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**FACTORS LEADING TO SLOW
GROWTH IN LISTED FIRMS ON STOCK
MARKETS IN THE EAST AFRICA REGION**

The case of Nairobi Security Exchange (NSE)

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Full Length Research Paper

Factors leading to slow growth in listed firms on Stock Markets in the East Africa Region: The case of Nairobi Security Exchange (NSE)

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A stock market is a key component of a vibrant economy. It is not only vital to the listing company but to the government too. It is thus, an obligation of the respective Governments to offer an enabling environment friendly enough to various firms and encourage them to list and be active in stock markets. Some of the benefits that accrue to a firm from listing include creating a market for the company's shares, enhancing the status and financial standing of the company, increasing public awareness and public interest in the company and its products, providing the company with an opportunity to implement share option schemes for their employees, increasing access to additional fundraising in the future by means of new issues of shares or other securities, facilitating acquisition opportunities by use of the company's shares, and offering existing shareholders a ready means of realizing their investments among others. The study established existence of various factors which hinder the listing of firms at NSE. These factors include institutional factors, environmental factors, regulatory factors, historical factors, informational factors. Subsequently the study has suggested strategies to overcome these hindrances.

Key words: Slow growth, Stock markets, East Africa, Nairobi Stock Exchange (NSE).

INTRODUCTION

Stock markets are expected to accelerate economic growth by boosting domestic savings and increasing the quantity and the quality of investment (Singh, 1997). The markets encourage savings by providing corporate organizations with an additional financial instrument that may better meet their risk preferences and liquidity needs. Stock markets also provide an avenue for growing companies to raise capital at a lower cost. The direct benefits of listing to the firms include increased investment, profitability and growth opportunities and also easing the financial constraints for the firms. The decision to list a company needs to be made once the company is realistically assessed in terms of its management, resources, stage of development, long-term strategy, goals and future prospects (Demirguc-Kunt and Levine, 1996).

According to the evolution of financial sector, the stock market tends to more likely stimulate and promote economic growth (Har et al., 2008). In Kenya, for

instance, because of the smaller number of current and new listings, NSE has remained stagnant and has not been able to contribute significantly to economic development. On average, the firm has been able to finance only about 0.18 percent of Gross Domestic Product (GDP), (KIPPRA, 2006).

Stock market development has been central to the domestic financial liberalization programs of all the East African countries. Any program of financial liberalization in East Africa is incomplete without the establishment and development of stock markets. Over the years, NSE in particular has witnessed slow growth in the number of listed firms (Yenkey, 2011). The number of firms listed in 2005, is less than that at independence in 1963.

In fact, the NSE was referred to by the head of the USAID delegation in 1988 as "an exchange in name only" He expressed concern over the lack of competition among buyers and the low numbers of total investors which distorted share prices, reduced trading volume and

Table1: East African Stock Market Statistics, 2007

Country	No. of Listed Companies	Market Capitalization (US \$ Billions)	Market Capitalization as % to GDP	Value Traded(2003/2007 (US Millions)	Turnover (%)
Kenya	54	13.61	53.18	3700.95	10.41
Tanzania	6	2.28	4.67	72.19	2.29
Uganda	12	3.53	30.2	59.50	1.42

Source of Data: International Financial Statistics (IMF); Emerging Markets Database (IMF) (2008).

Table 2: Number of Listings in the East African Markets between 1991 – 2007

Countries	YEARS																
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Kenya	53	57	56	56	56	56	58	58	57	57	55	50	48	48	47	51	54
Tanzania										4	5	5	6	6	6	6	6
Uganda											2	3	3	5	5	5	12

Source of Data: International Financial Statistics (IMF); Emerging Markets Database (IMF)(2008).

liquidity, and ultimately inhibited the NSE from mobilizing individual savings (Bishop, 1988).

Since 1954, when NSE opened up to more participants to enable vibrancy, the number of firms listed fifty seven years later has been rather low at 55 by the end of 2011. However, with the government projection that the country needs to attain middle income status (M.I.S.) by the year 2030, it is imperative that more firms are encouraged to participate (Har et al., 2008).

In 2000, Kenya, Uganda and Tanzania signed the Joint Stock Exchange Taskforce report on cross border listing. Since then, several Kenyan companies have taken advantage and cross listed within the region's stock market. For example, firms such as East African Breweries, Kenya Airways, Kenya Commercial Bank, Nation Media Group and Equity Bank are already trading within the three East African Countries. However, by 2012, only UMEME Holdings Ltd of Uganda had listed in Nairobi Security Exchange. It listed by way of introduction. No firm from Tanzania has done cross border listing either in NSE or in Uganda Stock Exchange (USE), thus failing to achieve the objective of boosting the listed firms.

