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**EFFECT OF AN IPO ON THE FINANCIAL PERFORMANCE OF  
LISTED COMPANIES IN THE NAIROBI SECURITIES  
EXCHANGE**

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## **EFFECT OF ECONOMY PRICING STRATEGY ON THE PROFITABILITY OF INSURANCE FIRMS IN KENYA.**

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### **Abstract**

**Purpose:** The objectives of the study were to analyze effect of an IPO on the financial performance of listed companies in the Nairobi securities exchange

**Methodology:**The study will adopt an events study. The target of this study is companies that have issued IPOs and are listed in the Nairobi Securities Exchange.The sample will consist of companies that issued IPOs between 1996 and 2011.Our sample size is 13 listed companies in the NSE (Appendix II).The study will make use of secondary data.Market model will be used in coming up with Expected/Normal Return (R), Abnormal Return (AR), the Cumulative Abnormal Return (CAR) and then lastly, test for the significance of the study.

**Results:**It was also possible to conclude that there was a positive but insignificant relationship between mean market return and PBT.It was possible to conclude that the mean abnormal retruns after the IPO were higher than before IPOIt was possible to conclude that going public allows the firm to enhance its bargaining power with bankers and financial creditors, and consequently reduces the firm's cost of credit. It is also possible to conclude that selling shares to the public enhances a firm's financial flexibility by generating additional sources of capital to finance growth and expansion and these is reflected by the high share prices. The study also concludes that increase in investor recognition and shareholder base due to an IPO lowers the firm's cost of equity; enhances stock liquidity which is valuable for managerial incentive schemes, which inturn turn increases firm value. .

**Policy recommendation:** The study recommends that the current efforts of listing small firms/SMEs should be fast tracked so as to facilitate the listing of small firms. It was recommended that the listed companies to go public as this enhances a firm's financial flexibility by generating additional sources of capital to finance growth and expansion. This is reflected in their share prices.The study recommends that each county should have security exchange so that the private firms in the county can be listed. It was recommended that CMA should encourage firms to list as doing so would increases investor recognition and shareholder base which would lowers the firm's cost of equity and improves frims value

**Keywords:***IPO,*

## 1.0 INTRODUCTION

### 1.1 Background of the study.

*Ritter (1991)* An initial public offering (IPO) occurs when a security is sold to the general public for the first time, with the expectation that a liquid market will develop. In going public, an issuing firm will typically sell 20-40% of its stock to the public. The issuer will hire investment bankers to assist in pricing the offering and marketing the stock. In cooperation with outside counsel, the investment banker will also conduct a due diligence investigation of the firm, write the prospectus, and file the necessary documents with the now Nairobi Securities Exchange. After a successful IPO launch, a company is deemed to be a listed company in the stock Exchange. *Wu et al. (2009)* indicate that the most commonly used performance indicators are the return on assets (ROA) and the return on equity (ROE). The ROA is defined as the ratio of profits to total assets, and the ROE is calculated as the ratio of profits to equity.

*Greg (2006)* Listing of a company in the stock exchange has a particular procedure. It entails the company first issuing its shares and submitting its application and prospectus for approval to the authority with a copy to the Exchange through the sponsoring broker. Second, the Exchange shall submit its comments if any, to the Authority within ten working days of receipt of the copy of the application. Then the Authority shall consider as appropriate the comments of the Exchange while granting approval to listing. On receipt of a letter of approval to listing from the Authority in compliance with the Act, the Exchange shall approve the listing without any other conditions save the attainment of the prescribed minimum shareholding following a public offering or offer for sale, attainment of minimum subscriptions (if any) as disclosed in the information memorandum or prospectus, as the case may be, payment of listing fees and signing of the memorandum of listing. In case of Introductions and additional listings approved by the Authority, the Exchange shall admit securities to listing on payment of listing fees by the issuer without any further condition. The statutory requirements for additional issues prescribed by the Authority are set under Part V of these rules as the 'Fourth Schedule'. Other issues applicable to additional listings are set out in Schedule 2 under Part VI. The sponsoring stockbroker shall ensure the issuer complies with the documentation required under these rules (Nairobi Securities Exchange, 2011).

#### 1.1.1 Initial Public Offer (IPO)

*Greg (2006)* An Initial Public Offering (IPO) or *stock market launch* is a type of public offering where shares of stock in a company are sold to the general public, on a securities exchange for the first time. Through this process, a private company transforms into a public company. IPOs are often used by smaller or younger companies to raise expansion capital, to possibly monetize the investments of early private investors, and can also be done by large privately owned companies looking to become publicly traded enterprises.

In an IPO the issuer obtains the assistance of an underwriting firm which helps it determine what type of security to issue (common or preferred), the best offering price and the time to bring it to

the market also referred to as public offering. After the IPO, when shares trade freely in the open market, money passes between public investors. Although an IPO offers many advantages, there are also significant disadvantages, chief among these are the costs associated with the process and the requirements to disclose certain information that could prove helpful to competitors or create difficulties with vendors. Details of the proposed offering are disclosed to potential purchasers in the form of a lengthy document known as prospectus.

