

MARKET IMPEDIMENTS TO ISSUANCE OF CORPORATE BONDS AT THE NAIROBI STOCK EXCHANGE.

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issuance of corporate*



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DECLARATION

This research project was my own original work, and has not been presented to any university of college for any ward. The results will however be made available to interested persons and or institutions on request.

Mr. Morara Dennis Bulla.

Signature.. 

Date: 13/10/2010

The research work was submitted for presentation with my approval as university supervisor.

Signature : 

Date 18/10/2010

Supervisor: Mr. Ndede F.W.S

The research work was submitted for presentation with my approval as university Chairman.

(Department of Accounting and Finance)

Signature 

Date 18/10/2010



DEDICATION

This work is dedicated to my wife Naomi and son Glen for their love, support and understanding throughout the preparation, execution, and compilation of the study report. You endured with grace many days and nights without my full attention. I really am grateful to you two!

And to my loving mom Esther who, since my early childhood, has continued to encourage my intellectual pursuits-I love you more, mummy! "You gave me the gift to follow my dreams." May you live to be a million years!

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Lastly, I am heavily indebted to my wife Naomi and Son Glenn, who endured many lonely evenings to allow this work to be accomplished. “I love you two, so very much”!

ABSTRACT

This research work was motivated by the deficiency of corporate bonds at the Nairobi Stock Exchange since the market segment opened in 1996. The study sought to investigate market impediments to issuance of corporate bonds at the exchange. Bonds as debt instruments are a cheaper source of external capital for companies when interest rates are comparatively low. The general objective was to test the significance of issuance procedure, cost of issue, state of secondary market and level of transparency in attracting corporate bonds to the market. Methodology was to survey selected finance officers from the listed companies and stockbrokers to determine if they thought the factors had retarded growth of the public debt market and offering opinion on how the situation could be reversed. Analysis of data was conducted using chi-square which returned a no- difference between observed and expected value for the factors under study. The significance level was 0.05 for each impediment tested.

LIST OF ABBREVIATIONS

ATS	:	Automated Trading System
CMA	:	Capital market Authority
DvP	:	Delivery versus Payment
E	:	Equity
IPAR	:	Institute of Policy Analysis and Research
IPO	:	Initial Public Offer
MTN	:	Market-to-market
MTN	:	Medium Term Note
NSE	:	Nairobi Stock Exchange
PDS	:	Private Debt Securities
PTA	:	Preferential Trade Area Bank
SEC	:	Security and Exchange Commission
TB	:	Treasury bill
V	:	Value of Firm
WACC:		Weight Average Cost of Capital
WAN	:	Wide Area Network
YTM	:	Yield to Maturity
PPP	:	Public-Private Partnership

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OPERATIONAL DEFINITION OF TERMS.

Bond: A debt investment with which the investor loans money to an entity (company or government) that borrows the funds for a define period at a specified rate.

Benchmark: A standard against which the performance of a security, index or investor can be measured.

Chi square test: A test that fits the theoretical frequency distribution and frequency distribution of observed data for which each observation fall into one or several classes.

Commercial paper: Money market security issued by a large corporation to finance short-term projects/ expenditure

Corporate bond: Debt security issued by a corporation as opposed to those issued by government.

Coupon: The interest rate that the issuer pays to the bondholder.

Credit rating: Assessing credit worthiness of a corporation or individual or country.

Critical value: In statistics, value corresponding to given significance level-also table value defining the boundary point between rejection region and acceptance region of an hypothesis.

Efficiency (market): Bond prices reflecting all known information

Equity: Stock or any other security representing an ownership interest.

Floating rate: Interest rate that is reset periodically, monthly, quarterly, half yearly.

Investor: a person who purchases income-producing assets to be held for longer than a year.

Issuer: The entity, such as corporation or Municipality that offers or proposes to offer its securities for sale.

Liquidity: The quality of being readily convertible into cash.

Primary market: The market in which investors have the first opportunity to buy a newly issued security.

Private placement: Raising capital through a limited or specified number of investors

Regulators: The rule makers: Government, the Capital Market Authority (CMA) and the NSE management board.

Secondary market: A market on which an investor purchases a security from another investor rather than issuing corporation.

Security: An investment representing ownership of a bond or stock or the right to ownership (derivate). It can be assigned a value and traded.

Stock Exchange/ Bourse/ Open market: An exchange where professional stockholders conduct security trading.

Syndicated loans: A large loan that a group of bank work together to provide.

Tax shield: A reduction is tax income resulting from taking tax-deductible allowable expense.

Transparency (market): Buyers increased knowledge of supply pricing.

Treasury bill: A short-term debt security offered by the government.

Treasury bond: A long-term debt security offered by the government.

Yield curve: Graph showing relationship between yield to maturity (YTM) and term to maturity of a security or bond.

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CHAPTER ONE

1.0

INTRODUCTION

1.1 Background To The Study

1.1.1 Role of Capital Market

African countries, particularly those in sub Saharan Africa (SSA) remain the only developing region in which development assistance flows exceed s private capital flows (Omare,2008) this was attributed to lack of a well developed financial sector(such as capital markets, banks and other financial institutions) and the poor economic policies including incompetent institutions in African countries.

The capital market is a market for long-term business finance. It is required to finance major infrastructural projects like new equipment and plant expansion. Different securities are traced at the capital market. The choice of a particular security depends on the financial needs of a company. Toa large extent, the cost of capital also plays a major role. Commonly traded securities are, ordinary equity, preference, bonds, and rights, A balanced capital structure between equity and debt (long term) enable a firm to minimize the cost of capital. This occurs ideally at a level of 50% equity and 50% debt. It must be realized that whereas corporate taxes encourage debt financing since interest payments are tax-deductible expenses, increased debt increases business risk and introduces financial distress. Hence the cost of equity and debt for a highly geared firm is higher as bondholders and stockholders demand higher premiums to cover increased risk. If a firm has adequate debt capacity, then it should prefer debt financing as long as it is capable of making adequate profits and has a tax liability. Emergence of fixed income markets is a recent feature predominantly spread onward 1970 period. It is a market falling in between equity market and bank finance. It therefore suits the class of investors/borrowers who either are not considered high risk taking or act under

relatively safe parameters within bank finance (www.oppapers.com/essays/importance/)

Barkart, Garcia and Harvey (1995) asserted that capital markets play an important role in the economic development of emerging capital markets. They stated that well functioning markets ensure that corporations and investors get or receive fair prices for their securities. This ensures that valuable projects are financed while negative value projects will be rejected. Most importantly, integration into the world capital Markets will accelerate the growth process. "A country that elects to international participation will face a higher cost of capital" they indicated.

The liquidity, solvency and efficiency of the economic system of a country can be better accomplished by Capital Markets. Banks have been traditionally major sources of all types of credit particularly industrial credit. They are restricted from financing long term due to short term nature of deposits. Therefore the capital market beckons as the only major source of finance for industrialization and privatization. The existing state of this market thus requires transformation and structural change to improve confidence both local and foreign and to boost functions of the capital market as well.

In a debt capital market, trading involve both government and corporate securities. In major world capital markets, corporate debt capital constitutes about 50% of total domestic debt. Financing by debt through the stock market is better than through private placement or through syndicated loans by commercial banks. This is because the cost of debt is likely to be lower compared to banks if the market is efficient i.e. the market impounds all information to reflect in the prices. Debt securities are of different categories namely, Government securities (treasury notes and bonds), Corporate bonds (fixed, floating, and rate protected coupon

bonds), Municipal bonds, Subordinated debt structures, Asset backed securities, Islamic debt securities and other structured debt obligations.

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1.1.2 Nairobi Stock Exchange

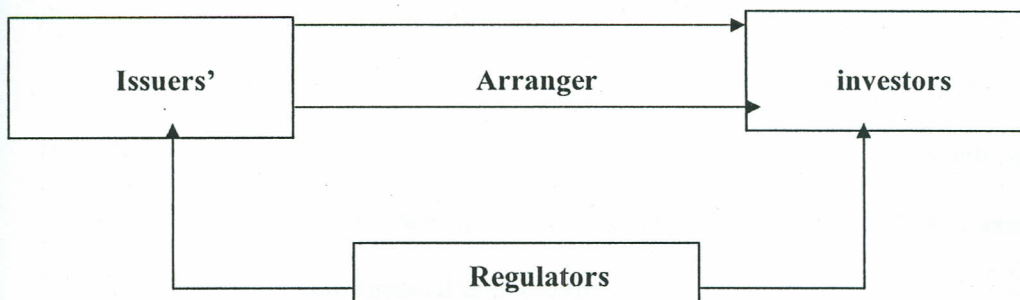
The Nairobi stock Exchange was formed in 1954. It began by trading in equity until the late 90's. In 1996 the market was opened to trade in debt instruments mainly government securities (Ouma (2007)). Corporate debt ventured into the market in the early 2000,(Ibid) .Celtel ,PTA bank and ShelterAfrique issued their bonds. Todate, only seven companies have issued bonds in the market. These are Faulu Kenya, Shelter Afrique , PTA Bank, Barclays Bank, Sasini Tea, East Africa Development Bank and Athi River Mining.

1.1.3 Role of the Nairobi Stock Exchange

The role of the NSE is to promote savings, employ idle resources, and promote higher standards of accounting, resource management, and transparency in management. Further, it provides a mechanism for liquidating investments and being a market for raising funds for development. Debt capital is becoming a critical source of capital for many companies, parastatals, governments and the financial institutions. This is because of high cost of issuing equity compared to debt securities. Rights issues in turn dilute the share price while reserves are assumed to be inadequate. Therefore it is desirable to develop our debt market to attract more private businesses instead of borrowing at higher rates of interest from commercial banks resulting from concentrated risk and market imperfection in the industry.

Among the reasons for developing a debt market (Essenburg ,2003) are; make debt investment capital accessible for intermediate and long-term finance ,more transparent pricing of credit risk ,diversify and dis-intermediation of commercial banking, wider variety of investible products for institutional investors, improve secondary market liquidity, Promoting economic stability and An impetus for fuller development of Africa's financial service sector. The bond market players comprise of the issuers on one hand, the investors on the other hand and the arranger as intermediary. The regulators govern activities of the market. These are the government, the capital markets authority, and the Nairobi Stock Exchange management.

