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DETERMINANTS OF EQUITY PRICES AFTER INITIAL PUBLIC OFFER (IPO) OF QUOTED COMPANIES IN NAIROBI SECURITIES EXCHANGE (NSE)

BY

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A Research project submitted for the Degree of Master of Business Administration (Finance Option) in the School of Business of Kenyatta University.

NOVEMBER, 2012

DECLARATION

I declare that this research project is my original work and that it has not been presented in any other university or institution for academic credit.

Signature _____ Date 25/11/12

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DEDICATION

This research project is dedicated to my dear parents **Mr. & Mrs. Kithinji** , brothers and sisters who have been a source of inspiration and support both financially and morally and their strong held believe in education.

Regards to my dearest fiancé **Martin Gatheru** for his continued support and encouragement.

ACKNOWLEDGEMENT

This study is due to the almighty God who gave me the courage to face the challenges in getting the information needed for the study. I would also like to acknowledge my supervisor **MR.THUO** for his guidance, patience and encouragement during my proposal writing period, without which the proposal would not have been successful.

ABSTRACT

Market reacts differently to various factors ranging from economic political, and socio-cultural. The stock prices of quoted companies in Kenya are affected either positivity or negatively by a number of factors occurring within or without the economic system. The paper intended to examine the impact of Dividend per share, foreign exchange rate, Earnings per share, Gross Domestic Product (GDP), Lending/Interest Rate (INT) and Inflation Rate (INF) on stock prices of quoted companies in NSE. IPOs are often issued by smaller, younger companies seeking the capital to expand, but can also be done by large privately owned companies looking to become publicly traded. The initial public offering (IPO) is a vital step for young entrepreneurial firms, providing them access to the public equity market for the first time. Previous literature had focused primarily on IPO under pricing phenomenon to measure the performance of companies. However, researchers argued that IPO pricing, which was a key factor in under pricing had remained relatively unexplored in literature. The study employed descriptive research design. The study targeted a total population of quoted companies in Nairobi security market which had gone public for the last 10 years. The study depended on secondary data collected from the Nairobi Securities Exchange. In addition, questionnaires were used to get further information from company executives. Data was analyzed by the use of SPSS. Data was presented in frequency tables and percentages, graphs and charts. The findings of this research would be beneficial to various stakeholders such as investors, companies, policy makers, underwriters.

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DEFINITION OF TERMS

Risk: the loss that is incurred as a result of fluctuation of share prices.

Excess return: buy or hold returns that are in excess of the return on a market performance gauge such as the NSE 20- share index.

Information: anything which, when known, will cause share price to rise or fall. It must not be related to anything previously known.

Pricing efficiency: ability of the stock market to adjust share price rapidly and accurately to the release of economically significant information.

LIST OF ABBREVIATIONS

CMA - Capital Market Authority

IPO – Initial Public Offer

NSE - Nairobi Securities Exchange

EPS- Earning per share

DPS- Dividend per share

INF- Inflation

FX- Foreign exchange

GDP- Gross Domestic Product.

ER – Exchange rate

LR-Lending rate

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study.

The initial public offering (IPO) is a vital step for young entrepreneurial firms, providing them access to the public equity market for the first time (Lewellen (n.d). Indeed, it is the first sale of stock by a private company to the public and the consequential listing on a stock exchange. Going public allows firms to raise and access funds necessary to accelerate growth in order to achieve market leadership (Ernst and Young, 2010). In addition, the liquidity created by going public provides initial inventors, owners, founders and (or) shareholders with an opportunity to collect on their investment. Furthermore, an IPO can facilitate future acquisitions, higher valuations, debt reductions and public profile enhancement (Blum, 2011)

Recent research looked at the pricing mechanism used at the IPO.

According to (Kipngétich et al 2011), Initial Public Offerings (IPO) involve problems regarding price discovery due to uncertainties regarding aggregate demand and the quality of the issuer. Bensveniste and Spindt (1989) argue that issuers can feign themselves to investors as being of high reputation than they are. Derrien (2005) concurs that pricing of IPOs can be an uphill task due to obscurity of discovering an appropriate comparable firm.

Research available mainly in developed countries has documented the extent of under pricing of IPO's without identifying the main factors involved in setting the IPO offer price. Many researchers (Cornelli, 2004; Ljungqvist, 2006 and Purnanandan and Swaminathan, 2003) have presented evidence that IPOs are under priced. Under pricing refers to the percentage difference between the offer price and the first day

closing price (Paleari and Vismara, 2007). Under pricing is a loss to the issuing firm because it is a loss of money that could be utilised for profitable investment opportunities.

This phenomenon contradicts one of the major purposes for companies going public, which is to raise funds to support expansion of the firm. In addition, it also contradicts efficient market hypothesis, which postulates that security prices fully reflect all publicly and privately available information. As compared to developed markets the number of companies going public in Kenya was low.

Corwin, (2003) identifies uncertainty and asymmetric information as a strong influence on a firm's equity pricing and as a matter of fact lead to under-priced instrument. The market is information-sensitive. Easley, Hridkjaer and O'Hara (2001) agree that market is information sensitive at least to the extent that insider information affect equity returns and advised that it should not be ignored for efficient asset pricing, Kang (2008). The factors affecting the price of an equity share can be viewed from the macro and micro economic perspectives.

1.2 IPO Pricing in Kenya

In Kenya, 2008 it looked as though Kenya's stock market might continue its bull run of recent years. But listed equities on the Nairobi Stock Exchange (NSE) inevitably took the same downward slide as the rest of the world - although not necessarily for all the same reasons. The result was a 35% drop in the NSE's benchmark index, the NSE 20 Share Index (NSE-20) over the year, closing 2008 at 3,521.18, a three-year low, compared to 2007's close of 5,444.83. A good deal of the selling was by foreign investors who had earlier piled into the bullish Kenyan equities market, local media reported.

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As the violence waned and investors returned to the NSE, one of the country's largest retail-based investment houses collapsed and sent many retail investors fleeing. Others hung in, expecting a mid-year boost from the initial public offering (IPO) in March-April of mobile-phone provider Safaricom, but those hopes fell as the oversubscribed share price rose quickly but then fell below the offer price. The later IPO of Co-op Bank fared little better. By the end of 2008 Safaricom was trading marginally lower - at around 4.5 Kshs - than its original offer price, while Co-op Bank was trading just above it at around 10 Kshs. Safaricom proved the greater disappointment to investors. Its Kshs 50 billion IPO, 25% of the Kenyan government's total stake, attracted almost one million new investors to the NSE and was oversubscribed by January 2009 Safaricom shares were still trading below their 5 Kshs offer price and most shareholders, analysts concluded, are staying with Safaricom - and Co-op Bank, for that matter - for the long haul. Some 382% but after the share price almost doubled-up the issue price in mid-year it began sliding, falling below 4 Kshs at one point.

