap funds in the firm. This is line with Handal (1972) where it was noted that CP is issued primarily to reduce borrowing costs; it serves as a relatively low-cost alternative to bank loans and as a flexible financial instrument that can be sold with little difficulty in the amounts and maturities required.

This study shows that CPs play the role of providing a cheap source of funds in our Kenyan market. This is in line with the finding in Anderson and Gascon (2009) which indicated that in the U.S.A., the CP market was originated by firms seeking short-term funds at interest rates and terms more favorable than bank loans.

The respondents also highlighted financing of inventories as a major role played by CPs in their firms. This was in line with the other researchers findings. Downing and Oliner (2007) indicates that firms use CP to finance inventories, to provide bridge financing in connection with various transactions, and for day-to-day cash management. Financing inventories has been seen as a major role of CPs as it is highlighted under the third requirement of exemption from registration in the U.S.A Securities Act of 1933, Section 3(a)(3).

The study findings also indicated that CPs play the role of financial flexibility which makes them superior to other short-term sources of funds. These findings are in line with the findings in Kahl, Shivdasani and Wang (2008). In their paper ‘Do firms use Commercial Paper to enhance financial flexibility?’, they concluded that though CPs have a short-term maturity, both financial and nonfinancial firms often use CP as financing for capital expenditures and roll it over continuously or until alternative financing is found.

Anderson and Gascon (2009) notes that the funds raised through CP issuance have a variety of uses, including payroll and inventory finance. From the findings of our study, CPs have played the role of providing funds for inventory financing. 48% of the respondents indicated
that they use CPs to finance inventories in their firms. The role of payroll financing is not indicated as a major role from the study findings. Only 10% of the firms indicated using funds from CPs for payroll financing. Only 6% of the respondents indicated that they prefer CPs to other short-term sources of finance due to its role in payroll financing. The findings in this study are in contrast with the findings in Nganga (1999) who concluded that funds sourced from CP issuance have been mainly limited to the financing of working capital needs of firms.

This study findings also indicate banks and insurance companies use most their proceeds from CP for bridge financing. This is in contrast with the findings in Hahn (1993) that indicate that that insurance companies issue CP to finance premium receivables and operating expenses. Hahn (1993) further indicates that finance companies use CPs to provide consumers with home loans, retail automobile loans, and unsecured personal loans.

5.3.3 Benefits of raising funds through commercial paper.

The results of the study showed low interest cost as the most important benefit of CPs. 86% of respondents cited low interest cost as the main benefit of CPs over other short-term sources of funds. This is in line with Kahl, Shivdasani and Wang (2010) whose findings indicates that one reason why firms may employ CP is because it is a very cheap source of financing for highly rated issuers, as indicated by the low spreads over Treasury bills. The respondents also cited low issuance costs as one of the major benefits of issuing CPs and as a reason while they prefer CPs as compared to other sources of short-term funds. This is consistent with the findings Hahn (1993) that indicate that to a significant extent, the advantage of CP issuance is cost: high-quality issuers have generally found borrowing in the CP to be cheaper than bank loans.

68% of the respondents indicate flexibility in terms of amounts that can be borrowed as the main benefit of raising funds through CP. This is in line with Goacher (2003) and Rettl (2011). Goacher (2003), indicates that borrowing through commercial paper provides a flexible term for the borrowing since CPs can be issued with original maturities of seven
days upwards. CP issuers are flexible in adjusting their outstanding balances every time the roll over their paper, which occurs multiple times per year (Rettl (2011)).

52% of the respondents indicated the ease of rollover of CPs as one of the benefits associated with CPs. This contrasts with Kacperczyk and Schnabl (2009) which indicates that the need to roll over maturing CP generates the risk that investors may not be willing to refinance maturing CP. However, the findings are consistent with Calomiris (1995) which indicates that nonfinancial firms often use CP as financing for capital expenditures and roll it over continuously or until alternative financing is found.

Companies that had been operation over 5 years indicated that CPs are more convenient for raising large amounts of fund as compared to other sources. These findings are in line with those of (Apte (2002). However, CP issuers that has been in operation between 4-5 years disagreed.

5.4 Conclusion

5.4.1 Decline in use of commercial paper in Kenya.

The study shows that there is a decline in usage of CPs between year 2000 to year 2011 in Kenya. This decline could not be linked to any event/change affecting the Kenyan financial market.