### **1.1.2 Financial Performance**

According to *Jain and Khan 2007* A subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firm's across the same industry or to compare industries or sections in aggregation. It measures the results of a firm's policies and operations in monetary terms. These results are reflected on measures such as a firm's Return on Investment, Return on Assets and Value added.

### **1.1.3 Effect of IPOs on Financial Performance**

Wu et al. (2009) indicate that the most commonly used performance indicators are the Return on Assets (ROA) and the Return on Equity (ROE). The ROA is defined as the ratio of profits to total assets, and the ROE is calculated as the ratio of profits to equity. The results that are obtained for the values of the ROA and ROE before and after an IPO are what show the relationship between an IPO and firm performance. They also noted that the profit after tax of a firm is affected by total assets as well as total equity which increase after an IPO issue. Operating performance as measured by either operating return on assets or cash flow over book value of assets, picks in period before the offering, worsens on impact at the IPO date. Production is assumed to depend on physical capital, which increases with the IPO. An IPO also allows the firm to overcome the borrowing constraints that keep production at an optimal level. The decision to be listed under the a stock exchange is triggered by a sudden and permanent increase in total factor productivity. Since the level of capital employed in production is set to advance at a level that is lower than the ex post efficient one, the return on assets increases too.

At the date of the IPO, equity increases given decreasing return to scale, the return on asset decline sharply in the IPO period. ROE shows how well a company uses investment funds to generate earnings growth. Firms conducting initial offerings have historically experienced relatively low long-run equity returns (*Ritter (1991), and Loughran and Ritter (1995)*). Additionally, these returns co vary with firm characteristics such as size and book-to-market (*Brav and Gompers (1997)* and (*Brav, Geczy, and Gompers (2000)*)).

## 1.2 Research Problem

Listing of companies in the stock exchange as a result of an IPO is something that is gathering momentum. It is evident that there are benefits that come with issuing shares to the public (Ritter and Welch (2002), Maksimovic and Pichler (2001), Pagano et al (1998), Merton (1987), Chemmanur and Fulghieri (1999)). These benefits can only be justified if an IPO has a positive influence on firm financial performance. The practice of listing of new issues on the stock market is of immense utility to the potential investors who can be sure that should they receive an allotment of new issues, they will subsequently be able to dispose them off any time. The absence of such facilities would act as some sort of psychological barriers to investment in new securities. The stock exchange exercise considerable control over the organization of new issues in terms of regulatory framework related to dealings in securities.

*Athi River Mining*, a cement and construction materials business financed expansion by selling shares to the public through an offer for subscription (IPO). *Access Kenya Limited*, a corporate Internet service provider wanted to raise Kshs.800 Million to finance growth and at the same time acquire the option to use its own shares as instruments for acquisitions. It sold 40% equity to achieve this. The Government of Kenya offered 30% of its shareholding in *Kengen* for sale to the public through an Initial Public Offer (IPO). *Kengen's* shares were listed on the Nairobi Securities Exchange (NSE) and they instantly revitalized the capital markets. The Aga Khan group, majority owner of *TPS Serena* wanted to realize capital gains by partially divesting in the business through an IPO. The group later incorporated its other East African hotels businesses in the listed entity. It therefore created *TPS Serena EA* and substituted its shares with those of the former *TPS Serena Limited* which only constituted Kenyan operations.

*Carpenter and Rondi (2006)* found out that firms grow more slowly after an IPO. Their results suggest that going public does not guarantee faster growth or more jobs. As such, public policies that simply increase access to equity markets may not be effective unless they provide incentives for the firms' decision-makers to use the new capital to grow. *Wu and Chen (2009)* found that operational performance of listed banks is inferior to that of unlisted banks. The launching of IPOs by Chinese banks is found to have a significant positive impact on the Return on Assets. Their findings show a weak to moderate positive relationship between going public and firm performance.

*Kipnetich, Kibet, Guyo and Kipkoskey (2011)* found that public information disclosed in the prospectus is insignificantly mirrored in IPO offer prices and that rational theory cannot explain the effect of investor sentiment in IPO market in Kenya. *Ngugi and Njiru (2005)* found that only three companies were listed in the Nairobi Securities Exchange between 1980 and 1989 while between 1990 and 1999 there were nine listed companies, four of which were part of the ongoing privatization of government parastatals. They noted the growing popularity of listing companies in the NSE, this has been the trend to date. *Yenkey (2012)* found that state policies in Kenya condition the investing public to adopt short-term orientations toward share ownership. The role played by IPOs in recruiting new investors can scarcely be overstated as 98% of all new recruits to investors' capitalization in Kenya who entered the system by subscribing for shares in an IPO

rather than purchasing shares in an open market trading. *Dawnter and Malatesta (1997)* found that in an effort to recruit new investors into newly formed stock exchanges, policy makers in many developing and transition economies employ politicized offer terms when conducted IPOs.

*Ochieng (1984)* recommended that focus be on enlightening the investing public on a number of salient issues especially after the introduction of electronic commerce such as knowing the investment climate.