But markets had the final say. As the meltdown began in August, first foreign and then local investors dumped their Safaricom IPO shares, sending the stock into a volatile slump.The share price of Mumias Sugar Company (MSC) was on a downward slide despite the prevailing high liquidity in the market. Given the high liquidity in the market then, expectations were high that the post-offer price of the stock would certainly go up. Interest by investors towards the share was lukewarm, forcing the lead transaction advisers to extend the offer period. But when the company's half-year results for the period ending in December 2006 indicated a dip in profits, the market's reaction was swift and instantaneous.

When the shares opened for trading, prices tumbled, with retail investors coming out of the market without their shirts. In percentage terms, the exits have been most pronounced in Eveready East Africa where shareholders have been apprehensive about the company's future in view of the increasingly poor performance. The individual holdings reduced by 36 percentage points in value between December 2009 and December 2010 as their portion came to 27.14 per cent from 63.42 per cent.

1.3 Statement of the Problem.

The short and long term performance of newly issued equity has been of significant interest to investors. Benefits however to individual investors are not always clear when it comes to returns offered by the price used in the investment of shares in the stock market. Researchers abroad have suggested that investing in new ordinary equity results to cascading returns (high initial returns in the short term and inferior performance over the long term), Ritter (1991), Aggarwal, Leal and Hernandez (19930), Keloharju (1993), Levis (1993).

Capital markets efficiency is simply concerned with the relationship between information and share prices and that efficiency models the stock market in terms of the reaction of stock prices to the flow of information. The nature of emerging markets is such that prices cannot be assumed to reflect all available information. Where investors cannot correctly interpret information that is released and as such there is great potential for prices to move in a manner not justified by the information available, this raises important questions regarding the efficiency of the stock market and the effect of such conditions on stock returns.

What is needed in pricing an IPO is a way to engage in serious price discovery in setting the price at an IPO. The level of initial returns reaching unprecedented peaks and long-term under performance of the share price, the search for the reasons of these anomalies is still unresolved (Durukan, 2002). And this research project was actually based in identifying these various anomalies.

1.4 General Objective.

The general objective of the study was to find out the determinants of equity prices after the initial public offer (IPO) for quoted companies.

1.5 Specific Objectives.

1. To determine how dividend per share affect ordinary share prices.
2. To determine how earnings per share affect ordinary share prices.
3. To determine the effect of foreign exchange rate on share prices.
4. To find out how lending interest rate affect share prices.
5. To find out the effects of gross domestic product on the ordinary share prices.
6. To find out the effect of inflation on share prices.

1.6 Research Questions.

1. How does dividend per share affect ordinary share prices?
2. How do earnings per share affect ordinary share prices?
3. What are the effects of foreign exchange rates on the ordinary share prices after IPO?

4. What are the impacts of lending rates of interest on ordinary share prices?
5. What are the effects of gross domestic product on the ordinary share prices?
6. What are the effects of inflation on share prices?

1.7 Significance of the study.

1.7.1 Policy Makers:

This study would help the policy makers (Government) in formulating favourable policies that may promote or increase the Stock market performance. An example would be the Government support on Privatization through public issues or encouraging foreign investment in this market to hasten its development and prosperity.

1.7.2 Financial Advisors And Company Directors

The study would be useful to the setters of IPO offer prices in determining the optimal price of IPO's. Also companies that intend or have already issued new equity may also find this study useful.

1.7.3 Investors:

This study as well would be of assistance to investors both individual and corporate, dealers and stockbrokers in analysing and forecasting share price performance thus making viable investment decisions. Research that investigates the correlates of share performance (i.e., those ex ante factors associated with the performance of the firm on the day of the initial stock offering and thereafter) may assist potential investors in evaluating investment opportunities.

1.7.4 The Underwriters:

Underwriters assume the responsibility of distributing securities issue to the public. If they can't sell all of the securities at the specified offering price, they may be forced to sell the securities for less than they paid for them, or retain the securities themselves. Hence this study would be helpful to underwriters in making strategic decisions about taking part in share issues.

1.8 Justification of the Study.

Many Researchers have been carried out on IPO pricing like a study done by Tenai, Bitok, Shibia, Bett (2011) on determinant of IPO pricing in Kenya. Aminal, Ruhani, Zamri (2010) did a research on an empirical investigation of the under-pricing of IPO. But not much has been done on determinant of equity prices after IPO. This necessitated a need to carry out a study on this phenomenon.

1.9 Scope and Limitation of the Study.

The study focused on finding out the determinant of ordinary share prices after IPO for quoted companies in the NSE. The study sought information from the companies that had gone public within the past 10 years.

The tight work schedule of respondents was a major challenge for the study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter consists of literature review which provides proper understanding of ordinary share prices; empirical studies have also been discussed and summary of the gaps to be filled and the conceptual framework of the study. The materials are derived from research works by other researchers, reports from CMA and the companies that have gone public for the last ten years, published financial reports and Journals.

2.2 The IPO Process

According to Kipngétich (2011), because of the information asymmetry between the issuing firm and investors, issuing company usually hires investment banks to assist in the valuation of the firm. The process of IPO pricing begins at the time the issue is filed. This initial stage involves registering a preliminary prospectus relating to the company and the proposed offering with the authority responsible for regulating the securities exchange. The preliminary prospectus among other things contain all financial data for a company for the past five years with focus on management, and description of the company's target market, growth prospects and competitors.

The prospectus is then filed with securities exchange authority. Because most issues are too large for one underwriter to effectively manage, the lead underwriter usually invites other investment bankers to participate in joint distribution of the offering. The syndicate investment banks will then gather conditional offer from clients, usually institutional investors to determine initial demand for the

offer. Before meeting with potential investors, the lead underwriter determines the offer price band within which the offer price is most likely set (Kipngétich, 2011).