Figure 1. Players in the Bond Market.



Source: Researcher (2010)

Issuers of bonds are governments, multinational corporations, large local corporations, and financial institutions. The reasons for issuing bonds are; diversification of funding base and increased stability of the capital structure, secure intermediate maturity funding for long-term projects and capital expenditure, mitigation against exposure to interest rate risk through rate protected instruments (caps, floor, swaps), foreign exchange risk. While funding costs relative to maturity tend to be cheaper than rolling over short term bank facilities, branding through market publicity impacts positively on organizations.

Investor base include, insurance companies, pension funds, asset managers, broker dealers and banks. They invest in bonds because of higher yield pick-up over government securities, diversification of investment portfolio to reduce overall risk profile, matching duration of assets and liabilities, to fulfill asset allocation criteria and to contribute toward development of the domestic capital market.

Regulators are, the government, CMA, and the NSE management. The government institutes macro -economic measures and a strong legal framework that create an enabling environment for market growth. The capital markets authority (CMA) ensures investor protection through supervision of securities industry. The stock exchange provides a market place for secondary

trading activity and approves the listing of new issues. Arrangers perform the functions in the primary market like advisory, arranger, underwriter, and structuring products. In the secondary market, they engage in market making, liquidity provision, research activity and post deal communication. Institutional investors are very critical to developing the debt market since they dominate trading. These investors include, pension funds, asset managers, insurance companies and financial institutions

To encourage participation, the government should maintain macro economic stability to contain volatility of interest rate and inflation rate, foreign exchange stability and develop a bond benchmark yield curve (Remolona, 2005). Restrictions by government on the pension funds on the amount to be invested and in what securities can be revised to promote participation by the international investor. Companies can raise capital to finance major expenditures through equity or debt or a combination of both. The most preferable mode of financing capital expenditure for public companies is debt. This is so because debt financing attracts investors at a lower rate of return, and the cost of issue is relatively lower compared to equity. Borrowers would find financing through debt less risky than through equity. Besides interest payments on debt is a tax-deductible expense, risks are spread compared to the alternative of concentrating the risk to a commercial bank (Goodfriend,2005).

However the bond market in Kenya especially in the open market is not well developed. Over the years since 2001, only a few firms like Preferential Trade Area (PTA) bank- 720million, Faulu Kenya-750million, East Africa Development Bank-1.134billion, Shelter Afrique-133million, Barclays bank-3000m, and Athi River Mining-800million and Sasini Tea-600million have floated Medium Term Notes (MTN) through the Nairobi stock exchange-(February,2009).Many of the listed companies at the exchange have shied away from raising

debt capital through the market. The performance of the bond market has been poor as witnessed by a decline of 18.75% from shs.40.1billion to a turnover of only Shs.34.1 billion in 2004. The Year 2005 witnessed the biggest decline in the turnover in the market of about 60.16% from shs.34.1 billion to Shs.11.59 billion. During this period, the economy of Kenya was growing while the debt market was not. This trend is curious and points to a problem in the market for fixed income securities and especially with regard to corporate debt securities (bonds).

The Nairobi stock exchange had 53 listed companies by February 2009 (www.nse.co.ke/newsite). These companies can utilize the bond market for debt financing. This would allow other companies both domestic and foreign to participate in debt issues in the market. The corporate bond segment of the market has remained quiet with only less than thirteen listings worth shs.44.5 billion for the last six years by Dec.2009. Compared to other emerging markets of Asia like Malaysia, and Singapore, this proportion is very small- at 10% of all debt issues in the market.

Therefore, it is this poor performance of the corporate bonds at the market that this investigation is to be carried to determine the possible causes by testing the hypothesis and to advise on what can be done to reverse the trend.

1.1.4 Importance of Corporate Bonds.

Kalu and Kishan (2009) argued that debt issuing firms experience significant reductions in both overall and systematic risks, and incur lower cost of capital following issuance compared to non-public debt issuers. This suggested deepening National debt Markets can be a fruitful financial market development exercise in emerging markets.

Bond Markets are important for reasons including, (i) Diversification of the financial sector into equity, debt and bank financing,(ii) Effective allocation of capital competition in financial sector,(iii) Support infrastructure development, privatization, securitization and the rise of new institutional investors requiring long term assets to match long term liabilities, (iv) Reduce currency, interest rate and funding exposure risks. (v) Allow more efficient allocation of savings by reducing banks role which also reduces the element of political interference.(vi) Allow borrowers to use capital tha is tailored to their assets and operations ,and lastly provide retail and institutional investors with several high quality and liquid domestic savings vehicles(www.oppapers.com/essays)

1.1.5 Corporate Bonds in Kenya

The Kenya government has developed an ambitious development plan that is designed to transform the country into a middle-income state by the year 2030. The plan has spelt out major investments in infrastructure; education, industry, information technology, water and health. It demands an investment of over Kshs. 500 billion over the next 20 years to actualize this goal. Therefore, the government will rely heavily on private sector support and partnership to realize the objective.

Corporate bonds offer the opportunity to finance this major investment by providing longer dated, unsecured financing. Indeed the government has successfully raised shs.18.5 billion in the last three weeks through this instrument and even achieved a 45% oversubscription by 18th February 2009 on the very first infrastructure bond in the country. The bond had a tenor of 12 years and a coupon rate of 12.5% with a redemption structure as 44% -6th year, 40%-8th year, and the balance to be repaid end of year 12. The private sector will compliment

government effort through this avenue. This capital will come from public borrowing through issue of infrastructure bonds, utility bonds, and construction bonds. It is this prospect that will enable the government fast track development at the pace necessary. Hence, new issuance should grow tremendously as it happened in Malaysia and china to meet the capital needs of the country. A target that 50% of the value of securities in the capital market be debt capital would be appropriate. This would include corporate bond issues locally and internationally. It is in the light of this that this study was conducted to determine if cost of issue, approval procedure, state of secondary market and transparency significantly influence corporate bond issuance at the NSE.

1.2 Statement of the Problem.

Corporate bond issuers at the Nairobi Stock Exchange have remained low, at about 10% of all issuers over the years since the market was launched in 1996 (Ouma, 2007). Government bonds have been dominating the market despite increased demand for debt financing which would occur at competitive interest rate, provide savings in tax liability and diversify risk and capital structure. As a result, there has not been savings in tax liability to would -be beneficiaries. Therefore, “Is the corporate bond market depressed due to the cost of issue, procedure for approval, state of secondary market and diminished transparency”? Besides, how important is credit rating, bond insurance and securitization in improving uptake of bonds in the stock exchange? This scenario contrasts with that of the emerging economies of Singapore, Malaysia and China where domestic debt is made up of 40% corporate securities (Guonan, 2006). Since Kenya wants to follow in their footsteps, then a study of how to improve bond market performance is necessary. This will increase liquidity, diversity, and enhance financial performance of issuers at the exchange. The financial meltdown that began in the second half of 2008 has depressed the equity markets so that debt instruments remain

the only steady investments in a plummeting financial market. The study aimed at providing an explanation as to why entry into the bond market by companies has been slow at the NSE.

1.3 Objectives of the study

1.3.1 General Objective

The general objective of the study was to establish whether the stated factors significantly retarded growth of the corporate bond market at the Nairobi stock exchange.

1.3.2 Specific Objectives included;

- i) Testing whether approval procedure significantly influence corporate bond issuance at the NSE.
- ii) Determining if a significant relationship exists between corporate bond issuance and the cost of issue.
- iii) Finding out if the state of the secondary market significantly determined issuance of corporate bonds at the exchange.
- iv) Establish if transparency and or disclosure of information was significantly influencing bond issuance at the bourse.

1.4 Research Hypotheses.

$H_0: O = E$

O-Observed

$H_1: O \neq E$

E- Expected.

Significance level =5%

- (i) H_0 : Approval procedure is not significant in promoting corporate bond issuance at the exchange.
 H_1 : Approval procedure is significant in promoting corporate bond issuance at the NSE.
- (ii) H_0 : The cost of issuing bonds is not a significant factor for issue of corporate bonds at

the NSE.

H₁: The cost of issuing bond is a significant factor issue of corporate bonds at the NSE.

(iii) H₀: The state of secondary market does not significantly influence corporate bond issue at the NSE.

H₁: The state of secondary market significantly influences issuance of corporate bonds at the NSE.

(iv) H₀: Corporate bond issuance at the NSE is not significantly influenced by the level of transparency at the exchange.

H₁: Corporate bond issuance at the NSE is significantly influenced by the level of transparency.

1.5 Significance of the Study.

The Capital Markets Authority (CMA), the Government, the NSE management, issuers and investors may therefore use these findings to reform and streamline the market operations especially with regard to this segment to turn around activity.

(i) The government shall on the basis of the outcome of this study formulate new laws to improve the performance of the bond market laws relating to bond trading, transparency and protection of issuers and investors.

(ii) CMA being the market regulator and supervisor must intensify its supervisory role and institute reforms to make the bond market more open and efficient through adoption of best practices, vetting the players and licensing new ones to enhance primary and secondary market dealership.

(iii) The NSE management board should be professionalized by ensuring that conflict

of interest does not interfere with the operation of the exchange. Demutualization is necessary to control information asymmetry and insider trading. Over the counter (OTC) platform for bond transaction should be promoted alongside electronic bond trading (EBT).

- (iv) Investors at the exchange have to increase their participation with the market becoming more transparent though real time information flow made possible through appropriate transaction communication system. Long run investments earn higher interest i.e. longer term debt securities. Therefore, the investing public should improve their portfolio of securities by including bonds for steadier returns.
- (v) Issuers of corporate bonds will have to consider public debt as cheaper sources of capital along with other attractive bond features under low interest regime. They can avoid risk concentration by diversifying their debt sources. Companies can offer a variety of debt securities structured to suit different investors risk appetite thereby improving uptake. Credit rating and bond mortgage should be considered necessary for quality issues.

1.6 Scope of the study/Delimitation

This study covered 53 listed companies and 19 stockbrokers at the exchange by Dec 2009. The companies cut across all sectors as main investment market segment- MIMS, alternative investment market segment -AIMS, and fixed income security market segment-FISMS. Categorization is on the basis of capitalization. Sampled companies provided a respondent each purposively selected. Finance officers were participating in this study in both cases.