There had been extensive research done in developed countries; Jain and Kini (1994 and 1995) and Mikkelson, Partch and Shah (1997) have done so for the US market, Pagano, Panetta and Zingales (1998) for the Italian market, Khurshed, Paleari and Vismara (2003) for the UK market, Wang, Wang, and Lu (2003) for the Singaporean market, and Cai and Wei (1997) and Kutsuna, Okamura, Cowling (2002) for the Japanese market on the influence of an IPO on firm financial performance. This study aims at filling the gap by studying the same in Kenya, a developing economy, to see if the findings from developed economies can be replicated in developing economies. In Kenya, a few studies have been carried out on IPOs; Kipnetich, Kibet, Guyo and Kipkoskey (2011), Ngugi and Njiru (2005), Christopher Yenkey (2012), Dawnter and Malatesta (1997), Ochieng (1984). These local studies focused on IPO pricing and the influence of IPOs on investors. This study attempts to address the following research question: Do IPOs have an effect on the Financial Performance of companies listed in the Nairobi Securities Exchange?

### **1.3 Objective of the Study**

To determine the effect of an IPO on the financial performance of listed companies in the Nairobi Securities Exchange.

## **2.0 LITERATURE REVIEW**

### **2.1 Theoretical Orientation**

#### **2.1.1 Market Timing Theory**

The theory predicts that the correct capital structure is the cumulative effects of past financing decisions as does the pecking order theory, the major difference is that the market timing involves Issuance or repurchase of mispriced securities, while the pecking order imposes a preference ordering on the financial choices. Baker and Wurgler (2002) If firms do try to revert to the target leverage ratio market timing will have only a temporary effect on capital structure.

### **IPOs and Firm Financial Performance**

*Ritter (1998)* noted that most companies start out by raising equity capital from a small number of investors, with no liquid market existing if these investors wish to sell their stock. If a company prospers and needs additional equity capital, at some point the firm generally finds it desirable to 'go public' by selling stock to a large number of diversified investors. Once the stock is publicly traded, this enhanced liquidity allows the company to raise capital on more

favorable terms than if it had to compensate investors for the lack of liquidity associated with a privately-held company. Existing shareholders can sell their shares in open-market transactions.

*Pagano et al (1998)* observed that independent companies experience a reduction in the cost of bank credit after an IPO. This effect is present even controlling for firms' characteristics and for the reduction in leverage experienced after going public. Moreover, after the IPO, these firms borrow from a larger number of banks and reduce the concentration of their borrowing. The reduced cost of credit may stem from the improved public information associated with stock exchange listing or from the stronger bargaining position vis-à-vis banks determined by the availability of an outside source of funds.

*Ritter and Welch (2002)* argue that most firms go public primarily to raise new capital for growth. *Kim and Weisbach (2008)* examine IPOs from 38 countries and find that almost all firms raise a substantial amount of new capital in the IPO, but new funds raised in the IPO are used for several purposes in addition to financing growth, such as rebalancing leverage and increasing cash balances.

*Lyandres et al. (2008)* argue that firms go public primarily to pursue an efficient merger and acquisition strategy. They assume that a private firm is uncertain about the precise value of its capital. An IPO removes this valuation uncertainty and allows the firm to exercise its restructuring options optimally with cash or stock financing for acquisitions.

## 2.2 Empirical Review

*Merton (1987)* Foreign Firms in the US Market. This study was carried out in the United States. He undertook clinical investigation of 31 initial public offers by foreign firms in the US. The IPO process for foreign firms focuses on the firm for US shareholders emphasizing the transparency in the IPO offerings. The finding of this study were: foreign firms making IPOs in the US are larger and more mature and have more significant if not dominant position; foreign firms come to America in the belief that their securities undervalued at home will be appropriately valued in the US and are out to obtain greater financial flexibility by listing their securities in America.

The model consists of a large number of investors with identical initial wealth and he defines investor recognition of a security as the fraction of investors who know about the security. There are several issues to consider in developing an empirical proxy for Merton's construct. First, we cannot directly observe how many investors 'know about' a particular security. We can, however, observe the number of institutional investors who own a security. It seems reasonable to argue that the number of investors who know about a security is increasing in the number of investors that own the security. He predicted that an increase in investor recognition and shareholder base lowers the firm's cost of equity and increases its value.

### 2.3. Conceptual Framework

#### Independent variables

#### Dependent Variable



Source: Figure 1: Conceptual Model Researcher (2013)

### 3.0 METHODOLOGY

The study will adopt an events study. The target of this study is companies that have issued IPOs and are listed in the Nairobi Securities Exchange. The sample will consist of companies that issued IPOs between 1996 and 2011. Our sample size is 13 listed companies in the NSE (Appendix II). The study will make use of secondary data. Market model will be used in coming up with Expected/Normal Return (R), Abnormal Return (AR), The Cumulative Abnormal Return (CAR) and then lastly, test for the significance of the study.