The next step is the book-building process, during which company management meets institutional investors during the road show at different cities. The road show will create awareness among the investors and will act as a basis for price revision. Welch and Ritter (2002) argue that book-building process involve the creation and measurement of demand while at the same time act as a basis for price revision through collection of indications of interests from potential investors. The actual setting of offer price occurs after the securities exchange authority has given a green light to go ahead. The issuer and lead underwriter will then hold a price meeting at which offer price is agreed upon (Welch and Ritter, 2002). It is believed that the final price is set after the market closes on the day before the offering.

2.3 Significance of Security Pricing

Pricing of new instrument in corporate finance is a critical decision. A previous study identified three roles played by valuation including its significance in corporate control transactions; the need for firms going public to value their stocks; and its significance in determining capital structure of the firm (Koop and Li, 2001).Mispricing of securities leads to problem of uncertainties in the capital market. Where one party to a transaction has quality information more than the other party, a market for lemon arises (Akerlof, 1970). Akerlof argues that this problem leads to a situation where quality assets are driven out of the market because theowners of quality assets are not willing to sell at lower price

demanded by buyers. Buyers will seek risk premium to compensate them for taking risk.

The pricing and performance of public offerings is one of those empirical issues that incessantly attract the attention of many researchers in finance. Even though there is extensive empirical evidence on the abnormal initial returns provided by them, and in the "hot issue markets" both the number of public offering and the level of initial returns reaching unprecedented peaks and long-term under performance of the share price, the search for the reasons of these anomalies is still unresolved (Durukan, 2002).One of the best known and the most puzzling anomaly associated with the process is the concept of under pricing.

Under pricing is the difference between the price at which the firm's stock was initially and the stock's closing price on the first day of trading (Ibbotson, 1975; Ritter, 1998). Under pricing is a common occurrence for firms undertaking an IPO. IPO under pricing averages over 16 percent historically as stated by (Loughran & Ritter, 1995). During the internet bubble of 1999 and 2000, however, underpricing was considerably higher at an average of 65 percent (Loughran & Ritter, 2000). Perotti (1995) argues that underpricing is greater in circumstances where the Government is attempting to signal its attention not to interfere with the firm following the issue.

This argument has been considered useful in terms of privatization in emerging markets or where a major policy change has occurred. This hypothesis evidenced that the government under priced issues, sold a high percentage of shares at the original offer date and underpriced more when selling to domestic investors.

In less developed capital markets or in the presence of 'daily volatility limits' restricting price fluctuations, aftermarket prices may take some time before they equilibrate supply and demand. The Athens Stock exchange, for instance, specified daily volatility limits of plus or minus eight percent during the 1990s.Thus for many under priced issues, the first day return would equal 8% by force of regulation.

In the U.S. and increasingly in Europe, the offer price is set just days (or even more typically, hours) before trading on the stock market begins. This means that market movements between pricing and trading are negligible and so usually ignored.

As an alternative to computing percentage initial returns, under pricing can also be measured as the monetary amount of 'money left on the table". This is defined as the difference between the aftermarket trading price and the offer price, multiplied by the number of shares sold.

The implicit assumption in this calculation is that shares sold at the offer price could have been sold at the aftermarket trading price instead - that is, that aftermarket demand is price-inelastic.

2.4 The Role of Stock Market Efficiency on Equity Prices

Finance and accounting literature state that a capital market is efficient if it is not possible consistently to earn an abnormal return by trading on the basis of available information (Fama, 1976). Security markets are efficient with respect to information set, if and only if, revealing to all agents would change neither equilibrium prices nor portfolios (Lathan, 2002). Efficiency in finance is usually discussed and tested in various forms. The different forms are based on the definition of the information set used in the tests.

Some researchers have the view that securities markets in developing countries are not efficient because of their operating characteristics such as size, market regulation, trading costs and the nature of the investors (Drake, 2001 and 2002; Samuels, 2006; and Kitchen, 2010). Examination of the literature on emerging markets indicates that a major emphasis has been placed on forging a theoretical link between economic and market efficiency (Drake, 2001and 20002; Samuels, 2006; AI-Mudhaf, 1983; Kitchen, 2010; and Parkinson, 1984a, 1984b and 1987)

2.5 Dividends effects on Share Price

Because dividends are paid quarterly, companies issue dividends based on their net earnings for the quarter. Although dividends are not guaranteed, investors can expect to receive the same amount as the previous quarter. However, if an investor determines that the dividend payout might be greater than the previous quarter; this affects the price of the stock. Each dividend a corporation pays to stockholders is declared by the company's board of directors (J. Mark, 2012). When you buy shares of stock through a broker, the purchase takes three business days to officially "settle." The three-day settlement process means an investor must buy the shares at least three days before a dividend record date to be an owner of record on that date (J. Mark, 2012). An investor who buys shares two days before the record date will not get the dividend. The shares are said to go "ex-dividend" two business days before a dividend record date. On the ex-dividend date, the share price will open at the previous day closing price minus the amount of the dividend. For example, a stock paying a $1 dividend closes at $50 per share on the third day before the record date. The next morning -- the ex-dividend date -- the shares will start trading at $49. At the $49

price, the stock price quoting services will show the share price as unchanged from the previous day. The stock settlement process allows an investor to buy shares three days before the record date and sell the next day on the ex-dividend date and receive a dividend payment on the payment date. The drop in price prevents traders from making a quick profit from the dividend by owning the shares for less than one day. An investor who buys the example shares at $50 on the day before the ex-dividend date has, the next day, shares worth $49 plus will receive the $1 dividend for a total of $50 (J. Mark, 2012).

2.6 The Effects of Earnings per share (EPS) on Ordinary Share Prices

Earnings per share is used to calculate the widely used ratio PE Ratio; PE Ratio = Share Price/EPS; by combining it with a forecast of companies earnings analysts can describe whether the shares are over or under valued(IAS 33 Earnings Per Share). The PE ratio reflects investors' confidence and hopes about the international performance of the company and the industry sector. High PE Ratio may reflect investor confidence in the existing management; it can also reflect lack of investor confidence in the existing management team but an anticipation of a takeover. Low PE Ratio could indicate a lack of confidence in the current management or a feeling that a new management might find problems that are not easily sorted. The current EPS figures and the individual shareholders expectations of future growth relative to that of other companies also have an impact on the share price (Kang, 2008). EPS is calculated by dividing the earnings with the weighted number of ordinary shares. There are two types of EPS; Basic EPS that is based on ordinary shares currently in issue; and the Diluted EPS that is based on ordinary shares currently in issue plus potential ordinary shares (IAS 33 Earnings Per Share).

