Effect of Stock Market Listing on Financial Performance of Companies Listed in Nairobi Securities Exchange

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Abstract: **This study is on the effect of stock market listing on financial performance of companies listed in Nairobi Securities Exchange (NSE). The specific objectives of the study determining how the nature of business industry and size of companies affected their financial performance, how government policy effected through Capital Markets Authority (CMA) influenced financial performance of companies listed in NSE, how management of the companies listed in NSE affected their financial performance, and how availability of information influenced the financial performance of companies listed in NSE. The Population of the study as well as the target population was a census of all 61 listed companies at the Nairobi Securities Exchange (NSE) as at 31st December 2012. This study established that in general stock market listing affects different profitability ratios in different ways. Some improve as a result of stock market listing while others deteriorate.**

Keywords: **Nairobi Securities Exchange (NSE), Listing, Return on Assets (ROA), Return on Equity (ROE).**

1. INTRODUCTION

Trading in securities in Kenya started way back in the 1920s through call-over systems. The NSE started in 1954 as a voluntary association of stock brokers and was registered under the Societies Act after getting clearance from London Stock Exchange. After independence there were changes. Nineteen sixty-six (1966) was taken as the base year and 100 points were used in the trading. But after 1991 it started using 20 share index and geometric mean.

There were many quoted companies by 1990s quoted companies representing different sectors namely the Agricultural, commercial and services; finance & investment &; Industrial & Allied sectors in Alternative Investment Market. Trading on the stock exchange has become a fashionable tool for raising capital. Investors have become increasingly aware of the potential of the Nairobi Stock Exchange (Kihumba, 1993).

There is lack of public awareness at the NSE. However, CMA was constituted and segmentation of the NSE started in 2001 in order to encourage companies to trade in the NSE. There has been -0.83% growth in the NSE since its inception. In 2001 the government through CMA decided to introduce market segmentation at the NSE in order to enable as many companies as possible to list at the NSE. The following are the segments:

i.   Main Investment Market Segment (MIMS)

ii. Alternative Investment Market Segment (AIMS)

iii. Fixed Investment Securities Market Segment (FISMS)

Studies into this segmentation concludes that it has affected the prices of securities significantly (Chepng'ar, 2006; Ngugi, 2003)).

The stock exchange currently runs on an electronic trading platform known as the automated trading system and is open daily for a six-hour trading period. The stock exchange's main market index is the NSE 20 Share Index and also has an aggregate index known as the NASI All Share Index. The exchange trades in ordinary equity, preference shares and treasury bonds and has four companies cross-listed on regional stock markets. Within the last few years the Nairobi bourse has grown from a market capitalization of Ksh112.59 billion ($1.42 B) in 2002 to Ksh853.88 billion ($12.38 B) in 2008 (it hit a peak of Ksh1.28 trillion ($18.53 B) in June 2008 (NSE Handbook, 2006).

The stock market has increasingly become an avenue for bridging the requirements for both investors and borrowers. From early nineties many firms have been raising new equity through stock market for the first time. The role of raising capital by going public cannot be underplayed. A public offer if properly executed has the potential of raising large sums that would otherwise not be possible through borrowing. Going public offers a relatively cheap source of capital for investment and working capital requirements compared to the traditional intermediaries. It is, therefore, important to evaluate the effect that listing of a company at the Nairobi Stock Exchange has on its financial performance.

Previous researches (Jumba, 2002; Maina, 2005) have concentrated on the underpricing of IPOs. These two studies looked at changes in prices after IPOs and concluded that IPOs are followed by initial high returns hence are underpriced. A recent study by Weche (2005) on the pre and post privatization on financial performance of companies listed through the NSE covered only previously state owned enterprises. Not all quoted companies were state owned enterprises prior to their listing since there are many quoted companies which were privately owned before going public. For instance between 1984 and 2000, there were sixteen IPOs of which thirteen were issues by private companies while three were issues by the government as part of the privatization programmes. Weche's results of profitability and decrease in the leverage levels apply only to the previously state owned firms prior to their listing. Weche's study was therefore limited.

Going public may affect the firms' performance. Pagano, Panetta, and Zingales (1998) in their study found that profitability declines after IPO then increases gradually after the first year. The study also established that companies deleverage immediately after IPO. From such studies, it is apparent that most research studies in the area have been done in developed markets with very little evidence for emerging markets, particularly Kenya. This study, therefore, tries to bridge this gap by investigating the effect of listing companies at the NSE on their financial performance.