1.7 Study Assumptions

The study assumed that;

- (i) Public companies do not face internal constraints when it comes to accessing external public debt resources.
- (ii) External factors are the drivers of corporate bond issuance at the NSE.
- (iii) Spreading of risk is preferred to risk concentration.

LITERATURE REVIEW

2.1 Introduction:

This section explores literature both empirical and theoretical that guided the study. It illustrates the conceptual framework of the study, operationalisation and summary of gap to be filled by the study. Documented literature shed light on how the identified factors influence issuance of corporate bonds at a securities exchange

2.1.1 Theoretical Review

Debt securities include commercial paper, treasury bills, bonds, and corporate bonds. Bonds are long-term debt securities that provide the bondholder a steady income, in form of interest (coupon) paid periodically and at maturity principal and interest is paid (Liaw, 2001). It is instructive to note that bond prices and interest rate are inversely related while coupon rate remain unchanged throughout the term of the bond. This is determined at the time of issue.

Debt financing is attractive to businesses because of the following reasons: First, that interest payment on debt is tax-deductible expense and therefore it reduces tax liability.

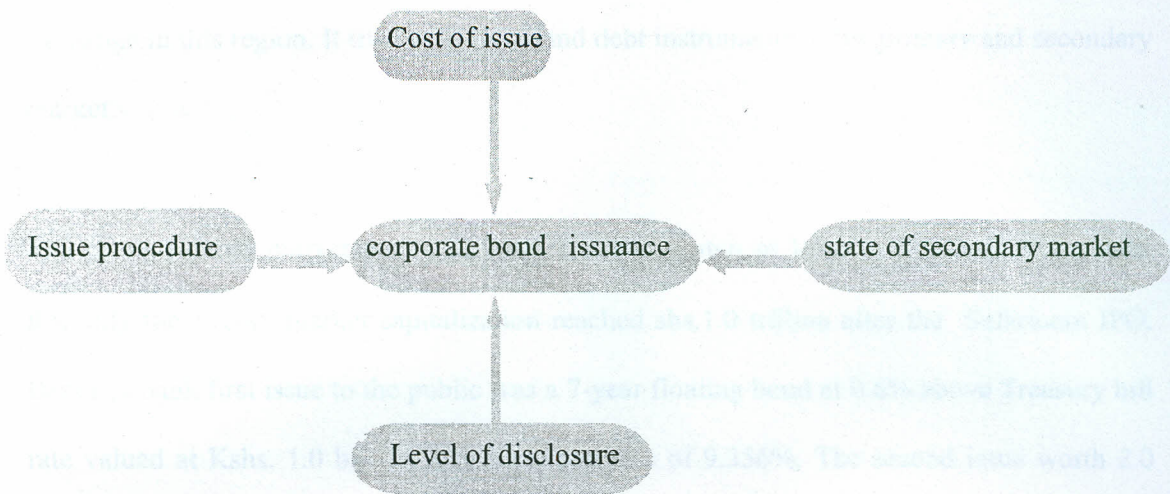
Secondly, an appropriate combination of debt and equity capital reduces the average cost of capital for firms. This is derived from the weighted average cost of capital (WACC) formula:

$r^* = (1-t) K_d D/V + K_e E/V$, also referred to as the adjusted cost of capital. Where, $(1-t)k_d$ is the after tax cost of debt, D/V is the proportion of debt in the firm's capital structure, and E/V is the proportion of equity in the firm's capital structure. $V(\text{firm value}) = E + D$.

Thirdly, according to Modigliani and Miller, (1958), debt increases the value of a firm above

that which is not levered by the amount of tax shield enjoyed. Demand and supply of bonds vary between short term and longer term bonds. Modigliani and Sutch (1996) argued that when long term treasury bond supply is higher than short term supplies, then expected returns on longer term treasury bonds must rise relative to short term securities return. They further asserted that patterns of corporate debt issuance respond elastically to differences in expected returns though no longer to the point of completely eliminating these return difference.

Figure 2: Variables Interaction in corporate bond issue.



Source: Researcher, 2010.

2.1.2 Empirical Review

The capital market is a market for accessing long-term capital to finance development needs of a country or organization (Brealey and Myers,2002). This market comprises of the commercial banks, the stock market and the specialized financial institutions. A public corporate bond market is important in fostering a credit culture, market discipline and observable benchmark for issuers, bond investors and other providers of capital. Between 1977 and 2004, the size of the Singapore corporate debt market expanded four fold, with the result that value of corporate securities outstanding is now about twice that of bank loans.

(Guanan ,2005). Singapore despite its small size, has made efforts to attract nonresident issuers in both local and foreign currencies as a way to enhance the size and depth of the corporate debt market.(Ibid)

Malaysia private debt securities (PDS) market is currently larger than the local government bond market accounting for over 80% of funds raised domestically compared with less than half in 1997 (Remolona , 2005). Nairobi stock exchange is an important securities exchange in East Africa. It was established in 1954 and has grown to become the most successful exchange in this region. It trades in equity and debt instruments in the primary and secondary market.

The primary bond market began in 1996 and has grown in leaps and bounds since then. Recently the overall market capitalization reached shs.1.0 trillion after the Safaricom IPO. Barclays bank first issue to the public was a 7-year floating bond at 0.6% above Treasury bill rate valued at Kshs. 1.0 billion with a coupon rate of 9.356%. The second issue worth 2.0 billion was fixed rate. Sasini Tea offered a fixed rate, 5-year bond at 10.5% coupon rate -600 million.The other listed companies with outstanding bonds at the exchange are ; Athi River Mining, marked at 1.75% above Treasury bill rate at 9.406%. These three companies out of fifty-three quoted are so far, the only ones that have ventured into this market for debt capital. The companies with bonds but not listed are; P.T.A Bank -Kshs. 1.8 billion, Faulu-Kshs.500million, Shelter Afrique -Kshs.200million and East Africa Development Bank-Kshs. 800 million.

The proportion of the bond market taken by the corporate bonds is about 2.0% at shs.7.7 billion. In sum the corporate bond issues are very few compared to issues in the newly

industrialized countries of East Asia like, Malaysia, Singapore and China where corporate bond issues are valued at over 40% of the debt market (Guannan , 2005).

2.1.3 Issuance procedure, Disclosure, Cost of Issue and Transparency.

Stanbic Bank Investment Director for East Africa , (Ngumi, 2008) attributed the low number of issues at the corporate bond segment to inefficiencies in the market in form of lengthy issuance procedures, disclosure requirements and high costs compared to commercial banks syndicated loans. Nairobi Exchange Chairman (Mbaru, 2008) on the other hand blamed poor performance of the corporate bond market on competition from commercial banks.

a) Issuance procedure

Procedure for issuing corporate bonds if made easy and fast would reduce interest rate risk and credit risk. A quick approval procedure encourages public debt to be as attractive as private arrangement. Therefore establishing clear standards and qualification rules to streamline the approval process is necessary for increased issuance of corporate bonds. By doing this, liquidity is increased in the secondary market as the primary market expands. Singapore reduced the period from 90 days to 14 days which resulted in the doubling of bond issuance from the private sector (UNESCA, 2007)

b) Cost of Issuing Corporate Bonds.

Costs are a disincentive in business. Therefore increased costs are likely to discourage issuance especially given that the market is competitive. Private and public issues are in competition hence needing low cost for issue. The cost relate to administration, legal, underwriting and listing fees. Competitive costs encourage liquidity and size of issues and thus narrowing the spreads between ask and bid prices. (ibid)

c) State of Secondary Market.

Corporate bond issuance significantly increases if the secondary market is active and liquid. Developing market infrastructure like electronic trading, delivery vs payment system, real time transaction reporting enhance transparency and disclosure necessary for attracting more issuers to the public issue. Primary and secondary market dealers are critical for pricing of corporate bonds. It is instructive to note that developing the secondary market also controls costs for issuers.

d) Transparency and Disclosure.

Levitt, (2003) to the house subcommittee on finance said that regulatory requirements for the securities exchange should be tailored to the specific qualities of each market. He stated further that enhanced transparency in the corporate debt market was necessary because it benefits the market, investor, and economy as a whole. This, he said would be achieved through market surveillance by the regulators. The market can use current technology to gather transaction prices, distribute them and interpret them in a timely accurate and efficient way. Transparency, which is the extent to which prices are visible and understandable to market participants play a fundamental role in promoting fairness and efficiency in the capital markets. Bond market prices should be transparent so that bonds can easily be valued but more so because market prices represent fair values. This is the markets way of allocating resources efficiently. Developing a database for transactions and a surveillance program for detecting fraud in the corporate debt market is the next logical step to take to improve investor confidence and liquidity in the market. (Levitt, 1999)

2.1.4 Benchmark Yield Curve.

The existing government yield curve enables companies to price bonds accurately by comparing the rate of return to the government benchmark. Therefore a longer tenor for treasury bonds (up to 20 years or more) would help companies issuing bonds to price them well and structure the instrument accurately. Commercial banks also require the risk free security YTM to determine an acceptable cost of credit. A stable yield curve is absolutely necessary for increased issuance of corporate bonds. Without an active secondary market, the yield curve would not be accurate and credible.

From the foregoing, it is apparent that in order to increase the number of issuers and investor in the debt market at the NSE, then a mechanism for improving transparency, disclosure, and distribution of information in real time must be undertaken. Open systems that reflect all known information should be adopted. This should also include providing hedging tools like swaps, Repos (Repurchase agreements), financial derivatives and market making. Clearing and Settlement system that utilizes the DvP system (delivery vs payment) to increase efficiency also becomes necessary.(Sundaresan, 2005).

2.1.5 Syndicated loans By Commercial Banks

Over reliance on commercial bank syndicated loans would easily exacerbate the fragility of the financial system (Philip, 2003). It is the financial sectors and especially the securities exchange that should be developed to make the financial system efficient, reliable and stable

2.1.6 Issuers and issue size.

More companies ought to be motivated to enter the bond market to increase size, depth and liquidity of the market. There should be more issuers, increased size of issues to improve

liquidity, a good mix of issuers from all sectors of the economy and a well structured debt instruments, proper regulatory and streamlining of operations and development of electronic clearing and settlement mechanisms to improve transparency and disclosure. A government bond benchmark yield curve already exists to serve this purpose. Inviting international investors and issuers can increase corporate issues. The bonds can also be denominated in local as well as foreign currency. A clean price system would be adopted to replace dirty price in the pricing of bonds since including accrued interest in dirty pricing distorts the true price of the bond.