2.7 The effect of Exchange rate on Ordinary Share price

The exchange rate is the value of the American dollar versus other currencies. The value of the dollar is both caused and reflected by interest rates, and interest rates have much to do with stock prices. Therefore, exchange rates affect stock prices and can be used to make predictions about the market. A weak dollar means American goods are cheaper abroad. It also means foreign goods are more expensive (W. Johnson, 2012). This suggests consumers will buy American goods. It also means that because money is cheap, the economy will expand, because more businesses will built capital stock, expand their production and continue to borrow money. For the short term, cheap money suggests the stock market will show price rises across the board. The dollar is closely tied to interest rates. A low rate will spur borrowing, while a high rate will retard it. All other things being equal, cheap money is good for the economy and manifests itself in higher stock prices. This works only for the short term, because stocks are always future oriented. If rates are low today, investors assume that they will rise soon. Therefore, the rise in stock prices resulting from a cheaper dollar leads to short-term price rises only (J. Mark, 2012).When interest rates are high, dollars are expensive. As a result, money moves to the bond market, where the expected interest rate is the margin of profit. When rates fall, money moves out of bonds and into stocks, pushing prices upward. Interest rates can and do affect stock prices. The reverse is also true. According to a 2005 report by Russian economist Desislava Dimitrova, stock prices can affect the value of the dollar. If stock prices begin to fall, foreign investors likely will liquidate some of their stock holdings, which drive the value of the dollar down. She also holds that when stock prices rise, there is a short-term trend toward a cheaper dollar as well, because this reflects an expansionary monetary policy. Therefore, at least for the short term, both rises and falls in stock

prices lead to depreciation of the dollar and, hence, its reduction in value. This might sound odd, but it makes sense. However, if the country targets exchange rate appreciation in a time of rising stock prices, the policy could remain ineffective. Secondly, multinational companies interested in exchange rate forecasting may consider the stock market as a forecasting indicator—when it rises, the currency is expected to depreciate. Similarly, if there is a stock market collapse, the exchange rate will appreciate and cause a rebound in the stock market. Thus, the joint relationship between the two markets aids self-recovery during a financial crisis. (J. Mark, 2012).

2.8 The effects of GDP, Interest rate and Inflation rate on Stock prices

According to a study done in Nigeria, it is a common trend for stock prices of some quoted companies to rise and fall or fall and rise twice or thrice within a year. The stock prices of quoted companies on the Nigerian Stock Exchange (NSE) are affected either positively or negatively by a number of factors occurring within and without the economic system. According to Corrado and Jordan (2002), some of the factors influencing stock price behaviour include company profits; political factors; and economic performance. Others are interest rates; inflationary rate; Real Gross Domestic Product; and shareholder-level taxes. Investment in stock market is long-term in nature; any development that could affect the stability of the polity or economy usually has serious impact on the stock prices. In recent times, the NSE has consistently lost points and the prices of stocks have experienced sharp decline *(International Research Journal of Finance and Economics - Issue 25 (2009)* 54). The downward trend in the market performance was attributed to varying reasons in line with those stated by Corrado, et al (2002).However, Onagoruwa (2006) was of the

view that stocks with history of good performance and fundamental attributes are good to buy at times like this when their prices are down and more affordable because they are most likely to bounce back since they have the capacity to absorb the depression in the market (D. Emmanuel & A. Samuel, 2009).

2.10 Conceptual framework – Al Tamimi Model of Asset Pricing

Several attempts have been made to identify or study the factors that affect asset prices. Some researchers have also tried to determine the correlation between selected factors (internal and external, market and non-market factors, economic and non-economic factors) and asset prices. The outcomes of the studies vary depending on the scope of the study, the assets and factors examined.

Al – Tamimi (2007) identified company fundamental factors (performance of the company, a change in board of directors, appointment of new management, and the creation of new assets, dividends, earnings), and external factors (government rules and regulations, inflation, and other economic conditions, investor behavior, market conditions, money supply, competition, uncontrolled natural or environmental circumstances) as influencers of asset prices. He developed a simple regression model to measure the coefficients of correlation between the independent and dependent variables.

SP = f (EPS, DPS, OL, GDP, CPI, INT, MS)

Where, SP: Stock price; EPS: Earnings per share; DPS: Dividend per share; OL: Oil price; GDP: Gross domestic product; CPI: Consumer price index; INT: Interest rate and MS: Money supply. The factors can be categorized into firm, industry, country