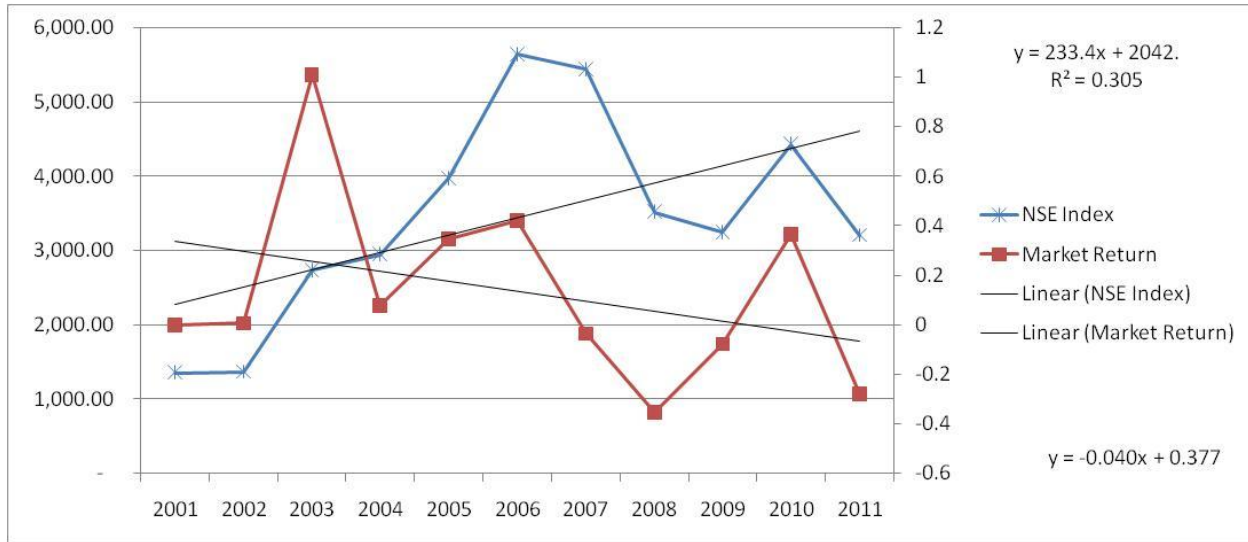
### 4.0 RESULTS FINDINGS

#### 4.1 Descriptive Results

Results in figure 1 indicate that the NSE index has gradually risen since year 2001. However, a sharp decline was witnessed in the year 2008 due to post election violence. The graphical representation of market returns indicates that the market return has been on the decline since the year 2001. The largest decline in market return was witnessed in year 2008 as results of the post election violence of 2007.

**Figure 1: NSE PBT and Returns (2001 to 2011)**



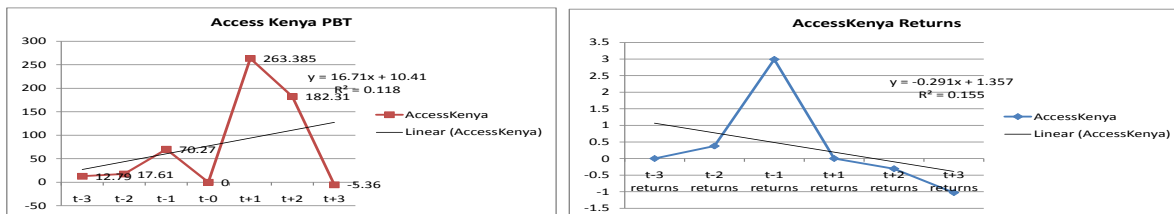


Descriptive results in figure 2 indicates that there was a consistent increase in PBT before and after the Scan Group IPO. However, the returns seem to have increased before the IPO but declined after the IPO.

**Figure 2: Scan Group PBT and Returns**

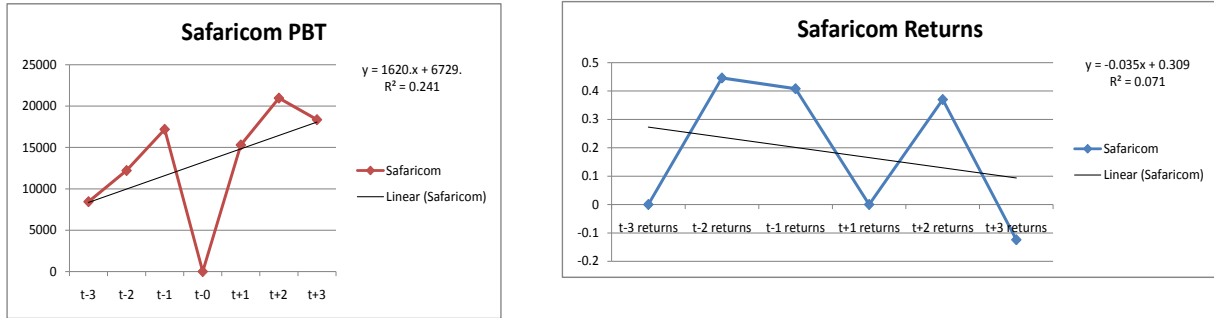
Descriptive results in figure 4.3 indicate that there was a consistent decline in Access Kenya PBT before and after the IPO.