CMA Regulatory requirements were found to be the main factors affecting the uptake of CPs. These factors are non-transferability of CPs meaning that CPs do not have secondary market for trading, the requirement that the minimum capital of issuing firm be at least Kshs. 50 million for issue of CP usage. Placing arrangements requirements by CMA, the minimum CP issue amount of at least Kshs. 1 million and CMA regulation and procedure on approval and issue of CP also emerged as factors discouraging uptake of CPs.

Fluctuations in market interest rates emerged as the main factor that would make a firm reduce the amount of funds they raise through CP.
5.4.2 Role of commercial paper in corporate financing in Kenya.

The findings indicated that the main role played CPs was as a cheap source of funds from the firms. This made CPs more attractive than other sources of short-term funds. The other roles played by CPs from the study were bridge financing, financing of inventories and financial flexibility. There was also no statistically significant difference medium enterprises and large enterprises interviewed on the role of CPs in their firms.

The findings indicate that the roles of cheap source of financing and financial flexibility made CPs have an edge over other sources of short-term funds. Payroll financing was not seen as a major role of CPs in Kenya.

5.4.3 Benefits of raising funds through commercial paper.

The results of the study show that low interest cost was seen as the most important benefit of CPs. The respondents also cited low interest cost as the main benefit of CPs over other short-term sources of funds. Low issuance costs emerged as one of the benefits of raising funds through CP.

Flexibility in terms of amounts that can be borrowed, ease of rolling over debt and convenience in borrowing large amounts were also ranked as some of the major benefits of raising funds through CP in Kenya.

5.5 Recommendation

5.5.1 Recommendations for improvement

5.5.1.1 Recommendations bases on objective one

The findings of the study indicate that CMA should educate the public on CPs to encourage the uptake of CPs. The study further recommends that the minimum CP issue amount be reduced to allow encourage uptake of CPs. The respondents also recommended licensing of more rating agencies that deal with issue of CP to encourage uptake of CPs.
5.5.1.2 Recommendations bases on objective two

The respondents recommended improvement on the CMA regulation and procedure on issue of CP to make it easier and cost effective to issue.

5.5.1.3 Recommendations bases on objective three

The respondents recommended that CMA lobbies the government on management of market interest rates because fluctuation on the interest rates affects uptake of CPs. regulation and procedure on issue of CP to make it easier and cost effective to issue

5.5.2 Recommendations for further study

The study mainly focused on why there was a decline in the issue of CP in Kenya based on the companies that have had at least one CP issue. The study did include companies that have not issued CPs. A study can be carried out on the decline in CPs basing the study on all incorporated companies. A study can also be carried out for the purpose of finding out if there was any event that triggered the decline in CPs during the period of study.

This study did not cover decline in issue of CPS for the various sectors. A study can also be carried out on the decline in CP issue for the different sizes of organizations and also for the companies that have been in operation for different durations to see whether the factors affecting decline of issue of CPs change with different sized organizations of organizations that have different durations.

A study can also be carried out showing the effect of educating the public on CPs on the uptake of CPS as well as what effect improvement of CMA regulation and procedure on issue and approval of CP would have on the uptake of CPs.
REFERENCE


Farlex Financial Dictionary, 2012


APPENDICES

Appendix I: Companies which have issued CP.

<table>
<thead>
<tr>
<th>POPULATION OF THE STUDY</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Crown Berger Limited.</td>
</tr>
<tr>
<td>2 Kenya Oil Company.(Kenol kobil)</td>
</tr>
<tr>
<td>3 Athi River Mining Company Limited.</td>
</tr>
<tr>
<td>4 TPS Serena.</td>
</tr>
<tr>
<td>5 Total Kenya Limited.</td>
</tr>
<tr>
<td>6 Kenya Power and Lighting Company Limited.</td>
</tr>
<tr>
<td>7 Nation Media Group.</td>
</tr>
<tr>
<td>8 Express Kenya.</td>
</tr>
<tr>
<td>9 CMC holdings</td>
</tr>
<tr>
<td>10 Kenya Hotel Properties.</td>
</tr>
<tr>
<td>11 Ecta Kenya.</td>
</tr>
<tr>
<td>12 Mabati Rolling Mills.</td>
</tr>
<tr>
<td>13 Cooper Kenya limited.</td>
</tr>
<tr>
<td>14 East Africa Industries (Unilever).</td>
</tr>
<tr>
<td>15 Pan Africa Paper Mills.(Pan papermills ltd)</td>
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<tr>
<td>16 Davis &amp; Shirtliff Limited.</td>
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Appendix II: Companies that have issued commercial paper issues from year 2000 to year 2011.