2.2 Main Review of past studies done in the area.

The Kenyan bond market is characterized by fixed rate, floating rate and zero coupon bonds. Fixed rate bonds are associated with government securities while corporate bonds pay fixed and floating rate, that is, some percentage points above prevailing Treasury bill rate. Government bonds dominate the Nairobi stock Exchange possibly because they are risk free. In the policy brief titled 'Prospects for Developing a Regional Bond Market in East Africa' (IPAR,2003) concluded that countries in the region have not mobilized domestic resources fully and collectively. This situation continues to constrain the development of the bond market in the region.

Essenburg (2003) in his testimony also identified challenges of the debt market in Africa to include chronically high interest rates and inflation, lack of comprehensive market regulation, absence of intermediate maturity benchmarks (yield curve) and a credit rating culture, lack of deep investor base (non bank financial institutions), limited market liquidity, fear of the unknown by potential borrowers, and lack of financial strategy in companies. Reduction in regulatory impediments and enhanced coordination in Malaysia resulted in a surge in the debt

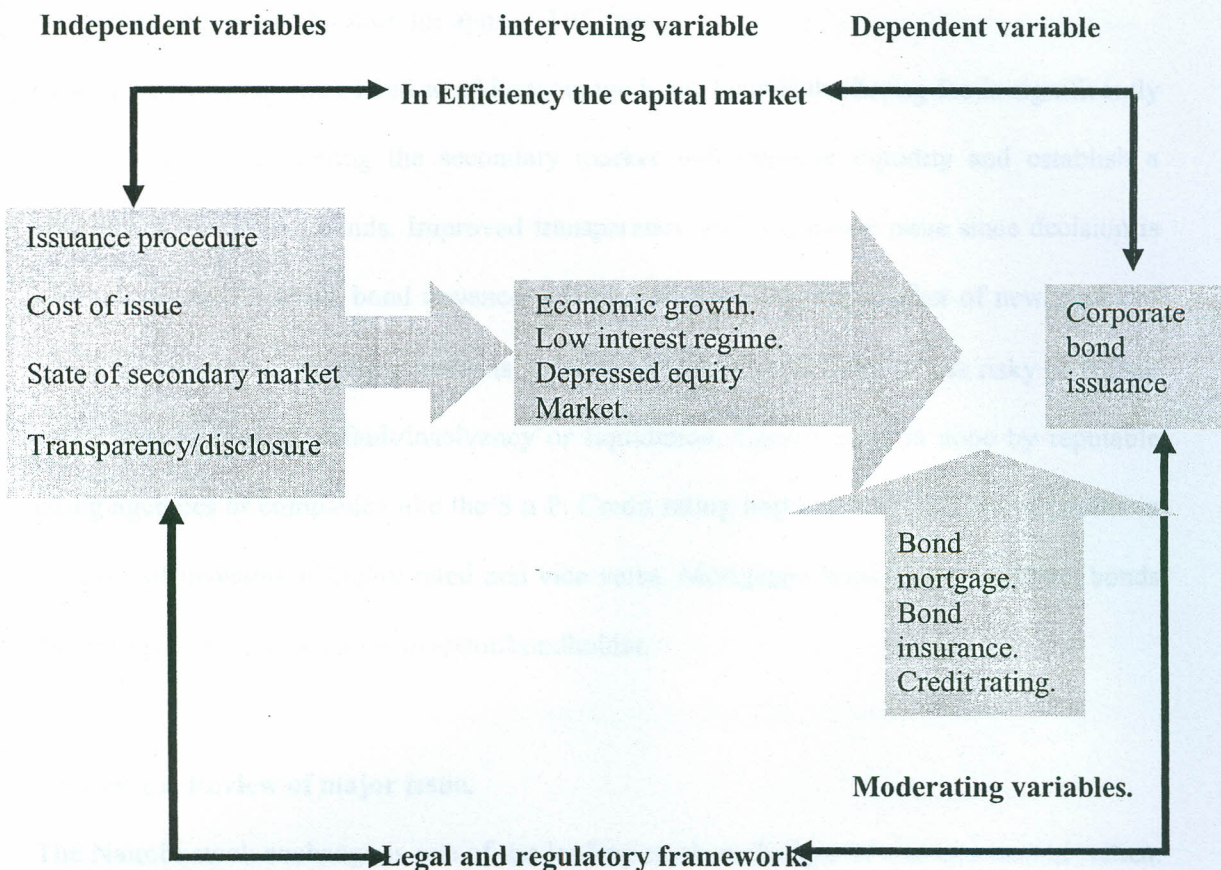
market -124 times between 1989 to 2004: the approval process was reduced from 9-12 months to a maximum of 14 days (Muhammad , 2005) .High interest rates on short-term securities and lack of disclosure by companies have limited the development of the bond market. This together with lack of a secondary market for bonds continues to depress the bond market. It is also apparent that reforms already taken by the capital market authority have not so far favored the primary bond market. Stringent legal, regulatory and bureaucratic procedures relating to listing of bonds, moral hazards and adverse selection (information asymmetry), competition from government bonds and high cost of issuance (taxation and listing fees) have constrained the full exploitation of the market.

Establishing a credit rating agency is also considered to be very necessary at enhancing investor confidence. Buyers and sellers should increase the number and types of bonds to improve participation. The interventions required include, measures to increase supply and demand for bonds, legal and regulatory measures to protect investors and issuers and measures to integrate Nairobi stock exchange with other stock markets in the region.

Source: Researcher (2010)

2.3 Conceptual Framework.

Figure 3.



Source: Researcher. (2010)

The study categorized the two main variables namely issuance procedure, cost of issue, state of secondary market and level of disclosure or transparency as independent variables. Corporate bond issuance is the dependent variable. Between the two, there is bond insurance, credit rating and mortgage bond acted as intervening variables to catalyse acceptance and therefore accelerate issuance. Capital market efficiency and the regulatory framework constitute the external factors nurturing the market. Capital market efficiency occur when information flow is easy and fast. Regulation by CMA and NSE ensure development of the market and protection of participants.

2.4 Operational variables.

Issuance procedure and duration would improve issue of bonds if it is streamlined and efficient to reduce the duration for approval of listing.

Cost of issue on the other hand would encourage bond issue if the listing fee is significantly reduced. While developing the secondary market will improve liquidity and establish a benchmark for pricing bonds. Improved transparency will encourage issue since decision is well informed. Corporate bond issuance will be determined by the number of new issues of bonds to the market. Bond insurance is securing of bonds to make them less risky or reduce actual loss in case of default/insolvency or liquidation. Credit rating is done by reputable rating agencies or companies like the S n P. Credit rating improves the position of issuers in the eyes of investors if highly rated and vice versa. Mortgaged bonds are securitized bonds that mitigate credit risk on the investor/bondholder.

2.5 Critical Review of major issue.

The Nairobi stock exchange is one of the leading stock exchanges in east and central Africa. It is better developed and has acquired some sophistication like the electronic trading system (ATS) and has expanded to cover a wide area (WAN). However the market cannot be said to be efficient enough without all the segments playing a significant role in its development.

Consequently, the market has not done well in the fixed income securities segment while the equity segment continuous to attract more investors. It would be very ambitious to expect the corporate bond market to grow in pace with equity market. This is because many companies have not been credit rated and therefore lacks an acceptable benchmark yield curve to help in pricing the bonds. Besides information disclosure in real time is also undermining investor confidence in bonds. The market therefore requires a transparent process to attract investors.

Long-term debt instruments should be encouraged as a way of borrowing for companies undertaking major capital expenditures. Companies will continue to stay away from the market because investor confidence in corporate debt instruments remains low. This is however a temporal situation that can be reversed by undertaking much needed reforms in the debt market.

Improvements in the market for bonds are to be measured by increased number and value of corporate bonds traded at the exchange over time. The purpose at this point is to increase the number of issuers of corporate bonds and to diversify the market so that it is deepened to improve liquidity. The market regulators should streamline operations of the exchange to make it competitive and efficient in this region of Africa. For example, listing requirements should be made easy. This should then be followed by establishing a benchmark yield curve and to enhance the electronic trading system to improve settlement time and transparency

2.6 Summary and gap to be filled by the study

Why corporate bonds are issued at the Nairobi Stock Exchange few? What is inhibiting issuance of these public debt instruments at the exchange? These are the questions the study was seeking answers to. It looked at the perception of the players in the market in regard to the identified factors considered responsible for the retarded corporate bond market. Consequently, the study recommends to authority how to diminish market impediments to promote issuance.

CHAPTER THREE

RESEARCH METHODOLOGY:

3.0 Introduction.

This chapter describes the research plan. It explains the study design, target population, sampling techniques, data collection methods and analysis techniques. How the objectives were achieved is indicated as the study findings are described and conclusions made.

3.1 Study design

This study design adopted for this study was descriptive and utilized inferential statistics in understanding the relationship among variables (dependent and independent). Inferential statistics is based on descriptive statistics and assumptions that generalize to the population from a selected sample (Maldonado, 2005). A 4*4 decision matrix was used to arrive at a valid conclusion regarding the hypothesis at 5% significance level. The hypothesis described all possible outcomes with respect to the inference (Trochim, 1984). The study outcome indicated the relationship between observed and expected value for cost of issue, procedure for approval, state of secondary market and level of transparency. "Are the few issuers of corporate bonds at the NSE due to the stated factors"? In this study, few issuers were directly related to few issues of corporate bonds.

3.2 Location of the study

The location of the study was Nairobi city where the NSE members and listed companies offices were found. NSE members are the stockbrokers transacting business at the exchange. This location was chosen because all the participants would be easily accessed for the study. Market regulators (CMA), managers of the exchange, and other players are domiciled in the city. The NSE trading floor is at the Nation house though with the automation, stockbrokers

work from their offices.

3.3 Target population

The population comprised of the 72 companies made up of 53 listed companies and 19 stockbrokers (members of the stock exchange by Dec, 2009). Appendix iv and v contains the list respectively. From all the firms, finance officers or managers were involved in the study. The two groups were considered important because one comprises the issuers (companies) while the others are the arrangers (stockbrokers). This was done to add value to what companies said.