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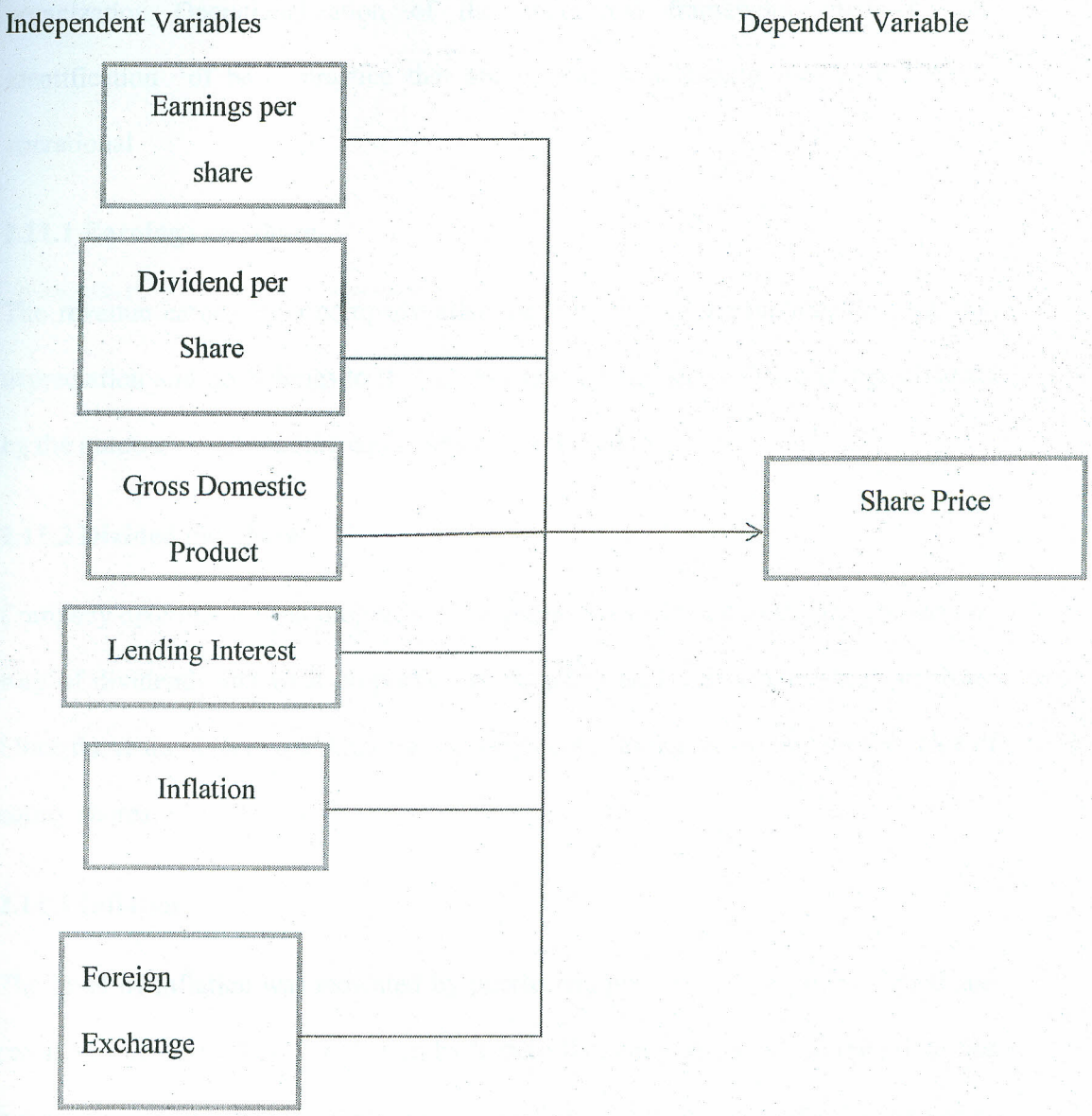
and international or market and non-market factors, and economic and non-economic factors. All the factors can be summarized into two classes - micro and macro factors.

Figure 2.1 Conceptual Framework Based on Al Tamimi Model



Source: (Author, 2012)

2.11 Operationalization

Involves putting into practice the various theories strategies in abide to ensures that the goals and objectives of a firm are meet. With regard to share prices of an organization Operationalization of the conceptual framework involves the identification of best practice that are critical in achieving the desired results operational

2.11.1 Earnings per share

The revenue earned by a company after meeting cost of production, then interest, depreciation and tax belongs to the equity share stockholders. The earnings dividend by the number of outstanding equity shares is referred to as eps.

2.11.2 Divided per share

Company determines what proportion of earnings is distributed to the shareholders by way of dividends and what proportion is ploughed back for reinvestment purposes. Since the main objective of financial management is to maximize the market value of equity shares.

2.11.3 Inflation

The level of inflation was indicated by purchasing power and the price of good and services. The variable was measured by hyperinflationary index. Since the prices rise but no additional value is added. This means that your money lose purchasing power and as a result you buy less with the money you have than before Since revenues and earnings of companies rise at the same pace as inflation, their financials are overstated since no additional value is created When the inflation starts to fall to its normal levels, the overstated earnings and revenues will decline as well.

2.11.4 GDP

The GDP was measured by number of goods and services produced locally and its indicators were country population and the domestic income

2.11.5 Foreign exchange rate

Local and foreign investors tend to invest in an economy that has a very high currency exchange rate to foreign currencies. It was measured in terms of exchange rate and indicators were the level of imports and exports in the country.

2.11.6 Lending interest rate

The key indicator was the no of borrowers and it was measured using CBK lending base rate and financial institution lending rates in Kenya.

2.12 Summary of review and gap

Tenai, Bitok,Shiba, Bett (2011)In the study the determinants of IPO pricing in Kenya. Found that regression result was consistent with the findings of preceding studies such as Daily (2005) and Loughran and Ritter (2002). Daily (2005), for example, found no relationship between IPO offer price and firm-specific information disclosed in prospectus, inconsistent with the Efficient Market Hypothesis, Signaling Theory and Resource Based View of the firm. Their study was based in IPO offer price but this research project was based on share price performance in NSE after issue.

Tanui (2003) assessed the factors affecting development of emerging capital markets using the Kenyan capital market. He found that one of the factors is lack of national awareness and knowledge about the stock market, which prevents wide participation and effects efficiency. His study focused on EMH which is one of factors affecting share prices and didn't cover other factors thus necessitated this study to be carried

out to incorporate other factors like EPS, DPS, Inflation, GDP, exchange rate and lending rate.

Mutinda (2005) assessed the impact of dividend announcements on future prospects for firms quoted at the NSE. He found that securities with high dividends gained value much faster than low dividend securities. He however did not deal with the implications of this relationship on the share prices which the project kept in consideration.

Nyamosi (2011) assessment of the pricing efficiency of the NSE and found that NSE market reacted to earnings announcements through a rise or fall in price. Found that excess returns were realized both before and after the announcement. The study didn't put into consideration the reaction of these share prices in other stages while the project went and found out the reaction of share prices in long run getting the longitudinal data.

Somoye (2012) in his study Determinants of equity prices in the stock markets in Nigeria found that the forces of demand and supply have direct effect on the stock price while the other indeterminate number of firm, industry and country factors influences the demand and supply factors. He incorporated factors like oil pricing in his al tamimi model but in the project had no Kenyan product included in the model.

There are so many studies done in the developed countries incorporating the variables in this study but very few has been done in developing countries especially using the Al tamimi model in finding the determinant of share price performances in long run and this gives reason for carrying out this study to find out the determinants of share price performance for quoted companies in Kenya to fill the gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter described the research methodology and explained procedures which would be followed during data collection and analysis. It included research design, target population, population/sampling frame and sample size, data collection methods and procedures and data analysis.

3.1 The Research Design

The project was both descriptive and exploratory in nature of the assessment of determinants of equity price performance after the initial IPO for quoted companies in NSE. This was done through evaluating the impact of Dividend per share, foreign exchange rate, Earnings per share, Real Gross Domestic Product (RGDP), Lending/Interest Rate (INT) and Inflation Rate (INF) on stock prices of quoted companies in NSE (Nairobi Security Exchange). The approach helped in meeting the specific research objective.