In the East African region there are three most active

stock markets located in Kampala, Dar-es-salaam and Nairobi as shown in table 1.

In 2008 however, Rwanda launched a stock market, "Rwanda Over The Counter Market" (ROTCE), which is still in its preliminary growth stage. In 2010, ROTCE had only three listings. The number of firms listed in the E.A. markets for seventeen years 1991-2007 shows the grim picture of the situation (Table 2).

There has been a notable stagnation on the number of listing in the three stock exchanges, with Uganda showing some consistent growth though at a slow pace. The growth in listings in the East African Stock Markets for five years 2003-2007 also shows the grim situation (Table 3)

The countries which were at par in economic growth with Kenya and some even economically weaker during the 1960's and 70's had their stock markets established around the same period or even later. In fact, Malaysia's stock market was started in 1930, whereas the Kenya's market was started in 1920s. However, the number of firms listed in Malaysia stock market has grown over time in leaps and bounds. The Stock Market in Malaysia has been a major contributor to the economic growth of the country. It is against this background that the study

Table 3: Number of Listings/Droppings in the EAC between 2003 – 2007

COUNTRIES	YEARS									
	New Listings					Droppings				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
Kenya	0	0	0	4	3	0	0	1	0	0
Tanzania	0	0	0	0	0	0	0	0	0	0
Uganda	0	2	0	0	7	0	0	0	0	0

Sources: DSE, NSE and USE

explores factors hindering the growth in the number of listings in NSE and seeks ways in which the same could be reversed to ensure its active participation in economic growth of Kenya and the region.

Objective

- Evaluate and critically review factors leading to slow growth in the number of listed firms in Nairobi Security Exchange (NSE).
- Determine necessary strategies to improve listing of firms in Nairobi Security Exchange

METHODOLOGY

Research Questions

- Which factors have contributed to slow growth of the number of listed firms?
- What are the major challenges do the region market face in attracting firms to list?
- What strategies should be employed to improve the number of listing firms in NSE

This study used secondary data from various stock markets and their evolution. The reviews explored strategies employed by the global stock markets in their growth and development. To meet the above objectives and address the research questions, the study reviewed various factors limiting listing in NSE and corrective strategies which should be employed to improve the listing in NSE.

The Nairobi Stock Exchange (NSE) was established by British colonial businessmen who sold shares of their Kenya-based enterprises to a select group of fellow colonialists. The political and economic decisions of colonial masters were translated to legal framework that established and operationalized Nairobi Securities Exchange. Therefore, the exchange has not been successful in attracting a large number of other market transactions in addition to the privatized public enterprises to list (Ngugi, 2005). In fact, it is only in the recent past we have seen local communities participate and even then, in a very insignificant proportion (Ngugi, 2005).

An examination of the levels of capital market development and economic growth in Asia with those in sub-Saharan Africa shows that India and China continue to add several hundred companies to their stock

exchanges annually. The immediate benefit of the flourishing capital market activity in Asia is reflected in the sizeable increase in the momentum of private sector development. In contrast, the number of companies added by each of the major sub-Saharan African exchanges other than South Africa was generally fewer than 10 (Yartey and Adjasi, 2007). In Kenya, economic growth has not been sustained over time, even after attainment of independence, which could ensure growth of firms to facilitate continuous listing in the stock market. There has been erratic growth due to the significant role that political maneuvers play in ensuring stability and also the effects of the world economies.

Blueprints on how to sustain growth in the economy have been put forward. The relevant institutions should endeavour to implement them to attract more players through among others creating different categories of listing firms for example based on capital, level of operation. They should also ensure that dealings at the stock markets are easily understood to demystify perceived complexity (Munga, 1974).

The East African Stock Markets are highly concentrated with the best shares being held by pension fund, SACCOS, banks and insurance firms that do not want to sell because they have few alternative assets to buy with sales proceeds. In addition, the markets infrastructure is underdeveloped particularly with regard to trading, settlement and delivery as manual systems and processes dominate their operations Bond markets are relatively underdeveloped in these capital markets, yet they have the potential of mobilizing significant amounts of capital. NSE bond market, which was established in 1996, had a turnover of average Kshs.40 billion by the end of year 2011 which is far below par in comparison with other markets with similar capacity. A well-integrated and customized financial information service that provides timely and accurate information service to individuals and corporate institutions is necessary for the development of bond markets (Yartey, 2008).