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<tr>
<th>2000 NAME OF ISSUER</th>
<th>FACE VALUE IN 2000</th>
<th>DATE APPROVAL OF IN 2000</th>
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<td>Feb-00</td>
<td>R</td>
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<tr>
<td>General Motors</td>
<td>500,000,000.00</td>
<td>Mar-00</td>
<td>R</td>
</tr>
<tr>
<td>Caltex Oil</td>
<td>500,000,000.00</td>
<td>Apr-00</td>
<td>R</td>
</tr>
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<td>Kenya Shell</td>
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<td>R</td>
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<td>Total Kenya</td>
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<td>Jul-00</td>
<td>R</td>
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<td>Jul-00</td>
<td>Np</td>
</tr>
<tr>
<td>Crown Berger</td>
<td>200,000,000.00</td>
<td>Jul-00</td>
<td>Np</td>
</tr>
<tr>
<td>Express Kenya</td>
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<td>R</td>
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<td>Sep-00</td>
<td>R</td>
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<td>TPS Serena</td>
<td>100,000,000.00</td>
<td>Oct-00</td>
<td>R</td>
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<td>Mabati Rolling Mills</td>
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<td>R</td>
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<td>Ecta</td>
<td>50,000,000.00</td>
<td>Oct-00</td>
<td>Np</td>
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<td>Kenya Hotel Properties</td>
<td>150,000,000.00</td>
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<td>Np</td>
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<td>Nov-00</td>
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<td>13-Jun</td>
<td>R</td>
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<td>Kenya Oil Company</td>
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<td>General Motors</td>
<td>1,000,000,000.00</td>
<td>1-May</td>
<td>R</td>
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<td>Caltex Kenya</td>
<td>1,800,000,000.00</td>
<td>1-May</td>
<td>R</td>
</tr>
<tr>
<td>Bidco Limited</td>
<td>200,000,000.00</td>
<td>1-Apr</td>
<td>Np</td>
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<td>Shell Kenya</td>
<td>200,000,000</td>
<td>1-May</td>
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<td>Crown Berger</td>
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<td>R</td>
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<td>Panpaper Mills</td>
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<td>1-Jun</td>
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<td>Total Kenya</td>
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<td>1-Jul</td>
<td>R</td>
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<td><strong>Unilever(kenya) limited</strong></td>
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<td>Third Renewal</td>
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<td>2-Feb</td>
<td>First Renewal</td>
</tr>
<tr>
<td>CMS Holdings</td>
<td>350,000,000.00</td>
<td>2-May</td>
<td>Second Renewal</td>
</tr>
<tr>
<td>TPS Serena</td>
<td>200,000,000.00</td>
<td>2-May</td>
<td>Third Renewal</td>
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<tr>
<td><strong>Crown Berger</strong></td>
<td>100,000,000.00</td>
<td>2-Jun</td>
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</tr>
<tr>
<td><strong>Pan Paper Mills</strong></td>
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<td>2-Jul</td>
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<tr>
<td><strong>Kenya Hotel Properties</strong></td>
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<td>2-Sep</td>
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**2003**

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<tr>
<td>CMC Holding Ltd</td>
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<tr>
<td>TPS (serena) LTD</td>
<td>200,000,000.00</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Athi river mining</td>
<td>50,000,000.00</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><em>Crown Berger</em>*</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>NAME OF ISSUER</td>
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</tr>
<tr>
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<td>--------------------</td>
<td>--------------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>*Pan paper mills ltd</td>
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<td></td>
<td></td>
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<tr>
<td>*Kenya Hotel Properties ltd</td>
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<tr>
<td>*Ecta (kenya) limited</td>
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<tr>
<td>*Mabati Rolling mills ltd</td>
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2004

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</thead>
<tbody>
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<td>Crown Berger</td>
<td>200,000,000.00</td>
<td>Nov 19 2003</td>
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<td>Kenya Oil Company Ltd</td>
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<td>Feb 1,2004</td>
<td>1st Renewal</td>
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<tr>
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<td>Feb 1,2004</td>
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<td>Mar 1,2004</td>
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<tr>
<td>CMC Holdings limited</td>
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<td><strong>Total approved</strong></td>
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2005

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<td>*Kenya Hotel Properties Limited</td>
<td>300,000,000.00</td>
<td>1/2/2005</td>
<td>3rd Renewal</td>
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<tr>
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<td>Total approved</td>
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<tr>
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<td>550000000</td>
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<td>*Ecta (Kenya)</td>
<td>700000000</td>
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<td>1st Renewal</td>
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<tr>
<td>*CMC Holding</td>
<td>2500000000</td>
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<td>5th Renewal</td>
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<td>Crown Berger</td>
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<td>4th Renewal</td>
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<td>Kenya Hotel Properties</td>
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<td>1st issue</td>
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<td>Ecta (Kenya)</td>
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<td>1st Renewal</td>
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72
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<td>Kenya Oil Company Ltd</td>
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<tr>
<td>Ecta (Kenya)</td>
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**2010**