3.4 Sampling Technique and sample size

A total of 61 firms were thus selected randomly from the fifty three listed companies and nineteen stockbrokers to make the sample size. The method applied was mixed lottery probability sampling without replacement. Sample size formula was;

$n = \text{sample size}$

$$n = N / 1 + N (e)^2$$

Where; $N =$ population size,

$$e^2 = \text{error margin} = 0.05$$

$$n = 72 / 1 + 72(0.05)^2$$

$$= 61.$$

Since the population comprised of two independent groups of different structure and size, a stratified proportional random sampling was adopted to determine the size for each group that participated in the study. However no stratification was made on the basis of the industries in which the different companies operate. This was done on the assumption that capital needs of all the firms were not related to the respective industries. This was worked out as under:

$$n_1 = 53/72 * 61 = 45$$

n_1 = sample 1,

$$n_2 = 19/72 * 61 = 16$$

n_2 = sample 2

Table 1. Sample Size Distribution.

	Population Size	Sample size
Listed companies	53	45
NSE stock brokers	19	16
Total	72	61

Source; Research Data, 2010.

A simple random sampling was done for each group to select the 45 and 16 members respectively. 61 respondents who were finance officers in the respective firms were identified purposively and questionnaires mailed to them with a return envelope.

3.5 Data collection instruments

The instruments used in this investigation were; semi-structured questionnaire and interview guide. 61 questionnaires were mailed to a respondent in each of the 61 units selected through a probability sampling process. Interviewees were five and their selection was purposive since the intension here was to enrich the study through expert opinion. Data triangulation through electronic searches was also made to improve internal and external validity. Many of the questions in both instruments are close ended for ease of tallying and analysis. Items measured opinion or perception on nominal and ordinal scales.

3.6 Data Collection Procedure.

The procedure for data collection was to mail questionnaires to respondents and in certain cases physically present the instruments to the selected respondents. This depended on convenience on my part in terms of time to be taken and ease of access. The respondents then filled in the questionnaires and mailed them back using return mail enclosed and in other cases, i collected physically from their offices. As for the interviews, I physically conducted a face-to-face interview that lasted about fifteen minutes each. The interviewees were located within the city of Nairobi. This exercise took a maximum of three days. A Lickert scale was used in the questionnaires to measure the strength of opinion regarding bond issues and the existing conditions. The range was between very significant to insignificant with respect to each stated factor. I collected all the 61 questionnaires through the mail back approach and follow up where I physically collected 15 questionnaires.

3.7 Data Analysis.

Qualitative data in this survey research comprised data collected from investment advisor and stockbrokers through face-to-face interview. The interview was semi structured to allow for probing of facts and figures. This provided a deeper and richer understanding of the challenges faced by our stock exchange especially will regard to promoting corporate bond issues. Information gathered and recorded was corroborated with that collected through questionnaire and other documented sources, and then analyzed to determine theme and pattern contained that directed concussion.

Analysis done here was inductive from the classification and tabulation of responses. Quantitative data was derived from the pre-designed questionnaire distributed to 61 respondents who were, finance managers or officers and stockbrokers of randomly selected

companies. One respondent from each company formed part of the sampling unit. The purpose here was to identify relationships among the main variables by utilizing descriptive and inferential statistics to test hypothesis. The main focus was on the stated factors that are considered to hinder corporate bond issue and listing at the exchange. A matrix table identifying the factors and the level of significance of these factors was used to enable easy response and analysis. On the basis of the responses, the hypothesis was tested using the chi-square test after generating a theoretical contingency table of expectations against which variations were measured. Calculated chi-square value was determined against the critical table value of 12.59 at 5% significance and 6 degrees of freedom for all factors. A comparative bar graph and proportional circles were used to present data obtained. Calculated chi square value χ^2 is derived from the formula;

$$\chi^2 = \sum \frac{(O_f - E_f)^2}{E_f} \quad \chi^2 = \text{Chi square distribution.}$$

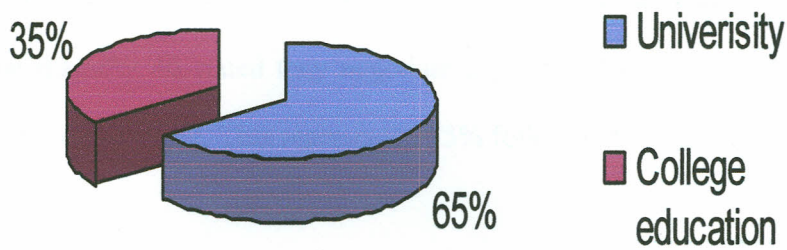
FINDINGS, ANALYSIS AND INTERPRETATION.**4.1 Introduction**

This study purpose was to test the hypothesis that the stated factors were impeding growth and development of the corporate bond market. The problem was that this debt capital market had not developed as fast as the equity market at the stock exchange. The question therefore was “are corporate bond issues few at the NSE due to market impediments in the form of issue procedure, cost, state of the secondary market and transparency”? Seventy questionnaires were sent out to each of the respondents-52 corporate officers and 18 stockbrokers over a period of one week. The results were then tested using chi-square independence test. 61 questionnaires were received comprising of 45 from listed companies and 16 from stockbrokers. The data was then organized, reduced and analyzed per item and hypothesis tested at 5% significance level. Data is then presented in charts, tables and graphs.

4.2 Education level

On the first score regarding education level of the respondents, 40 out of 61 had university education and the rest had college education. This represented 65% of those surveyed having had higher education. This factor was a dummy variable hence no significance test was done. They all held the position of finance officer in the companies they worked for.

Figure 4: Respondents education level.

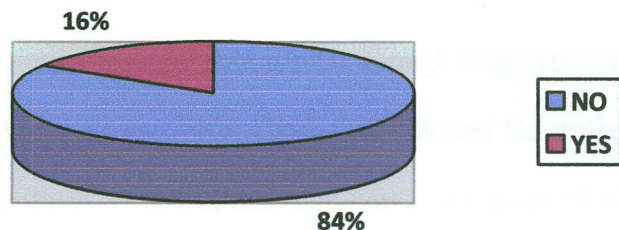


Source: Research Data (2010)

4.3 Public Debt Raised in the last 5 years

The respondents were also asked to indicate whether the companies they worked for had raised debt capital through corporate bonds in the last five years. 45 stated no while the remaining 8 indicated yes. This represented 84% of the total respondents. Out of those who stated yes, six (6) had done it once while only two (2) had raised debt capital from the stock market twice. Those that had not raised capital through the market had to skip this part of the question.

Figure 5: Has public debt been raised in the last 5 years?

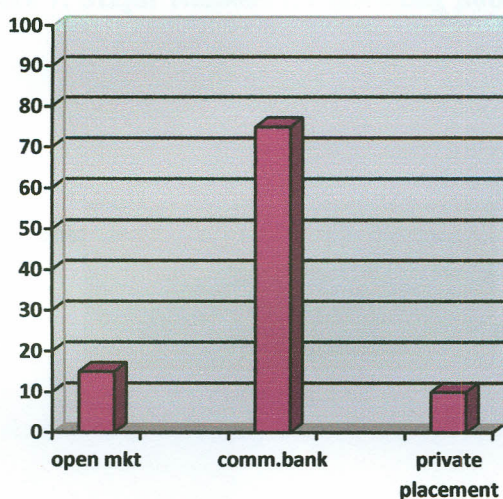


Source. Research data (2010)

4.4 Access to Long Term External Debt

The respondents were then asked where they access their long term debt finance. 8 indicated that they raised it from the open market, 5 raised their capital finance from private placement while the majority 40 stated they negotiate commercial banks syndicated loans to finance their capital expenditure. This represented 75% followed by NSE 15% and private placement (10%).

Figure 6: Source of Debt Capital (%)



Source: Research data (2010)

4.5 Debt Capital Preference

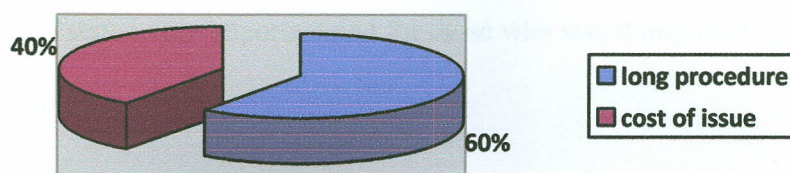
On the question on whether companies prefer external debt capital through corporate bonds, 48 respondents answered affirmatively while 12 stated No. Those that indicated No attributed their response to long procedure for approval 37 (60%) and high cost of issuance.25(40%) The market is considered a good source of cheaper capital which can be structured to suit various investors. Those that did not think the open market is a preferable source as it stands now attributed it to a lack of information about benefits of accessing these debt capitals

through these sources. See table and figure below.

Table 2: Preference for Public Debt.

VARIABLE	RESPONSE	PERCENT
YES	48	78
NO	12	20

Figure 7: Major Reasons for not using public debt market.

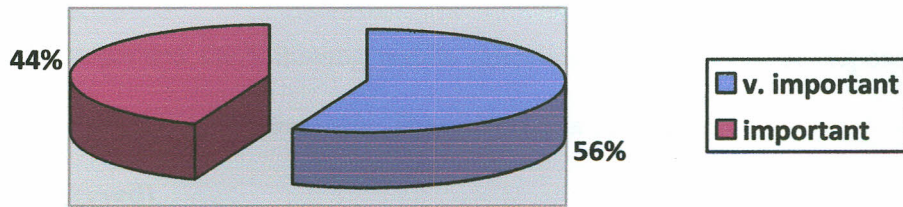


Source: Research data.(2010)

4.6 Importance of Stock Market

Respondents were also asked their opinion on how important the stock market is as a source of debt capital. Out of 53, 30 indicated the market was very important while 23 stated it is important. None of them stated no.

Figure 8: Importance of Stock Market



Source: Research Data (2010)

The main reason given for the response above was that the cost of credit is more competitive. Those who stated very important and for those who stated important gave risk spread as their main reason.