2. METHODOLOGY

This study is an exploratory study and it utilizes survey method. A survey is an attempt to collect data from members of a population in order to determine the current status of that population with respect to one or more variables. Survey is therefore a self-report study which requires the collection of quantifiable information from the sample (Mugenda and Mugenda, 2003).

The data for the study was collected from websites of the Companies and the Capital Market Authority Library where all financial reports of companies listed are stored so that the public can have access to them whenever they need them. The target populations of the study are the 61 firms listed in Nairobi Securities Exchange as at close of 31st December 2012 trading period. Purposive sampling was used by the researcher.

The data that was used in this study is secondary data that was collected based on the annual financial statements reports released by the companies which have listed there shares at the Nairobi Securities Exchange as at 31st December 2012. The data was analyzed and reported quantitatively using descriptive and inferential statistics.

3. FINDINGS

3.1 Introduction:

These are the findings of the study on the survey of companies listed at the NSE between 1993 and 2012. The findings have been summarized in tables to give the general background information of the companies studied and graphs to show the trend of financial performance.

3.2 Return on Assets:

Table 1: Return on Assets

	Year 1 %	Year 2 %	Year 3%	Year 4 %	Year 5 %	Year 6 %
Cmc	2.00	1.70	1.50	3.90	4.80	5.40
Firestone	27.00	27.00	6.00	45.00	47.00	46.00
Mumias	0.271	1.31	7.66	0.684	-2.39	8.65
Kengen	4.80	2.20	2.30	2.40	4.50	1.90
Scan Group	7.14	10.22	14.51	13.94	8.37	10.20
Equity	2.50	2.00	3.00	3.60	5.00	4.20
Access Kenya Group	2.37	15.40	5.86	13.00	13.60	6.40
Eveready	32.70	38.10	32.90	19.70	3.30	4.20
Average	**9.85**	**12.24**	**9.22**	**12.78**	**10.52**	**10.87**

Table 2: Average Returns on Assets

Average Return on Asset		
	Before Listing %	**After Listing %**
CMC Motor	1.70	4.70
Firestone	20.00	46.00
Mumias	3.08	2.10
Kengen	3.10	8.80
Scan Group	10.60	10.80
Equity Bank	2.50	4.30
Access Kenya	7.88	11.00
Eveready	3.46	9.07
Average ROA	**10.44**	**11.39**