**Figure 3: Access Kenya returns and PBT**

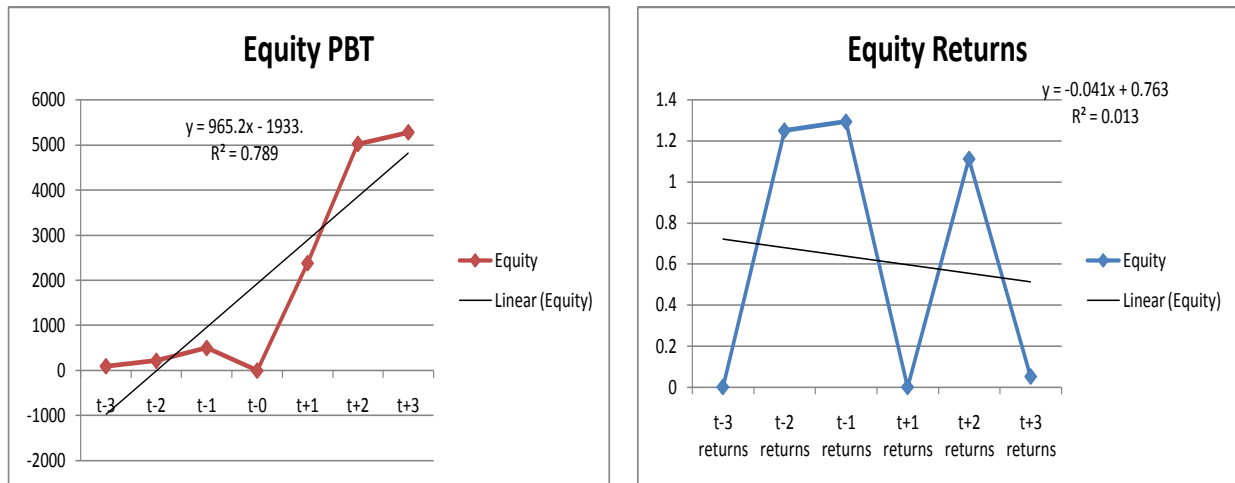


Descriptive results in figure 3 indicate that there was a gradual rise in SAFARICOM PBT before and after the IPO. However, a slight decline was reported in year t+3. The returns indicate an overall decreasing trend.

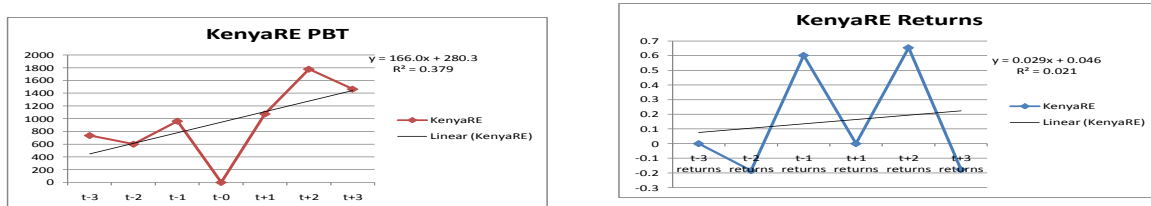
**Figure 4: Safaricom Kenya returns and PBT**



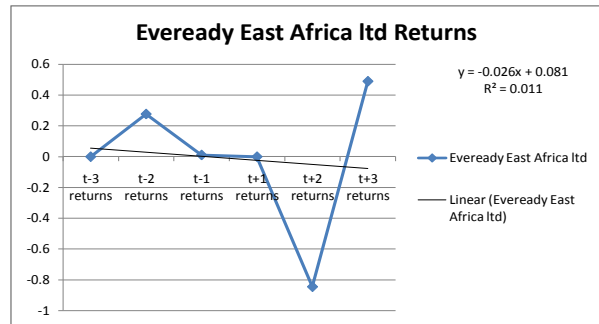
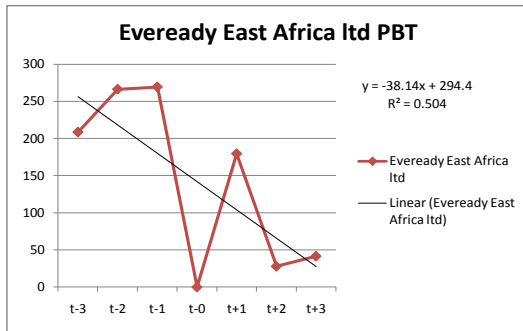
**Figure 5: Equity Bank Kenya returns and PBT**