3.2 The Target Population and Population Frame

The research project comprised of a population of quoted companies which had gone public for the last 10 years. This population was obtained from the latest edition CMA handbook; researcher also accessed the NSE website and respective stock exchange documents.

Table 3.1: Equity Issues (IPO's) 2000-2011

COMPANY	SHARES ON ISSUE	TYPE OF ISSUE	YEAR OF STUDY	ISSUE PRICE	SUBSCRIPTION LEVEL
MUMIAS SUGAR	4 000 000	IPO	2001 NOV	6.25	60%
KENGEN	300 000 000	IPO	2006 APRIL	11.90	833%
SCANGROUP	69 000 000	IPO	2006 JUNE	10.45	620%
EVEREADY	63 000 000	IPO	2006AUGUST	9.50	830%
ACCESS KENYA	80 000 000	IPO	2007 MARCH	10	363%
KENYA RE	240 000 000	IPO	2007 JULY	9.50	334%
SAFARICOM	10 000 000 000	IPO	2008 JUNE	5.00	532%
CO-OPERATIVE	701 000 000	IPO	2008 OCTOBER	9.50	81%
DEACONS KENYAN	12 800 000	IPO	2010 NOVEMBER	62.50	87.5%
BRITISH AMERICAN	660 000 000	IPO	2011 SEPTEMBER	9.00	60%

Source: Capital Markets Authority

3.3 Data Collection

The project depended on secondary data collected from the Nairobi Securities Exchange. To ensure accuracy, credibility and validity of data, data collected was cross-checked in the respective company prospectus documents. In addition primary data was collected from company managers by use of a research questionnaire.

3.4 Data Analysis

The data was analysed using Microsoft excel and Statistical programmes for social sciences (SPSS) where data collected was analysed through the use of statistical tools and measures of central tendency. This entailed the use of graphs and use of percentages respectively which enhanced easy interpretation of information. Inferential statistics like the correlation and regression analysis were also used to establish the relationship among the dependent and the independent variables.

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction

This chapter presents the results based on the study and discusses its interpretation. The chapter begins by presenting these findings highlighting the key determinants and their effects on Equity pricing in Nairobi Stock Exchange. This is presented and discussed in line with the objectives of this study.

4.2 Characteristics of the respondents

4.2.1 Gender of the respondents.

Among the respondent, both male and female shared the platform equally on a 50% basis. This basically implied that the number of women respondents was the same as that of their male counterparts. This was not purposive or preplanned but occurred randomly.

Table 4.1: gender of respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	5	50.0	50.0	50.0
	Female	5	50.0	50.0	100.0
	Total	10	100.0	100.0	

Source: Research data

4.2.2 Duration the respondent has worked in the company.

60% of the respondents had worked in the firm's for five to ten years, 30% for less than five years while only 10% had worked in the firm's for more than ten years. The majority of the respondents (70%) had worked in the firms for more than five years which validated the information collected on the basis of experience of the respondents within the respective firms.

Table 4.2: Duration the respondent had worked in the company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0-5 Years	3	30.0	30.0	30.0
	5-10 Years	6	60.0	60.0	90.0
	10-15 Years	1	10.0	10.0	100.0
	Total	10	100.0	100.0	

Source: Research data

4.2.3 Highest level of education attained.

50% of the respondents were graduates while a close 40% of the respondents had postgraduate qualifications. Only 10% had other academic qualifications. Approximately all of the respondents (90%) were literate and with a fast hand grasp on stock related issues.

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		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	5	50.0	50.0	50.0
	Female	5	50.0	50.0	100.0
	Total	10	100.0	100.0	

Source: Research data

Table 4.4: Firms Experience

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	11-20 Years ago	3	30.0	30.0	30.0
	21-30 Years ago	2	20.0	20.0	50.0
	31-40 Years ago	3	30.0	30.0	80.0
	Over 40 Years ago	2	20.0	20.0	100.0
	Total	10	100.0	100.0	

Source: Research data

4.3.2 Profit or loss status of the firm before IPO

All the firms had a profit period before the IPO. This implied that actually firms shy from IPOs if they were experiencing losses. This was viewed as a strategy to give confidence to the clients about the future performance of the shares in the market. The Percentage of profit was between 26-50% for most (60%) of the firms; as shown below. In other words, more than half of the firms studied experienced profits of between 26-50% before the IPO. The other firms (30%) had profits as well; though at a lower rate of 1-25%.

Table 4.5: Percentage of profit before the IPO

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1-25	3	30.0	33.3	33.3
	26-50	6	60.0	66.7	100.0
	Total	9	90.0	100.0	
Missing	System	1	10.0		
Total		10	100.0		

Source: Research data

4.4 Earnings per share

4.4.1 EPS and IPO

The IPO was an important factor in this study. The behavior of EPS in regard to IPO was therefore vital in this study. The earnings per share after the issue of IPO increased in 60% of the firms. This clearly predicted a linear correlation between EPS and IPO. The Percentage increment of earnings per share after IPO was 26%-50% for 50% 0f the firms. Only 20% of the firms recorded a 1-25% increment. Which meant that over half (70%) of the firms recorded some increment in EPS after the IPO; further confirming the dependability between EPS and IPO.

Table 4.6: Percentage Increase in EPS after IPO

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1-25	2	20.0	28.6	28.6
	26-50	5	50.0	71.4	100.0
	Total	7	70.0	100.0	
Missing	System	3	30.0		
Total		10	100.0		

Source: Research data

4.5 Effects of dividends on Share Price

70% of the firms paid dividends two to five times before the IPO while 10% of them paid it more than five times before the IPO. This was viewed to be in relation to the firms experience and profitability in the market. The Stock prices went up for 80% of the firms before payment of dividends; only 20% of the firms had a stagnant. Three quarters of the firms experienced an increase in stock prices just before dividends issue; thus confirming that dividends actually affected share prices. The Stock prices after dividends payment went down for 80% of the firms. This confirmed that that actually dividends is a serious factor that determines share pricing for firms listed in NSE whether it was because of consumer speculation or not.

Table 4.7: Share prices after dividend issue

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Stagnate	1	10.0	10.0	10.0
	Go up	1	10.0	10.0	20.0
	Go down	8	80.0	80.0	100.0
	Total	10	100.0	100.0	

Source: Research data

When asked directly about the effect of dividends on share prices, 90% of the respondents confirmed that dividends greatly affected share prices; as shown in the table below.