4.7 How to Attract Corporate Bonds to the NSE

Respondents were also asked to give the own opinion on what can be done to attract more corporate bonds to the stock market in Kenya. This open ended question was dealt with by noting the responses down on account of the theme. The main highlights captures were, one that companies need to be educated or sensitized on the benefits of raising capital through corporate bonds to add value to companies' liquidity requirements.

Secondly, the regulators should streamline procedure to make it easy and fast. Third, the cost of issue should be reduced to bring over more player/issuers since this constitute a significant portion compared to other sources like bank loans.

Lastly, respondents also noted that the market required development through a reliable benchmark yield curve and improvement in trading practices to increase transparency.

4.8 DATA ANALYSIS:

Factors behind Corporate Bond Issuance at NSE

Question 8 in the instrument was constructed as a 4x4 grid response item. The research hypothesis had identified four factors to be tested for significance against expected values. The grid table yielded the following results reflecting the frequency of responses of each factor across a four point interval scale. The summary is as follows:

Table 3 (Observed)

factor	V.Significant	Significant	Not quite sig	Insignificant	TOTAL
Lengthy procedure.	22	21	12	6	61
Cost of issue	19	23	14	5	61
State of sec. market	20	25	11	5	61
Disclosure/transparency	21	20	14	6	61
TOTAL	82	89	51	22	244

(Source: Research data, 2010)

Given that the last column yielded frequencies lower than 5, a regrouping of data in the table by margins, the last two columns by horizontal summation was necessary, so that a chi-square test can be comfortably used. This would make all the frequencies in the cells to be above 10 (Kothari C.R. 2002, pg 170).

Table 4: Regrouped (Observed)

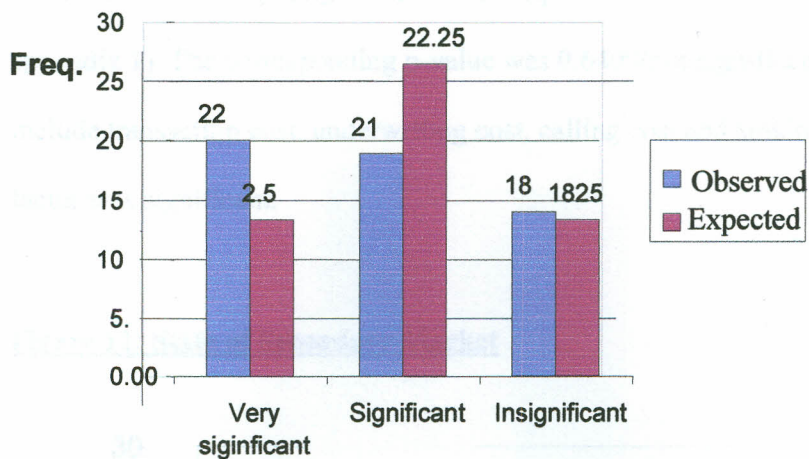
FACTOR	V.significant	Significant	Insignificant	total
Issue procedure	22	21	18	61
Cost of issue	19	23	19	61
State of sec. mkt	20	25	16	61
Disclosure level	21	20	20	61
total	82	89	73	244

Table 5: Expected value

factor	V.significant	Significant	Insignificant	total
Issue procedure	20.5	22.25	18.25	61
Cost of issue	20.5	22.25	18.25	61
State of sec. mkt	20.5	22.25	18.25	61
Disclosure level	20.5	22.25	18.25	61
total	82	89	73	244

Source: (Researcher, 2010).

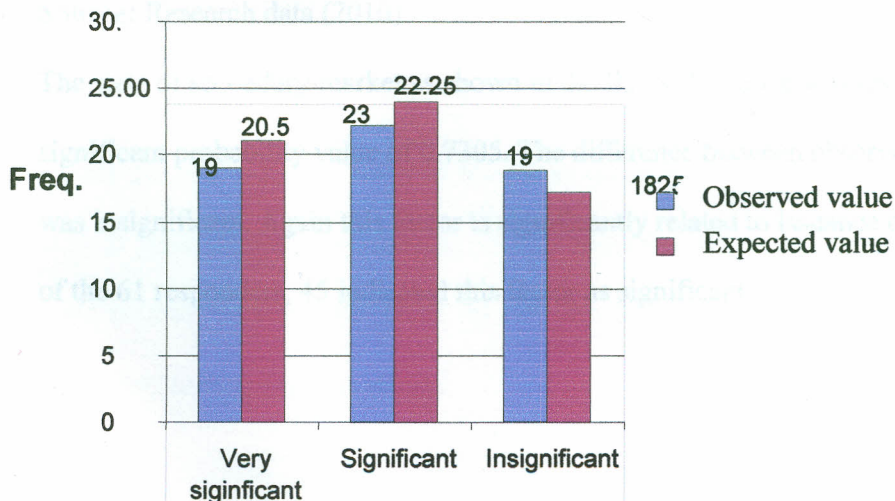
Figure 9. Issuance procedure



Source: Research data (2010)

Figure 8 above indicates observed and expected frequencies for issuance procedure with a chi-square value of 0.1824 and p-value of 0.9128 (see appendix 1). The difference between the two values was insignificant. Thus the factor is significant when issuing corporate bonds. More than half of the responders (43) were affirmative.

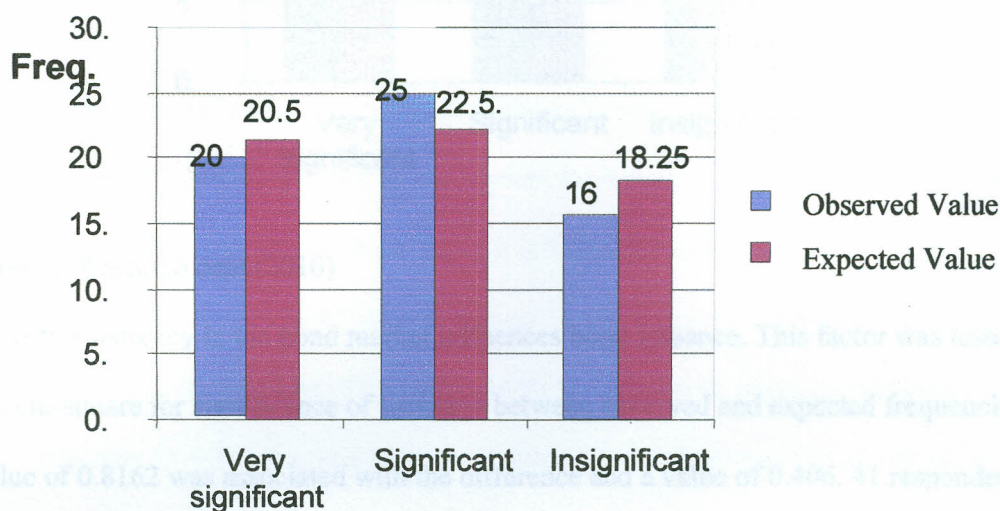
Figure 10: Cost of Issue



Source: Research data (2010)

Cost of issue was weighed against expectation as critical factor in the issuance of corporate bonds as shown above (figure 9). The chi-square test result returned a value of 0.8898 (see appendix 1). The corresponding p-value was 0.6408(not significant). Costs of issuing bonds include transaction cost, underwriting cost, calling cost and sinking fund. Therefore this factor was significant.

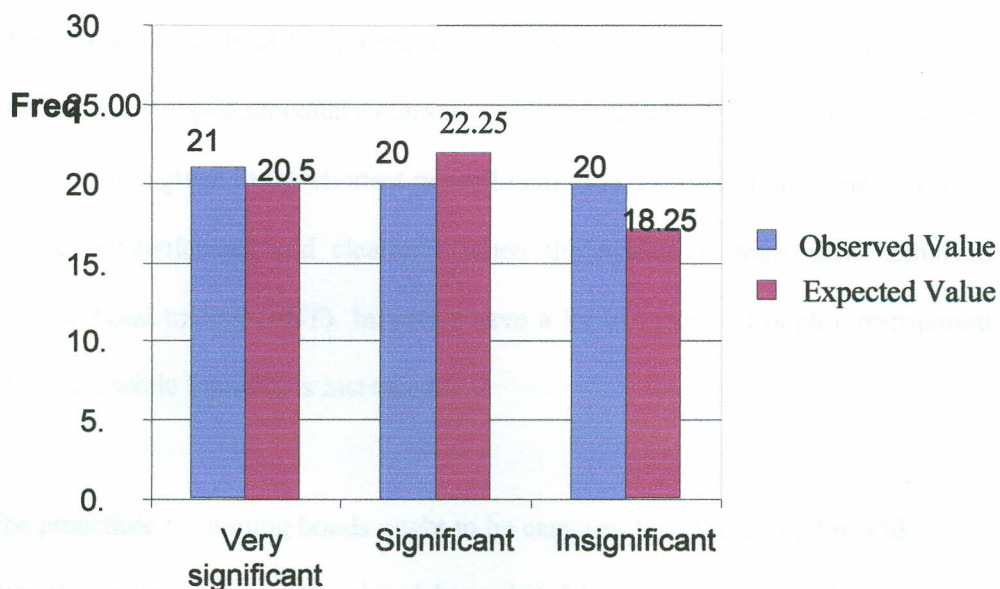
Figure 11: State of Secondary Market



Source: Research data (2010)

The state of secondary market as shown in the figure 10 above was tested and returned a not significant probability value of 0.7305. The difference between observed and expected values was insignificant. Again this factor is significantly related to issuance of corporate bonds. Out of the 61 responders, 45 indicated this factor as significant.

Figure 12: Transparency and Disclosure



Source: Research data (2010)

Price transparency in the bond market influences bond issuance. This factor was tested using the chi-square for significance of variation between observed and expected frequencies. A p-value of 0.8162 was associated with the difference and a value of 0.406. 41 respondents representing 67% thought this factor hindered issuance of corporate bonds at the exchange.

4.9 Discussion

Factor analysis done for the four factors to determine the relative importance indicated that cost of issue (factor 1) explaining 97% of the variation in the issuance of corporate bonds. This is consistent with the study by Edward, Hamis and Piwovar (2006). The state of the secondary market came in second.