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<tr>
<td>Copper (kenya)</td>
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<td>Davis &amp;Shirtliff</td>
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<td>12-Mar-10</td>
<td>8.41</td>
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<tr>
<td>Crown Berger</td>
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<td>13-Aug-08</td>
<td>11.33</td>
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<td>KenolKobil</td>
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**2011**

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</tr>
<tr>
<td>Davis &amp;Shirtliff</td>
<td>100,000,000</td>
<td>16-Mar-11</td>
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<tr>
<td>Crown Berger</td>
<td>300,000,000</td>
<td>13-Aug-10</td>
<td></td>
</tr>
<tr>
<td>CMC Holdings</td>
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</tr>
<tr>
<td>Company</td>
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<td>------------</td>
<td>-------------</td>
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<td>Kenya Kazi Limited</td>
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<td>16-Mar-11</td>
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<tr>
<td>Total</td>
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* Bank guaranteed

Note: All figures in Kshs.
Appendix III: Questionnaire.

**QUESTIONNAIRE**

This research study is in partial fulfillment of the requirement for the degree of Masters in Business Administration (MBA) at the United States International University – Africa. The purpose of this research is to find out why there is a decline in use of Commercial paper in raising funds by companies in Kenya.

The study focuses on all the companies that have issued commercial paper in Kenya since its inception in 1994. The results of this study aims at finding out the reasons for the decline in issue of commercial paper in Kenya. The study will also provide the regulatory framework with recommendations on how to encourage use of commercial paper market in Kenya.

This research is done purely for academic purposes and hence the information received shall be treated with utmost confidentiality.

**BACKGROUND INFORMATION**

Please tick the appropriate box

a. Please indicate the Industry Category your organization falls under

- Commercial & Services
  - [ ]
- Insurance/Investment
  - [ ]
- Energy & Petroleum
  - [ ]
- Banking
  - [ ]

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b. Please indicate the category of scale this firm falls under.

- Small Enterprise
- Medium Enterprise
- Large Enterprise


c. What is your designation? ........................................


d. How long has this firm been in operation?

- Less than 1 year
- 2-3 years
- 4-5 years
- Over 5 years


e. What percentage of your last commercial paper issue was taken up by the following investors?

- Banks
- Insurance Companies
- Fund Managers

- %
Investment Companies

Individuals

Other (please specify)............................

%
PART ONE: ROLE OF COMMERCIAL PAPER IN CORPORATE FINANCING

1. Why do you use commercial paper in your company? (Tick all applicable ones)
   a. Financing inventories
   b. Bridge Financing
   c. To reduce borrowing costs
   d. As a substitute of cash holdings or credit lines
   e. To finance maturing obligations
   f. Other (please specify).

2. What is the role of commercial paper in corporate financing? (Tick all applicable ones)
   a. A cheaper source of short-term funds
   b. Financing inventories
   c. For day to day cash management
   d. Payroll financing
   e. Finance investments
   f. To finance maturing obligations
   g. A bridge to long-term financing
   h. To borrow when there are good opportunities and avoid borrowing costs when there are no good opportunities (financial flexibility)
   i. Finance acquisitions
j. Other (please specify)
3. Have the commercial paper issues in your firm played this roles? (Tick all applicable ones)

   a. A cheaper source of short-term funds
   b. Financing inventories
   c. For day to day cash management
   d. Payroll financing
   e. Finance investments
   f. To finance maturing obligations
   g. A bridge to long-term financing
   h. To borrow when there are good opportunities and avoid borrowing costs when there are no good opportunities (financial flexibility)
   i. Finance acquisitions
   j. Other (please specify)

4. What other alternatives are available to play the role of commercial paper in your firm? (Tick all applicable ones)

   a. Commercial Paper
   b. Bank Overdrafts
   c. Bank Loans
   d. Trade Credit
   e. Lines of Credit
   f. Other (please specify)
5. Why has your firm not considered the other alternatives to substitute commercial paper in its role? (Tick all that are applicable ones)

a. Commercial paper is a cheaper source of short-term funds
b. Commercial paper provides bridge to long-term financing by rolling over the commercial paper
c. Commercial paper provide financial flexibility
d. Commercial paper are cheaper than the other alternatives
e. Payroll financing
f. Finance investments
g. To finance maturing obligations
h. A bridge to long-term financing
i. Finance acquisitions
j. Other (please specify) .................................................................