The smallness of the East African capital markets means that usually resources are unavailable for the acquisition of key infrastructure needed for market operations (Enrico and Pieter, 1999). Capital markets need institutions that are staffed by well-trained professionals who are competent in their jobs. Within

Table 4: Infrastructural Indicators of E.A. stock exchanges 2011

Country	Clearance and Settlement	Trading System	Trading Days
Kenya	Electronic	Electronic	5
Uganda	Manual	Manual	5
Tanzania	Electronic	Electronic	5
Rwanda	Manual	Manual	5

Source of Data: International Financial Statistics (IMF); Emerging Markets Database (IMF);(2008) and RSE

capital markets, the following groups of professionals can be identified, regulators (both internal and external), investment advisers, dealers/brokers, back office staff, exchange staff, fund managers, corporate advisers and consumers (Singn, 1997). Each of these categories requires training and maintenance of knowledge

Table 4 shows the infrastructural indicators of the East African Exchanges by the year 2011.

Though NSE has made tremendous development in the market infrastructure, through the establishment of Central Depository Settlement, Capital Market Authority and such like bodies, there still are issues relating to policy, legislation and control where we find conflicting roles and responsibilities. Some dealings recently reported in some of the listed companies such as CMC, KenolKobil and Uchumi Supermarkets puts the supervisory role of NSE into question.

The stock markets should expand on the various products they offer to their clientele. They also need to improve and promote existing products such as bond markets which have stagnated. There is also need to improve on the infrastructure to cope with technology trends and also interact with other global markets

Environmental Factors

The two basic building blocks necessary for a thriving securities market are a macroeconomic and fiscal environment conducive to the supply of good quality securities and sufficient demand for them and a market infrastructure capable of supporting efficient operation of the securities market (Pardy, 1992). Under this, the demand for and supply of securities is crucially linked to the state of the macro economy. If the macro economy is conducive to profitable business operations, a sufficient number of sound businesses can develop to a stage where access to securities markets (listing) is useful for their continued growth. This means that if there are not sufficient profitable businesses with good prospects for the future, there is little reason to have a securities market. Interest rate spreads are also high and at most unstable in all countries, standing at 12.6% in Tanzania, 13.6% in Kenya, and 14.2% in Uganda by the year 2007. Such wide spreads discourage both domestic saving and investment, as savers consider deposit rates too low and borrowers consider lending rates too high. In

the East African countries, domestic savings stand at less than 10% of GDP, which is too low to meet investment needs (Yenkey, 2011). During the year 2002, Kenya experienced poor output performance with an average GDP growth of about 1.3%. The supply of new equities into the capital market is thin and privatizations have accounted for the bulk of new issues in recent years. Kenya, which is the oldest and most active market, has only had a total of 12 new public listings since 1997, with 3 issues recorded for 2000 and 2001 respectively. Not surprisingly, the supply situation is worse in Tanzania and Uganda where the markets are much younger with less awareness of the benefits (and costs) of issuing equity. In the two countries combined, there have been only 7 equities issued to date and most firms still rely substantially on bank financing. Major factors limiting the supply of equities include the reluctance of many small family-owned businesses to dilute ownership, the tedious and costly process of making public offers and the generally underdeveloped state of the private sector in the region (KIPPRA, 2006).

Factors accounting for the low turnover ratios which limit the vibrancy in these markets include the limited floatation of shares and relatively high transaction costs. In Tanzania, only 34% of total market capitalization is available for trading and the largest company on the Dar es Salaam Stock Exchange (DSE), Tanzania Breweries, has only 7% of its shares on the market, with the rest held by controlling shareholders. The situation is similar in Kenya and Uganda where about 35% and 30% of market capitalization is available for trading respectively. In all East African countries, transaction costs range from 2-4% of the consideration and fixed commissions are the norm in Tanzania and Uganda. Kenya permitted negotiable commissions from April 2002. Liquidity is also limited by the high incidence of "buy-and-hold", especially among institutional investors who dominate the three markets (Kibuthu, 2005). Listed companies experienced losses or low profits as individuals faced low income thereby resulting in low demand for equities. This makes listing unattractive. In addition, the foreign investors' turnover and net foreign inflow declined between 2000 and 2002 due to political and economic uncertainties thereby reducing the amount of foreign portfolio investment that had been attracted into the country in

Table 5: Geographical distribution of demutualized exchanges in the world by 2006

Region	Number of demutualized exchanges	Percentage
America	9	29%
Europe	11	35%
Asia	7	23%
Australia	3	10%
Africa	1	3%

Source of Data: International Financial Statistics (IMF); Emerging Markets Database (IMF); (2008).

previous years (Kibuthu, 2005).