Bond transaction costs are not well known because corporate bond market are not nearly as transparent as are equity market (Edward, et al 2006). Secondary transaction cost in the bond

market decrease with trade size. A bonds transaction cost are lowest when the bond is just issued and again when it is about to mature. The cost declines with increased transparency which stems from a developed secondary market. Transparency also improves efficiency for listing when approval is given in the shortest possible duration. Further improvements can be noted in transaction settlement and clearance when the system is transparent achieved through electronic bond trading (EBT). Investors save a lot of money through a transparent bond trading system while liquidity is increased.

Generally, the procedure for issuing bonds ought to be easy and fast. Ensuring this will reduce the overall opportunity cost of raising debt capital. Listing fees at the market was identified as a disincentive to business when it is high compared to bank credit fee. On the other hand, a vibrant secondary market is critical for purposes of liquidating investment to match the consumption pattern of investors. More so, this would also help price the bonds more accurately from the frequent trading of bonds. It was also noted that the level of disclosure at the market is considered paramount for issuance of corporate bonds.

Transparency cultivates confidence in the retail investors as accurate and timely information becomes easily and widely available. These results are consistent with the findings presented by Guonan and Remolona (2006) in the Kunming discussions on the *Corporate Bond Markets in Asia*. Turner, (2003) in his policy paper for a joint World Bank group conference on the future of domestic capital markets in developing countries also arrived at similar conclusions

It was apparent from the data that these factors have retarded the growth of the corporate bond market. A quick redress of the situation is therefore necessary to turn around the market. The findings indicated that the bond market is a preferable source of debt capital,

especially when interest rate on government securities of comparable tenor is low and the equity market is depressed. This source of capital would also encourage small and medium sized enterprises to use debt financing to grow their businesses. Debt instruments can also be structured to suit different investor needs. It emerged that a majority of companies have shield away because of the under developed state of the market at the time. Pricing of this debt instrument was a major impediment since a proper benchmark yield curve had not been constructed. With increased government bonds being issued with longer tenor, a reliable benchmark yield curve for pricing the instrument would be established.

Companies that avoided the open debt, market indicated that their main source of external debt capital was commercial banks followed by private placement. The reasons were mainly because it was easy to arrange for capital from these financial intermediaries. From this argument it indicates that having a system of quick approval for issuing companies would significantly promote the corporate bond segment of the stock market. Therefore, the capital markets authority (CMA) should improve procedure to make the process open and fast if more corporate bonds are to be issued. Cost of issue should be reduced to make the market more competitive.

When asked to propose measures for promoting the market, the responses revolved around the following:

- i) Educating companies of the benefits of raising capital through the market to spread risk and enjoy a more competitive cost of credit.
- ii) That issue requirements should be revised to make them attractive to many companies that include medium to large.

- iii) Cost of issue was also very prominent as an incentive to companies wishing to raise capital for expansion and growth.
- iv) Trading practices and platform also was mentioned as potential area that would attract more players to deepen the market and improve liquidity. The electronic bond trading platform that matches bids for buy and sell will take care of this. Electronic trading also increases transparency and disclosure requirements.
- v) That bond trading would also be significantly improved if the instrument is well structured to attractive various classes of investors with varied investment needs and time horizons.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter gives a summary of the study outcome in reference to the objectives and makes conclusion on the hypothesis and eventually outlining recommendation that can reform the bond market to make it a world class exchange.

5.1 Conclusion

The general objective of the study was to establish whether the factors were significant in impeding development of the corporate bond market at the NSE. The data collected supported the hypothesis that there was no difference between observed values and expected values. This means that the stated factors, namely issuance procedure, cost of issue, state of secondary market and disclosure are significant in developing the bond market especially the corporate bond segment at the Nairobi Stock Exchange. Any deviation noted was random and therefore statistically insignificant.

The general objective was to test at 5% level, how significant the stated factors were in attracting corporate bonds to the NSE. The findings from the data indicated that the factors were indeed significant to the market. Therefore these market impediments hold some answers to why the corporate bond market lags behind the equity market and other markets in Africa like South Africa and Egypt. Rapid response is required to promote the market by increasing the participation by issuers and investors.

5.2 Recommendations

As the economy develops, firms need to secure external funding in the form of direct finance from the corporate debt and equity markets. Multiple financing channels that include commercial bank credit, private placement, internally generated funds and public debt, improve firm's capital structure, promote competition and encourage innovation. Besides, financial system is cushioned against shocks by a properly functioning corporate bond market. The beneficiaries of this study are; the public companies in Kenya, the CMA, NSE management and stockbrokers, policy makers, institutional and retail investors in Kenya and abroad.

- Public companies in Kenya should access debt capital easily and fast if the market is well developed and with adequate incentives for more issues of bonds and increased size of issue. Illiquidity in the secondary market can be improved through developing the trading infrastructure –electronic bond trading (EBT). A shorter duration (up to 14 days) for listing would compete favorably with other sources especially commercial banks. Companies must consider raising debt capital from the public because it is cheaper to obtain and easier to structure to suit the needs of investors both retail and institutional. A reduction in the concentration of risk will stabilize the capital market.
- The government should on its part encourage growth of the market by taming the macroeconomic fundamentals so as to reign in the interest rates while also deepening the market by offering longer term bonds to develop the benchmark yield curve which is the pricing standard.
- The CMA which is the market regulator must intensify its supervisory role in the market to protect investors and issuers. The regulator must embrace best practice improve its information gathering ability and disseminate critical information in real time.

- The NSE management and stockbrokers have a chance to deploy best practices in the industry by ensuring that ethical standards are maintained when dealing with clients. By so doing confidence will return to the market from the reluctant investor. They have to enhance efficiency in the market by making critical information available through the adoption of appropriate technology and elimination of conflict of interest. Attracting investors –big and small remain their number one priority. Policy makers have to enact laws that will protect the investor and the borrower from breach of contract. The judicial system will have to be efficient, fair, and just to litigants who seek legal redress. Pension institutions should be allowed to invest in both short and long term securities to increase liquidity.
- To investors, institutional and retail, the stock market is to be a preferable source of debt capital for all their investment needs. Deepening the market will require that products are well structured to suit the needs of a variety of investors. Pension funds, insurance companies, commercial banks and fund managers are institutional investors whose risk—return need vary with the time horizon. Retail investors include high net-worth individuals and small investors. These categories of people also have different consumption patterns hence investment needs.

An emerging corporate debt market like the Nairobi Stock Exchange suffers from illiquidity especially in the secondary market. This can be improved through developing the trading infrastructure to encourage more institutional investors to the market, take an active trading role to improve liquidity. This is also tied to the quality of issuers on the supply side. It was noted that the quality of issues can be increased through mortgaging the bonds, credit rating and bond insurance. These are intervening measures that improve quality of bonds so that more retail investors as well as institutions would take an active position in the market. The

CMA would greatly benefit from increased number of issuers and size of issues since the cost would be brought down and volumes increase. The retail market for bonds would thrive if there is enhanced transparency, a sound legal framework and the availability of hedging instruments for investors. These measures will diminish risks.

The secondary market for bonds should be developed both for cash transactions and derivatives while domestic and foreign investors and issuers encourage to participation in local and foreign currencies. The NSE should also develop a liquid government benchmark yield curve that is very essential at pricing the bonds over the term of the instrument. Secondary corporation bond spread helps banks access mark-to-market (MTM) loan position. The approval process for corporate issuance can be reduced to a maximum of 14 days. This is an important reason that would make this capital source attractive to potential issuers. The shorter the approval period, the more preferable the source is for companies. Credit derivatives are also important for the development of corporate bonds. Credit Default Swaps (CDS) markets are important for corporate bond and loan markets.

The Basel II Capital Treatment framework will encourage banks to seek credit derivatives to hedge excess exposure to certain credits, and may reduce crowding out in BB-rated credits. Accounting rules should match assets to liabilities to create capital market activity in long term agency, municipal and corporate bonds. (Remolona, 2005) MTM accounting tends to promote transparency and enhance market liquidity, since investors are better informed about the fair value of bonds, and have a greater incentive to trade than hold to avoid realizing losses (Guonan ma, et al, 2005). Transparency lowers transaction costs dramatically. US securities and Exchange Commission (SEC) used to trade reporting and compliance Engine (TRACE) system that require over the counter (OTC) trade in corporate bond be reported

within 15 minutes of the transaction (1 bid). Post trade transparency benefits investors and helps regulators with their oversight responsibilities (Edwards, Harris, Piwowar (2006).

It is of great importance that the government bond market is first developed to guide the debt market. The yield curve can best be developed using government bonds, transparency enhanced through information dissemination which is accurate and timely and user friendly. In central bank therefore can participate in appointing market makers and encourages and ensure sound custodian and payment system. Technology can greatly benefit the market by ensuring that trading; payment and settlement system is electronic thus making the market transparent, cost effective, with improved liquidity and deepened. Primary and secondary market makers will also assist in pricing the securities thus enable investor and insurers transact on an open platform devoid of many risk inherent in the market today.

5.3 Further Research

From this study, it is noted that while the bond market is dominated by institutional investors, the retail market comprising individual investors is very small. This contrasts with what is happening in other emerging markets of Asia. While it is appreciated that minimum investment capital has been reduced from one million to sh.100, 000, the composition of retail individual investors is very small. It is therefore necessary to investigate how the retail sector can be made to increase participation in this market as opposed to a few high network individuals.

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Appendix I

Factor Analysis Results for:

Variable Range = Sheet1!\$L\$1:\$O\$5

Factors were extracted by the Principal Component method

from the correlation matrix

All factors with eigenvalues > 1 were extracted

Descriptive Statistics

Variable	Mean	Std Dev.	Std Err	N
ci	15.250	7.632	3.816	4
ip	15.250	7.762	3.881	4
ss	15.250	8.958	4.479	4
dt	15.250	6.898	3.449	4

Correlation Matrix

	ip	cs	ss	dt
ci	1.000	0.950	0.959	0.986
ip	0.950	1.000	0.977	0.963
ss	0.959	0.977	1.000	0.937
dt	0.986	0.963	0.937	1.000

Explained Variance (Eigenvalues)

Value	Factor 1	Factor 2	Factor 3	Factor 4
Eigenvalue	3.886	0.078	0.036	0.000
% of Var.	97.153	1.944	0.903	0.000
Cum. %	97.153	99.097	100.000	100.000

Communalities

Variable	
ci	0.976
ip	0.973
ss	0.965
dt	0.972

C i=cost
of issue

Unrotated Factor Loadings

Variable	Factor 1
ci	0.988
ip	0.987
ss	0.982
dt	0.986

SUMMARY OF TEST RESULT

<u>Factor</u>	<u>Chi-square value</u>	<u>D.F</u>	<u>P-value</u>
a) Approval Procedure	0.1824	2	0.9128
b) Cost of issue	0.8898	2	0.6408
c) State of secondary market	0.628	2	0.7305
d) Transparency/Disclosure	0.406	2	0.8162

Source: Research data. 2010.