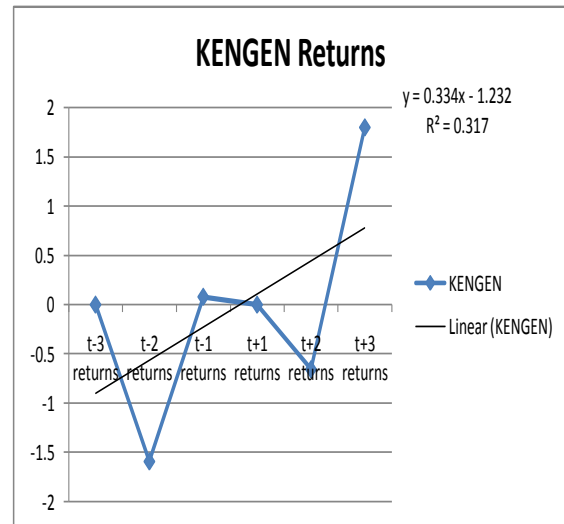
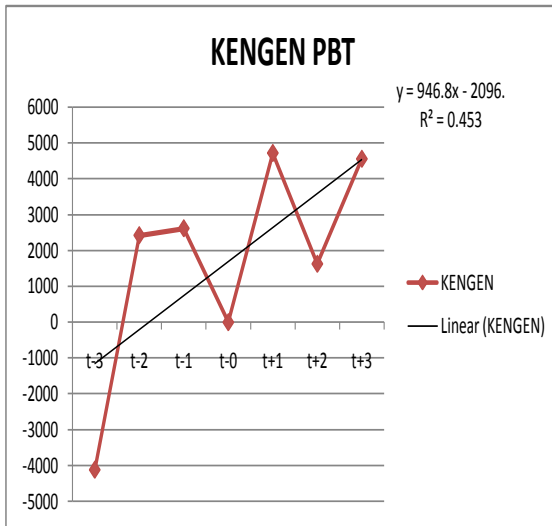
**Figure 6: Kenya RE returns and PBT**



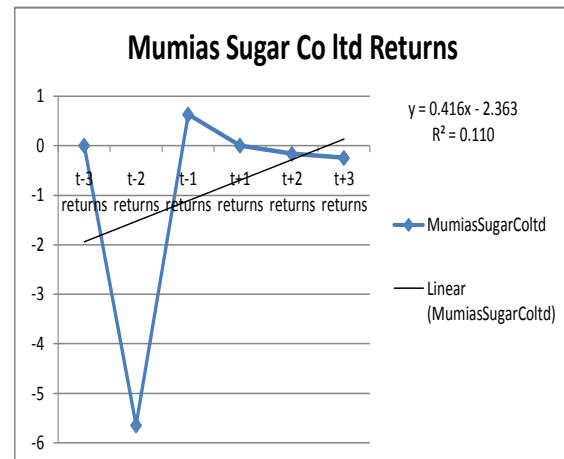
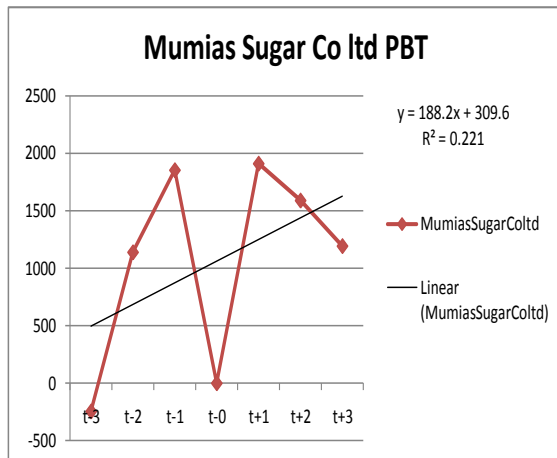
**Figure 7: Eveready East Africa returns and PBT**



**Figure 8: Kengen returns and PBT**



**Figure 9: Mumias Sugar returns and PBT**



### Individual Firm PbtAnd Returns

Table 1 presents the PBT and returns of the 8 companies that were listed between year 2000 and year 2011.

**Table 1: Individual firm PBT and returns**

Firm	Listi ng_ Date	t-3	t-3 retur ns	t-2	t-2 return s	t-1	t-1 retur ns	t-0	t+1	t+1 retur ns	t+2	t+2 retur ns	t+3	t+3 retu rns
Scangro up	200 6	52.6 1	-	88.06	0.67	200. 99	1.28	-	244.40	-	436. 76	0.79	544. 10	0.25
Access Kenya	200 7	12.7 9	-	17.61	0.38	70.2 7	2.99	-	263.39	-	182. 31	(0.3 1)	(5.3 6)	(1.0 3)
Safaric om	200 8	8,44 4.47	-	12,210 .50	0.45	17,1 92.7 4	0.41	-	15,304. 02	-	20,9 66.6 7	0.37	18,3 61.3 6	(0.1 2)
Equity	200 6	97.0 0	-	218.25	1.25	500. 53	1.29	-	2,378.0 0	-	5,02 2.00	1.11	5,27 8.00	0.05

KenyaRE	2006	735.79	-	600.29	(0.18)	961.49	0.60	-	1,074.40	-	1,777.02	0.65	1,463.80	(0.18)
EvereadyEastAfricaltd	2006	208.58	-	266.39	0.28	269.36	0.01	-	179.51	-	27.86	(0.84)	41.50	0.49
KENGEN	2006	(4,112.19)	-	2,425.70	(1.59)	2,618.80	0.08	-	4,719.20	-	1,628.80	(0.65)	4,556.20	1.80
MumiasSugarCoLtd	2006	-245	-	1,139.00	(5.65)	1,853.00	0.63	-	1,910.00	-	1,589.20	(0.17)	1,193.00	(0.25)

## NSE INDEX AND RETURNS CORRESPONDING TO EACH FIRM

Table presents the calculated NSE returns. The NSE returns were matched against the time of the individual company listing.