Table 4.8: If dividends affected share prices

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	9	90.0	90.0	90.0
	No	1	10.0	10.0	100.0
	Total	10	100.0	100.0	

Source: Research data

4.6 Effect of GDP on Share Price

The table below showed that 60% of the firms considered GDP before share pricing. It was obvious that share pricing within the firms was determined with GDP in mind. But 40% of the respondents did not think GDP was vital in share pricing.

Table 4.9: Is GDP considered in Share pricing?

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	6	60.0	60.0	60.0
	No	4	40.0	40.0	100.0
	Total	10	100.0	100.0	

Source: Research data

4.7 Effect of lending rates on share price

High lending rates resulted into lower share prices, according to 30% of the firms; while it remained stagnant for 10% of the firms. However, company share price went up for 30% of the firms when lending rates were low which predicted a positive impact on share prices.

Table 4.10: Effect of Lending rates on share prices

		Frequency	HIGH IR. (Percent)	LOW IR. (Percent)	Valid Percent	Cumulative Percent
Valid	Stagnate	1	10.0	10.0	10.0	10.0
	Go down	3	30.0	30.0	30.0	40.0
	Not sure	6	60.0	60.0	60.0	100.0
	Total	10	100.0	100.0	100.0	

Source: Research data

4.8 Inflation and its effect on Share Price

Most of the firms (80%) believed that inflation affected share prices by a great extent; as shown below. Even the remaining 20% did not ignore inflation but rated its effect to be moderate.

Table 4.11: Extent of Inflation affected Share price

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	To Great extent	8	80.0	80.0	80.0
	To moderate extent	2	20.0	20.0	100.0
	Total	10	100.0	100.0	

Source: Research data

50% of the firms had 11-40% effect of inflation on share pricing at NSE; while only 10% had a 41-60% effect.

4.9 Effect of ER on share prices

Table 4.12: Effect of ER on Share price

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	7	70.0	70.0	70.0
	No	3	30.0	30.0	100.0
	Total	10	100.0	100.0	

Source: Research data

When asked about extent of effect exchange rate had on share prices, 40% of the firms believed that ER affected them by a 'moderate extent'; only 30% believed it affected them by 'great extent'; as shown below. That added up to a majority (70%) of the firms confirming that actually exchange rate was a factor considered in share pricing.

Table 4.13: The extent of ER affected share price

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	To Great extent	3	30.0	42.9	42.9
	To moderate extent	4	40.0	57.1	100.0
	Total	7	70.0	100.0	
Missing	System	3	30.0		
Total		10	100.0		

Source: Research data

4.10 Correlation and regression analysis

4.10.1 Correlation analysis

Multiple regression assumptions were checked before data analysis was performed in order to ensure that the Independent Variables are not strongly related. Table below presents the correlation matrix among the independent variables. The findings do not indicate significant multicollinerity problem; the table showed a high positive

relationship between EPS and ER at 0.472 and a high negative relationship between EPS and DPS at -0.43.EPS had a moderate negative relation to -0.354 to LR and a lower negative relation of -0.330 to the GDP. The table showed a high positive relationship between EPS and ER at 0.472 and a high negative relationship between EPS and DPS at -0.43.EPS had a moderate negative relation to -0.354 to LR and a lower negative relation of -0.330 to the GDP

Table 4.14: Correlation Matrix table

variable	EPS	DPS	GDP	LR	IR	ER
EPS	1	-0.43	-0.330	-0.354	-0.154	0.472
DPS	-0.103	1	-0.137	-0.368	-0.03	0.536
GDP	-0.396	-0.137	1	-0.4543	-0.234	0.185
LR	-0.354	-0.500	-0.4543	1	-0.152	0.241
IR	-0.154	-0.03	-0.234	-0.152	1	0.421
ER	0.472	0.536	0.185	0.241	0.421	1

4.10.2 Regression analysis

The beta coefficients give the rate of standard deviations change on the dependent variable (EPS) that was produced by a change on the independent variables. Here, dividends took a lead with 0.587 deviation followed by lending rates at 0.293 , then

GDP at 0.251 and exchange rates at 0.196. The researcher thus concluded that dividends, lending rates and GDP had the major impact on EPS.

Table4.15: Partial regression coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-4.722	8.169		-0.209	.78
	Do dividends affect performance of co. shares	3.944	.438	.587	5.984	.046
	Do GDP affect performance of co. share prices at NSE	7.667	.395	.251	6.587	.045
	Ever considered effect of lending rates on share prices	4.667	.295	.293	4.421	.041
	Do you consider effect of ER on share prices	2.833	.163	.196	7.337	.023

Source: Research data.

4.10.3 The coefficient of determination

In data analysis, the larger the R the stronger the relationship between the dependent variable versus independent variables. R Square, the coefficient of determination, was the squared value of the multiple correlation coefficients. Here, it showed that about half the variation in the relationship was explained by the model. The value of R was 0.587 and R square was 0.179(17.9%) as shown in the table below. Since the value of R square was less than 50%, the researcher deduced that the proportion of variation associated to the independent variables had a moderate effect.

Table 4.16: The coefficient of determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.587(a)	.395	.179	11.858

Source: Research data.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter gives a summary of the findings and an analysis of the results and findings focusing on the objectives, research questions, recommendations and the various areas for further research.

5.2 Summary of Findings

The result of automated data analysis (SPSS) revealed that Gross Domestic Product (GDP), exchange rate, lending rates, Interest and inflation rates could be held responsible for variation on EPS of quoted companies in NSE with reference to 2002-2012.The F-statistic (ANOVA) of the model indicated that the model had closeness of fit which meant that the model was statistically significant. The estimated parameters were statistically significant. The autocorrelation between the variables under consideration was indicative, which further confirmed that the estimates were statistically significant. The economic implication was that a reduction in exchange rate, lending rate, interest rate, dividends and inflation rate resulted in increased stock prices of quoted companies in the NSE which showed a negative impacts in line with the priori expectation. On the other hand, there was a positive impact by GDP on stock prices; that was an increase in GDP resulted in increased stock prices in conformity with the priori expectation. From the estimated multiple regression

equation, the research revealed that the variables GDP, lending rates and dividends had the main effect on earnings per share.

The adjusted R squared coefficient (0.179) which is the coefficient of determination indicates that the explanatory variables accounted for 17.9% of the variation in the share prices. This could be described as a moderate effect but the outcome of such a magnitude could be felt throughout the NSE.