6. In your last commercial paper issue, what was the percentage contribution to the different commercial paper roles in your firm?

a. Financing inventories __ ____% 
b. For day to day cash management __ ____% 
c. Payroll financing __ ____% 
d. Finance investments __ ____% 
e. To finance maturing obligations __ ____%
f. A bridge to long-term financing  

---

g. To borrow when there are good opportunities and 
avoid borrowing costs when there are no good 
opportunities (financial flexibility)  

---

h. Finance acquisitions  

---

i. Other (please specify)  

---

PART TWO: BENEFITS OF COMMERCIAL PAPER

1. Which of the following forms of short term finance does your organization use?  
   a. Commercial Paper  
   b. Bank Overdrafts  
   c. Bank Loans  
   d. Trade Credit  
   e. Lines of Credit  
   f. Other (please specify)  

2. What are the benefits of raising funds through commercial paper to your firm?  
   (Tick all that are applicable ones)  
   a. Low interest rates of commercial paper  
   b. Flexibility in terms of amounts that can be borrowed  
   c. Flexibility in terms of the period of borrowing  
   d. Convenience in borrowing large amounts as compared to
other sources of funds

e. Low issuance cost
f. Increased scope of borrowing
g. Other (please specify)

3. What are the advantages of commercial paper as compared to other forms of short
term financing? (Tick all that are applicable ones)

   a. Low interest rates of commercial paper
   b. Flexibility in terms of amounts that can be borrowed
   c. Flexibility in terms of the period of borrowing
   d. Convenience in borrowing large amounts
   e. Low issuance cost
   f. Increased scope of borrowing
   g. Ease of rolling over debt
   h. Other (please specify)

4. The following factors influence selection of commercial paper as a source of finance:

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<tr>
<th></th>
<th>STRONGLY AGREE</th>
<th>AGREE</th>
<th>DISAGREE</th>
<th>STRONGLY DISAGREE</th>
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<td>a. Low interest rates of commercial paper</td>
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<td>3</td>
<td>4</td>
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<tr>
<td>b. Flexibility in terms of amounts that can be</td>
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83
<table>
<thead>
<tr>
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<th>AGREE</th>
<th>DISAGREE</th>
<th>STRONGLY DISAGREE</th>
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<td>c. Flexibility in terms of the period of borrowing</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>d. Convenience in borrowing large amounts as compared to other sources of funds</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>e. Low issuance cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>f. Cost of other sources of capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>g. Increased scope of borrowing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>h. Favourable regulatory requirement</td>
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</table>
PART THREE: DECLINE IN THE USE OF COMMERCIAL PAPER

1. Organizations that choose to raise funds through commercial paper issues could encounter certain challenges. Please indicate the extent to which you consider the following factors would discourage the use of commercial paper.

<table>
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<th>DISAGREE</th>
<th>STRONGLY DISAGREE</th>
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<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
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</table>

a. Requirement that the minimum capital of issuing firm be at least 50 million

b. Requirement that the issuing company should have made profit for two of the last three years preceding application

c. Non-transferability of commercial paper

d. Minimum commercial paper issue amount of Kshs. 1 million
2. Has your company ever wanted to roll over/re-issue a commercial paper but did not due to the requirements that had to be met?

   a. Yes
   b. No

   □ □
3. Which factors would make (have made) your organization reduce the amount of funds they raise through commercial paper? (Tick all that are applicable ones)
   a. Fluctuation in the market rates that affect the rate offered to the commercial paper investors. ☐
   b. Requirement that the issuing company should have made profit for two of the last three years preceding application ☐
   c. Non-transferability of commercial paper ☐
   d. Minimum commercial paper issue amount of Kshs. 1 million ☐
   e. CMA regulation and procedure on issue of commercial paper ☐
   f. Approval process of issue of commercial paper by CMA ☐
   g. Placing arrangements requirements ☐
   h. Approval process of issue of commercial paper by CMA ☐
   i. Uses for which funds raised through commercial paper are authorized to be put into ☐
   j. Other (please specify) ............................................

4. What can Capital Markets Authority (CMA) do to increase raising of funds through commercial paper in Kenya?
   a. Educating the public on commercial paper ☐
   b. Reduce the minimum commercial issue amount ☐
   c. Improve the CMA regulation and procedure on issue of commercial paper to make them easier to issue ☐
   d. Licensing of more rating agencies that deal with commercial paper issues. ☐
   e. Other (please specify) ............................................