**Table 2: NSE Index and Returns Corresponding To Each Firm**

Firm	t-3_Nse	t-3_Nse_returns	t-2_nse	t-2_nse_Returns	t-1_Nse	t-1_Nse_returns	t-0_nse	t+1_Nse	t+1_Nse_Returns	t+2_Nse	t+2_Nse_Returns	t+3_Nse	t+3_Nse_Returns
Scangroup	2,738.00	-	2,948.00	0.08	3,973.00	0.35		5,444.83	-	3,521.18	(0.35)	3,247.44	(0.08)
AccessKenya	2,948.00	-	3,973.00	0.35	5,645.65	0.42		3,521.18	-	3,247.44	(0.08)	4,432.60	0.36
Safaricom	3,973.00	-	5,645.65	0.42	5,444.83	(0.04)		3,247.44	-	4,432.60	0.36	3,205.00	(0.28)
Equity	2,738.00	-	2,948.00	0.08	3,973.00	0.35		5,444.83	-	3,521.18	(0.35)	3,247.44	(0.08)

KenyaRE	2,73 8.00	-	2,94 8.00	0.08	3,97 3.00	0.35		5,44 4.83	-	3,52 1.18	(0.35)	3,24 7.44	(0.08)
Eveready EastAfric altd	2,73 8.00	-	2,94 8.00	0.08	3,97 3.00	0.35		5,44 4.83	-	3,52 1.18	(0.35)	3,24 7.44	(0.08)
KENGEN	2,73 8.00	-	2,94 8.00	0.08	3,97 3.00	0.35		5,44 4.83	-	3,52 1.18	(0.35)	3,24 7.44	(0.08)
MumiasS ugarColtd	2,73 8.00	-	2,94 8.00	0.08	3,97 3.00	0.35		5,44 4.83	-	3,52 1.18	(0.35)	3,24 7.44	(0.08)

### 4.3 Estimated Market Model

The market model was estimated by regressing the Average PBT against the NSE/Market return. The coefficient of determination (Rsquared) indicates that 10.4% of the variation in PBT is explained by market return. This implies that 89.6% of variations in PBT are explained by other factors not included in the model.

**Table 3: Coefficient of Determination**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.323 <sup>a</sup>	.104	-.344	.69278

a. Predictors: (Constant), Market\_return

Results in table 4 indicates that the relationship between market return and PBT is positive but insignificant. A beta of 0.823 implies that an increase in market return by one unit leads to an increase in PBT by 0.823 units. The regression since the reported p values is 0.677. A p value of 0.677 indicates that there is a very high probability that the null hypothesis of “no significance” is true.

**Table 4: Regression coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		

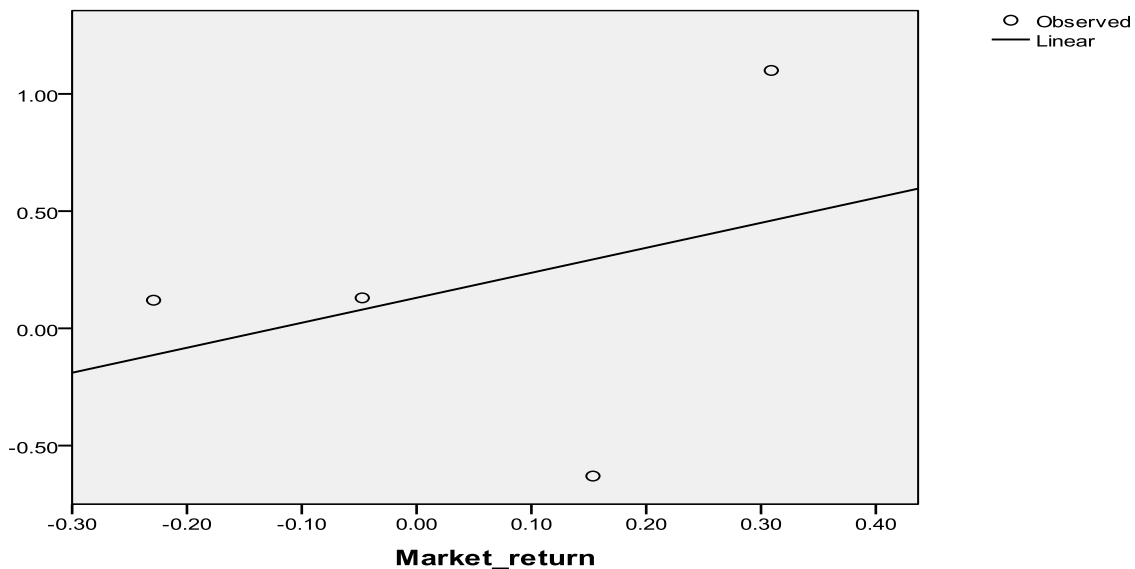
1	(Constant)	.113	.355		.318	.781
	Market_return	.823	1.705	.323	.483	.677

a. Dependent Variable: stock\_return

**PBT = 0.113 + 0.823 Market Return**

A graphical representation of the market model indicates that there is a positive linear relationship between market return and PBT.