5.3 Conclusions

This paper attempted to determine the impact of GDP, dividends, exchange rate, interest and inflation rates on stock prices of quoted companies in NSE. The findings were in line with a priori expectation expressed by Blanchard (1997), Tamtom (2002) and Daferighe (2009) .An important finding was that the explanatory variables in the model result in the direct influence on the stock prices of quoted companies in NSE for the period 2002-2012.The paper also provided preliminary evidence regarding the relative importance of the explanatory variables on stock prices of quoted companies in NSE. Specifically, the findings suggested that dividend was the most important variable influencing stock prices in Kenya.

Conclusively, government should implement policies that will check on dividends manipulation, reduce inflation rates and poverty levels through infrastructural development and improved standards of living. Also, lending and interest rates should be made moderate in order to encourage investment and transactions in NSE.

5.4 Recommendations

This study recommends that: the government of Kenya strengthen the CMA (Capital Markets Authority) to come up with mitigation measures to control the external

factors that interfere with share prices; with a possible measure to cushion NSE from international monetary fluctuations; Control and moderation of lending rates and interest rates to fast track and build the trade in NSE so as to enable the middle class citizens to increase their trade in shares; Creation and strengthening of an independent public institution to monitor dividend manipulation and even provide EPS insurance against share losses for firms in Kenya just like the Central bank (CBK) does to banks.

5.5 Suggested areas for further research

From the study and subsequent conclusions, the researcher recommends a further research on the impact of government policies on share prices of listed companies in NSE.

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APPENDIX 1

LETTER TO THE RESPONDENTS.

I am a student at Kenyatta University pursuing a Masters of Business Administration (MBA) degree. My purpose is to get information on the determinant of Equity prices after initial public offer by quoted companies in Nairobi Security Exchange. The questionnaire is aimed at eliciting information which will be useful in the above mentioned research as part of MBA degree requirements.

You have been selected as one of the respondents in this study. The information supplied will be used strictly for academic purposes only and will be treated with utmost confidentiality.

You corporation will be highly appreciated.

Thank you.

AILEEN MWARI KITHINJI.

APPENDIX II

QUESTIONNAIRE TO ELICIT VIEWS ON THE DETERMINANTS OF EQUITY PRICES AFTER INITIAL PUBLIC OFFER (IPO) OF QUOTED COMPANIES IN NAIROBI SECURITIES EXCHANGE (NSE)

Name: _____

Date of Interview: _____

A: BIO DATA

1. Company's Name (optional):

_____

2. Gender of the respondent:

Male [ ] Female [ ]

3. Duration the respondent has worked in the company?

0-5yrs [ ] 5-10yrs [ ] 10-15yrs [ ] Over 15yrs [ ]

4. Highest level of education attained:

- Primary [ ]
- Secondary [ ]
- Graduate [ ]
- Postgraduate [ ]
- Other(specify) :

5. When was your firm founded?

_____

B: EARNINGS PER SHARE.

N/B: Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent at all.

6. To what extent does EPS affect your shares price?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

7. Do you base your earnings on each share?

Yes [ ] No [ ]

8. If No, at what extent do you base your earnings on each share?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

9. Did your company make any profits the last two years before going public?

Yes [ ] No [ ]

10. If yes, what percentage of profit?

0-25% [ ] 26-50% [ ] 51-75% [ ] Above 75% [ ]

11. If No, what percentage of loss?

0-25% [ ] 26-50% [ ] 51-75% [ ] Above 75% [ ]

12. Has your company earnings per share been increasing since after?

Yes [ ] No [ ]

13. If yes, what percentage?

0-25% [ ] 26-50% [ ] 51-75% [ ] Above 75% [ ]

14. If No, what percentage?

0-25% [ ] 26-50% [ ] 51-75% [ ] Above 75% [ ]

SECTION C: DIVIDEND PER SHARE.

15. Has your company paid any dividends the last five years?

Yes [ ] No [ ]

16. If yes, how many times?

Once [ ] 2-5 times [ ] more than 5 times [ ] Not sure [ ]

17. If No, to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

18. If Yes, to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

19. From your past experience in this company, how do stock prices behave before dividends payments?

Stagnate [ ] Go up [ ] Go down [ ] Not sure [ ]

20. From your past experience in this company, how do stock prices behave after dividends payments?

Stagnate [ ] Go up [ ] Go down [ ] Not sure [ ]

21. In summary, do you believe dividends affect the performance of your company shares at the NSE?

Yes [ ] No [ ]

D. GROSS DOMESTIC PRODUCT

22. Did your company consider the GDP values before share pricing?

1. Yes 2. No

23. If No, to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

24. If yes, to what extent does GDP affect the stock pricing?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

25. Do you believe GDP affect the performance of your company shares prices at the NSE?

Yes [ ] No [ ]

26. In your opinion, does the GDP reflect serious stock trends that are considered important by your BOD/decision making organ?

Yes [ ] No [ ]

SECTION E: LENDING RATES.

27. Has your company ever considered effects of lending rates on its share prices?

Yes [ ] No [ ]

28. If yes, how many times?

Once [ ] 2-5 times [ ] more than 5 times [ ] Not sure [ ]

29. If No, to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

30. If Yes, to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

31. How does your company's share price behave if lending rates are high?

Stagnate [ ] Go up [ ] Go down [ ] Not sure [ ]

32. How does your company's share price behave if lending rates are low?

Stagnate [ ] Go up [ ] Go down [ ] Not sure [ ]

33. In summary, do you believe lending rates affect the performance of your company shares at the NSE?

SECTION F: INFLATION RATES.

34. Does your company consider the Inflation as an effect on share pricing?

Yes [ ] No [ ]

35. If No, to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

36. If yes, to what extent does inflation affect the share pricing?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

37. If yes, how would you rate the effect of inflation on share pricing at NSE?

0-10% [ ] 11-40 % [ ] 41-60% [ ] 61- 99%[ ]

SECTION G: EXCHANGE RATES.

38. Does your company consider the effect of exchange rates on its share prices?

Yes [ ] No [ ]

39. If No to what extent?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

40. If yes, to what extent do exchange rates affect the company share prices?

To a very great extent [ ]

To a great extent [ ]

To a moderate extent [ ]

To a little extent [ ]

To no extent [ ]

41. If yes, how would you rate the effect of exchange rates on share pricing at NSE?

0-10% [ ] 11-40% [ ] 41-60% [ ] 61- 99% [ ]

Thank you for your participation.