ROA is an indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is using its assets to generate earnings. CMC recorded a steady increase after listing over next three years under study. Firestone recorded a sharp increase in the first year after listing then a relatively stable ratio in the next two year under study. Mumias decreases in the first two years after listing having a negative ratio then increases in the last year of study. Kengen and Equity recorded a stable ratio in the first year after listing then a slight increase in the second year followed by a decrease in the third year. Scangroup recorded a stable ratio in the first year after listing then a decrease in the second year followed by a slight increase in the third year under study. As a result its average remained relatively stable with only an increase of 0.2% after listing. Access Kenya recorded a sharp increase in the first year after listing followed by a steady increase in the second year and a relatively sharp decrease in the third year under study. Eveready decrease sharply in the first two year after listing in the years under study then records a slight increase in the third year after listing in the years under study. On average the companies studied exhibited a slight increase in the return on assets from 10.44% before listing to 11.39% after listing.
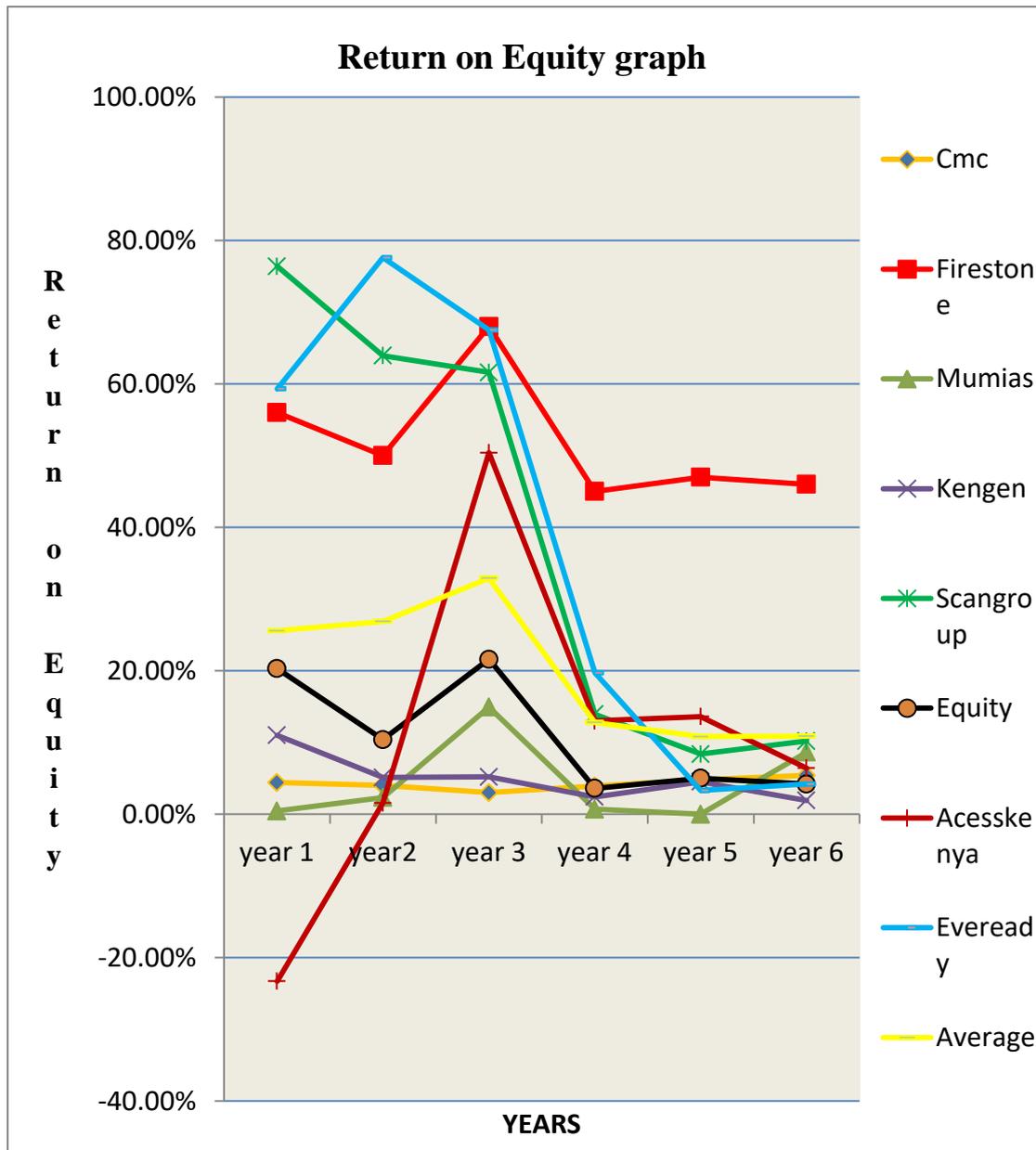
3.3 Return on Equity:

Figure 1: Return on Equity Graph

Table 3: Average Return on Equity

Average Return On Equity		
	Before Listing %	**After Listing %**
CMC Motor	3.80	15.43
Firestone	41.20	47.00
Mumias	5.90	3.84
Kengen	7.10	4.73
Scan Group	67.31	22.21
Equity Bank	17.43	17.07
Access Kenya	9.55	16.20
Eveready	68.13	13.53
Average ROE	**29.65**	**17.50**

ROE is the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. CMC recorded a steady increase in the ROE after listing. Firestone, Kengen and Scan group exhibited a decrease immediately after listing which continued for the next two years under study. Mumias performance decreased in the first two years after listing exhibiting a negative ratio, in the second year it increased in the following year; however, the average returns on equity after listing of 3.84% is lower than the average of 5.90% before listing. Equity's ratio decreases immediately after listing then increases in the following years under study. Access Kenya exhibits a seismological pattern where it decreases sharply after listing then increases slightly followed by a decrease in the last year of study. Eveready decreases sharply after listing for the following two years followed by a relative stability in the last year. In average, the companies under study recorded a decrease after listing from 29.65% to 17.50%.