**Figure 10: Graphical relationship between market return and PBT**



**4.4 Calculation of Expected Returns**

The calculated Alpha and Beta were used to estimate the expected returns. The expected returns were used to calculate the abnormal returns. The final results of the abnormal returns are given in table 4.5. The results indicate that the abnormal returns in t-2 period as -0.79, in t-1 the abnormal return was 0.54, t+2 was 0.19 and t+3 was 0.05.

**Table 5: Expected and Abnormal Returns**

Time	a	b	markt_return	expected _Stock_return	Actual_Stock_Re turn	Abnormal_Ret urns
t-2 returns	0.113	0.823	0.15	0.24	(0.55)	(0.79)
t-1 returns	0.113	0.823	0.31	0.37	0.91	0.54
t+2 returns	0.113	0.823	(0.23)	(0.08)	0.12	0.19
t+3 returns	0.113	0.823	(0.05)	0.07	0.13	0.05

#### 4.5 T-Test Calculations

A t-test was conducted to test whether the mean abnormal return differs between the two time periods. Results in table 4.6 indicates that the mean abnormal stock return before the IPO was - 0.1227 while the mean abnormal returns after IPO was 0.1227

**Table 6: Mean Abnormal Returns before and after IPO**

IPO	N	Mean	Std. Deviation	Std. Error Mean
Abnormal_stock_return Before IPO	2	-.1227	.94312	.66689
After IPO	2	.1227	.10072	.07122

## 5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

### 5.1 Conclusions

It was also possible to conclude that there was a positive but insignificant relationship between mean market return and PBT. The findings imply that the market return positively influences the PBT. It was possible to conclude that the mean abnormal returns after the IPO were higher than



before IPO. However, the difference between the two periods is insignificant. These results suggest that investors appear to value firms going public based on the expectation that earnings growth will continue, while in actuality the pre-IPO profit margins, on which the expectations are formed, are not even sustained. There are a number of potential explanations for the decline in the post-issue operating performance of IPO firms. One explanation is related to the potential for increased agency costs when a firm makes the transition from private to public ownership.

It was possible to conclude that going public allows the firm to enhance its bargaining power with bankers and financial creditors, and consequently reduces the firm's cost of credit. It is also possible to conclude that selling shares to the public enhances a firm's financial flexibility by generating additional sources of capital to finance growth and expansion and these is reflected by the high share prices. The study also concludes that increase in investor recognition and shareholder base due to an IPO lowers the firm's cost of equity; enhances stock liquidity which is valuable for managerial incentive schemes, which in turn increases firm value. These firm value is reflected in rising share prices and returns.

## **5.2 Policy Recommendations**

It was recommended that the listed companies to go public as this enhances a firm's financial flexibility by generating additional sources of capital to finance growth and expansion. This is reflected in their share prices.

It was recommended that CMA should encourage firms to list as doing so would increase investor recognition and shareholder base which would lower the firm's cost of equity and improve firm value. It was recommended that private firms should be encouraged to list as doing so enhances stock liquidity which is valuable for managerial incentive schemes, and this in turn increases firm value.

The study recommends that each county should have security exchange so that the private firms in the county can be listed. This will be in the spirit of devolution. The shares listed at county level can also be cross listed in the Nairobi Stock exchange on top of being cross listed in other East African Countries.

The study recommends that the current efforts of listing small firms/SMEs should be fast tracked so as to facilitate the listing of small firms. This would enhance their value as they would access finance which is crucial for growth. This would in turn increase employment opportunities in Kenya and lead to achievement of Vision 2030. SMEs have been noted to be the engines of growth and may be the answer to the achievement of 10% annual GDP growth.

## **5.3 Limitations of the study**

One of the limitations of the study was that the study did not investigate all the firms listed in the Nairobi Securities Exchange. Only 8 firms spanning the period 2000 to 2011 were included in

the study and this produced good results. The best results would have been obtained from a set of 50 companies currently listed at the NSE. However, accessing data of these 50 companies may be a problem.

Another limitation was that the study did not establish the perceptions and expectations of investors about how share prices should behave after an IPO. Such a study would have shed some insights on some of the behaviors observed during and after an IPO. For instance, what can explain the herding behavior witnessed in IPOs?. In addition, what can explain the speculative behavior of investors after IPOs?.

The study did not address the effect of IPOs on stock returns. The use of share prices may reveal a different picture from that of PBT. However, availability of share prices before IPO presents a problem. A study linking IPO to stock returns would have portrayed a clear picture.

The study failed to address whether the governance of companies changes after IPOs. The expectation is that listed firms should have better corporate governance than non listed firms. This issue is critical as witnessed by the infamous CMC incident where top managers and directors were accused of fleecing company accounts despite being listed.

#### **5.4 Suggested Areas of Further Research**

The study suggests that further areas of study should be on investigating the effect of IPO on all the firms listed in the Nairobi Securities Exchange.

The study suggests that further areas of study should be on establishing the perceptions and expectations of investors about how share prices should behave after an IPO. Such a study would yield insights on speculative behaviours of investors.

Future studies should consider addressing the effect of IPOs on stock returns. A dummy modeling approach should also be used to capture the effect of IPO on stock prices and stock returns.

Future studies should examine whether the governance of companies changes after IPOs and whether listed firms do better at corporate governance compared to non listed ones.

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