Many East African economies are still characterized by high fiscal deficits, high and volatile inflation, volatile and fast depreciating exchange rates and high interest rates. Policy inconsistency and macroeconomic instability will undermine the best laid out arrangements for a stock market. Thus, majority including NSE are considered risky not only by locals but also by foreign investors thus making them unattractive and uncompetitive. The East African Markets have also got to move with the trend which other world exchange markets are following in terms of demutualization to divorce membership from ownership. Some of the best stock markets which have done this include:-Toronto Stock Exchange (in Canada), Chicago Stock Exchange and New York Stock Exchange (in USA), Australian Stock Exchange (in Australia), Hong Kong Stock Exchange (Asia) and Johannesburg Stock Exchange (in Africa). This will open up the market for more listing by ensuring clear Management of NSE. Table 5 shows a summary of how the world exchanges have embraced demutualization.

It's critical that respective governments ensure prevalence of good micro and macroeconomic parameters as a prerequisite to sustainable economic development. Concerted efforts should also be put in place to ensure that economies in the region break barriers for cross listing to increase the number of firms listing. This will ensure vibrancy and liquidity of the market.

The development of capital markets requires dynamic and effective regulation. Regulation and supervision of the financial system also play a great role in determining both its stability and the extent of services provided. Regulation and supervision are typically aimed at the protection of investors from the potentially opportunistic behavior of insiders. Investor protection helps solve agency problems and information asymmetry arising from inside information. This helps in making optimal decisions, increasing access to external finance and resulting in productive investment and eventually higher firm growth (La Porta et al., 1997). A survey of African capital markets indicates that out of 19 markets, 15 of them have a formal supervisory authority. Most East African capital markets lack a robust regulatory framework. This is not because of lack of laws, rules or a

regulatory agency.

There are laws in place to regulate the securities markets while every stock exchange has a comprehensive set of rules for members and for listings.

In principle, copying laws and rules prevailing in other countries is relatively easy. The real challenge is the shortage of experienced supervisors and the absence of a strong tradition favoring compliance with the rules and discouraging regulatory forbearance (Vittas, 1998). In a recent case in an Asian emerging market, 10 brokers in the same room for two weeks called people to recommend that they buy the shares of a particular company (that they own but did not tell). After two weeks, the price of the share triples and the 10 men sold their shares and the price collapsed. The stock exchange and regulatory agency arranged prosecution but the court found no crime because no intent was proved (a case of a high evidentiary hurdle (Wellon, 2002)). Anecdotal evidence, in the East Africa and Kenya in particular, indicates that enforcement of rules and regulations is increasingly challenged by weak judicial systems making it difficult to obtain convictions when rules are violated. There is also a feeling that listing requirements are prohibitive and they target a cadre of firms that may not exist in this economy. Information asymmetry costs (adverse selection) tend to be an obstacle too for listing of small and medium firms (Yenkey, 2011).

It's important that the stock markets in the region even as they benchmark, they customize their regulatory frameworks to ensure that qualifying firms are not locked out from listing. These markets should train their staff to manage the evolving stock market.

Generally, there is lack of awareness and information on the role, functions and operations of the stock exchange and the Capital Market Authority (CMA) among potential investors and business entities. Many East Africans do not know enough about the NSE and the CMA, and the market does not seem to market itself sufficiently to potential investors or provide a variety of products to attract companies. This may be attributed to financial and human resource constraints. Firms in Kenya have an array of reasons why they would not list on stock markets. Apart from the lack of knowledge about how stock markets work, there are other reasons such as high

listing requirements and fear of losing control over family businesses (Kibuthu, 2005). However, this is not unique to Kenya alone within the continent. A study on the Ghana Stock Exchange (Yartey, 2005) revealed that 33 percent of firms surveyed were unwilling to list on the stock exchange because of fear of losing control. At the family businesses level, stock market could tap into potentially large amounts of financial wealth which exists outside of the financial system, by pursuing vigorous and consistent educational campaigns about stock markets at their levels.

The CMA has responded to the challenges of investor education by hosting workshops on themes pertinent to the development of capital markets, giving presentations at professional and business functions and publishing an annual report available to all market players. In addition, it has made arrangements for its members of staff to visit other countries and learn how they have worked to develop their capital markets in an attempt to build its capacity and learn from other more successful markets. However, there is need to improve the coverage of its investor education not only to large corporations and the business community in the city of Nairobi but also to the general public in other parts of the country. The lack of public awareness on NSE operations is a major hindrance to corporate participation in stock market (Kibuthu, 2005).

RESULT

The stock market in the region thus needs to critic their operations in relation to historical, environmental, informational, regulatory and institutional factors and apply the respective strategies to ensure that the region becomes a vibrant and liquid hub not only for local but also international investors.

CONCLUSION AND RECOMMENDATION

It's recommended that the stock market in the region should endeavor to integrate through formulating policies that will harmonize stock market operations. This will reduce bureaucracies and create an environment which will be conducive to firms to raise the needed capital.

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