All Probability values are > 0.05 .

APPENDIX II

TIME SCHEDULE

January 10, 2010-April 25, 2010

WEEEEK 1 and 2:	Distribution of questionnaires to the 34 sampling units: Three units to be supplied per day.
WEEK 3:	Conducting interviews in three companies and two stockbrokers.
WEEK 4 and 5 :	Collection of questionnaires from respondents .
WEEK 6 and 7:	preparation of data, classification and analysis.
WEEK 8 and 9:	Organization of findings and writing of project report
WEEK 10:	Type setting the project report.
WEEK 11-12:	Submission of final project report to my supervisor Mr. Ndede F. of the department of finance and accounting ,kenyatta university.

APPENDIX III

BUDGET FOR PROPOSAL DEVELOPMENT AND SURVEY RESEARCH.

SHS:

A. (i)	Typesetting @ shs 30.00 *48.....	1440
ii)	Photocopy @ shs.2.00 * 48p(one copy).....	96
	6 copies @ shs 96 * 7.....	672
(iii)	Spiral binding @ shs.40*7.....	280
	Transport and miscellaneous	<u>1500</u>
	Subtotal	3988

B. Pilot Study -6 days

i)	10 copies of questionnaire @ Shs. 10.....	100
ii)	Transport and miscellaneous.....	1800
iii)	Accommodation @ shs.1000 per day.....	<u>6000</u>
	Subtotal	7900

C. Data Collection:

(i)	75 copies of questionnaire @ shs 100	700
(ii)	Travelling and miss. @ shs.300 per day for 30 days	9000
(iii)	Accommodation @ shs.5000 per month for 3 months	15000
(iv)	Subsistence @ shs. 6000 per month * 3 months.....	<u>18000</u>
	Subtotal	42700

D. Data Analysis:

i)	Stationary.....	1000
ii)	Computer use.....	5000
iv)	Travelling and misc.....	<u>3000</u>
	Subtotal	9000

E. Production of final Report:

i)	Typesetting @shs 40 * 50pages	2000
ii)	Phottocopy, 7 copies *100.....	600
iii)	Spiral Binding @ shs 40 *7 copies.....	280
(iv)	Transport and misc.....	1500

Sub total 13380

Grand total 76968

To Whom It May Concern;

REF: MR. NTA MORARA BULLA
NO. D53/13277/05

It is to confirm that the above named is a master of business Administration MBA (Finance) Student in the department of Business Administration in the school of Business, Kenyatta University.


He is doing his research with course work. He has defended his research paper proposal and has been given all the necessary clearance to carry out the research in the name of the University of the project.

He is now embarking on research for his Masters degree paper and is in the process of collecting data.

Please allow him to do research and data collection.

Any assistance accorded to him will be much appreciated by this office.

Yours faithfully,


ISAAC LOKORIS
ICR/MEA COORDINATOR



**KENYATTA UNIVERSITY
SCHOOL OF BUSINESS
MBA COORDINATION OFFICE**

**P.O. Box 43844
NAIROBI
KENYA**

**10th August 2009
Tel: 810901-19 Ext. 500**

To Whom It May Concern:

Dear Sir/Madam,

**RE: DENNIS MORARA BULLA
REG. NO. D53/13277/05**

This is to confirm that the above named is a master of Business Administration MBA (Finance) Student in the department of Business Administration in the school of Business, Kenyatta University.

He is through with course work. He has defended his Masters degree proposal successfully and has done all the corrections that were pointed out by the examiners during the defence of the proposal.

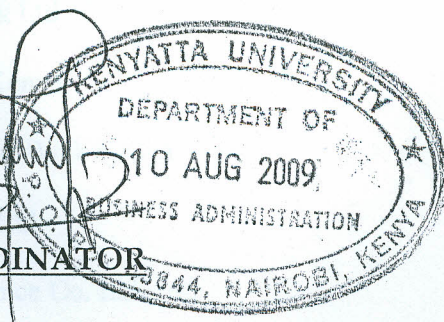
He is now embarking on research for his Masters degree project and is in the process of collecting data.

Please allow him to do research and data collection.

Any assistance accorded to him will be much appreciated by this office.

Thank you.

**ISAAC LOKERIS
FOR: MBA COORDINATOR**



APPENDIX V

LIST OF QUOTED COMPANIES AT THE NSE as at Nov 2009.

AGRICULTURAL

1. Kakuzi Ord.
2. Rea Vipingo plantation LTD
3. Sasini Ltd ord

COMMERCIAL AND SERVICES

4. Access Kenya Group
5. Car & General (K) Ltd
6. CMC Holdings Ltd Ord
7. Hutching Bierner Ltd Ord
8. Kenya Airways Ltd
9. Marshall (E.A) Ltd Ord
10. Nation Media Group
11. Scangroup Ltd
12. Standard Group
13. TPS Eastern Africa (Serena) Ltd
14. Uchumi Supermarket Ltd * (suspended)

FINANCE AND INVESTMENT

15. Barclays Bank Ltd
16. C.F.C Bank Kenya
17. Diamond Trust Bank Kenya
18. Equity Bank Ltd
19. Housing Finance Co. Ltd

20. Centum Investment Company Ltd
21. Jubilee Holdings Ltd
22. Kenya Commercial Bank Ltd
23. Kenya Re-insurance Corporation Ltd
24. National Bank of Kenya Ltd
25. NIC Bank Ltd
26. Pan Africa Insurance Holding Ltd
27. Standard Chartered Bank Ltd

INDUSTRIAL AND ALLIED

28. Athi River mining
29. B.O.C Kenya Ltd
30. Bamburi Cement Ltd
31. BAT Ltd
32. Carbacid Investment
33. Crown Berger ltd
34. E.A Cables Ltd
35. E.A Portland Cement Ltd
36. East African Breweries Ltd
37. Eveready East Africa Ltd
38. Kenya Oil Co. Ltd
39. Kenya Power and Lightning
40. KenGen Ltd
41. Mumius Sugar Co. Ltd
42. Olympia Capital Holdings Ltd
43. Sameer Africa Ltd

44. Total Kenya Ltd

45. Unga Group Ltd

ALTERANTIVE INVESTMENT MARKET SEGMENT

46. Baumann & Co. Ltd

47. City Trust Ltd

48. Eaagads Ltd

49. Express Ltd

50. Williamson Tea Kenya Ltd

51. Kapchorua Tea Co. ltd

52. Kenya Orchards Ltd

53. Limuru Tea Co. Ltd

APPENDIX VI

STOCK BROKERAGE FIRMS

Drummond Investment Bank Limited	Dyer & Blair Investment Bank Ltd	
Nyaga stock brokers ltd.	Ngenye Kariuki & Co. Ltd	Suntra Investment Bank Ltd
Reliable Securities Ltd.	CFC Financial Services – Stock Broking Division	Bob Mathews Stockbrokers ltd
Afrika Investment bank Ltd	Crossfield Securities Ltd	Sterling Securities Ltd
Apex Africa Investment Bank ltd	Faida Securities ltd.	Solid Investment Securities Ltd.
Standard Investment Bank Ltd	Kestrel Capital (EA) Limited	Discount Securities Ltd.
African Alliance Kenya Securities	Renaissance Capital (Kenya) Ltd	

APPENDIX VII (a)

This Questionnaire is to be filled in by Finance Manager/Controller/Officer. Please fill in all the parts of the questionnaire clearly and honestly. This shall help me do a proper analysis for the research topic on corporate bond issuance at the Nairobi Stock Exchange. After completing mail it back to me in the self addressed envelope.

QUESTIONNAIRE

1) Name of company.....

2) Job title

3) Education level

i. University ☐

ii. A-level ☐

iii. Secondary ☐

iv. Primary ☐

4. (a). Has the company raised long term debt through bonds in the last 5 years?

i. Yes ☐

ii. No ☐

(b) If Yes, how many times has debt capital been raised in the 5 years? Check one.

i. Once ☐

ii. Twice ☐

iii .Three times ☐

iv .More than thrice ☐

5. Where does the company raise its Long-term debt finance? Check one

i .Open market (NSE) ☐

ii. Private placement ☐

iii. Other, specify main

reason.....

.....

6. (a) Do you think companies prefer debt capital through corporate bonds at the stock market? ☐

i. Yes

ii. No ☐

b) If No, why? Briefly explain.....

.....

7.) a) How important is the stock market as a market for sourcing debt capital? Check one.

i. Very important ☐

ii.Important ☐

iii.Not important ☐

b) Give reason for your answer

above.....

.....

8. Please, indicate by a tick (✓) how significant the following factors are in attracting long-term debt securities to the Nairobi stock Exchange by companies.

FACTOR	Very significant	Significant	Not quite significant	Insignificant
a) Lengthy issuance procedure				
b) Cost of issuing income security in the open market.				
c) Under developed secondary market				
d) Diminished transparency & disclosure				

9) In your opinion, what can be done to attract more corporate bonds to the stock market in Kenya?

.....

.....

.....

APPENDIX VII (b)

Interview schedule.

1. a) Name of interviewee.....
b) Profession.....
c) Education level.....
2. Do you think companies prefer borrowing through corporate bonds as a source of debt capital in our stock market?
3. Why has the market failed to attract more corporate bonds?
4. What alternative do companies have for debt financing?
5. How important is the stock market as a market for sourcing debt capital and why?
6. What should be done to attract more corporate bonds to the stock exchange in kenya?
7. How significant are the following factors in attracting corporate bond issuance at the Nairobi Stock Exchange. Use the scale; very significant, significant, not quite significant and insignificant.
 - i. Issuance procedure.....
 - ii. Cost of issue.....
 - iii. State of secondary market.....
 - iv. Transparency/level of disclosure.....