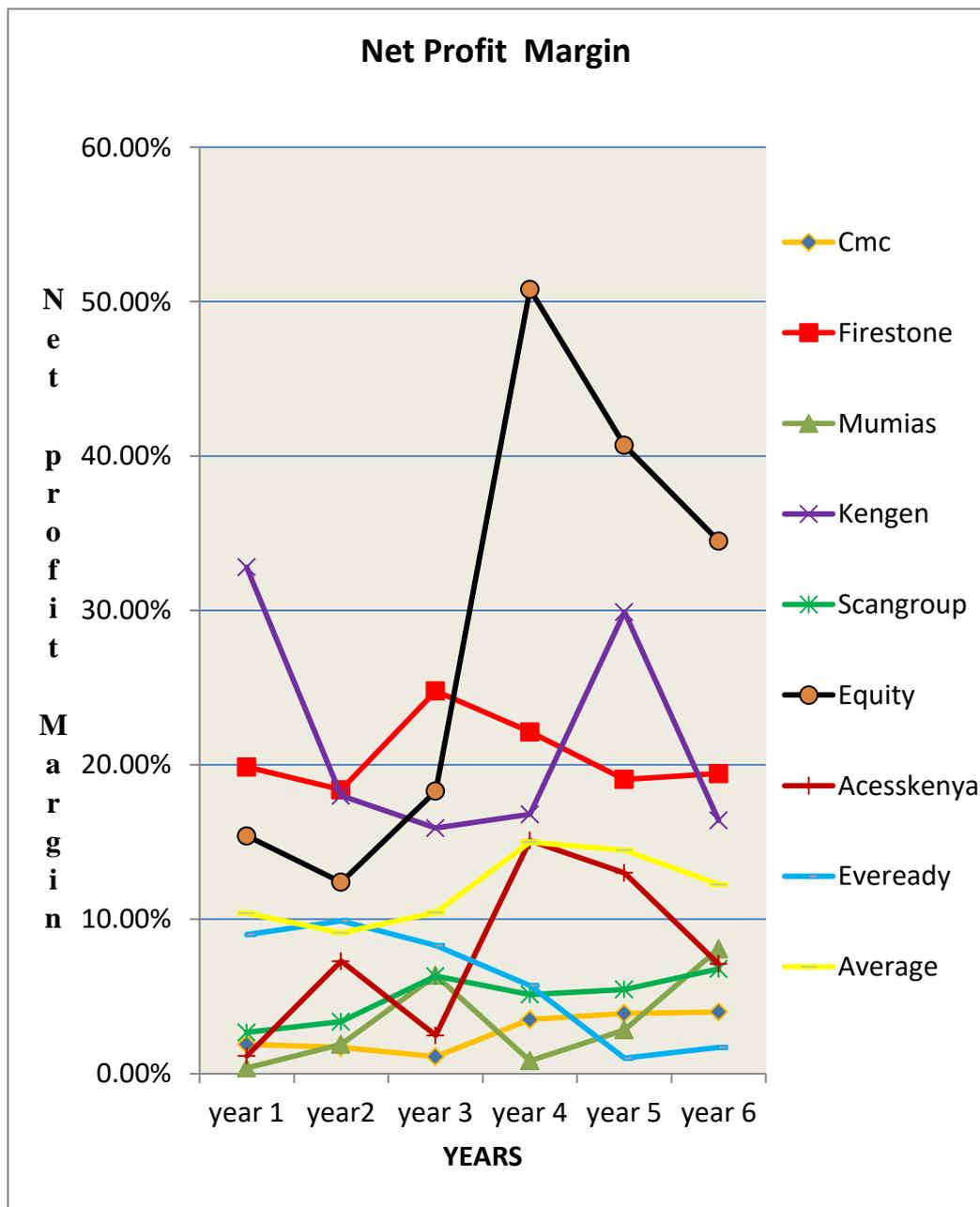**3.4 Net Profit Margin:**

Figure 2: Net Profit Margin Graph

Profit margin, net margin, net profit margin or net profit ratio all refer to a measure of profitability. It is calculated by finding the net profit as a percentage of the revenue. The study showed that CMC's net profit margin increased slightly immediately after it was listed. The increase continued for the next three years under study. However for firestone, the net profit margin decreased immediately after listing which continued for the next three years under study, Eveready follows the same pattern except that the decline started before the listing. Mumias decreased immediately after listing for one year and then increased in the following years under study. Kengen exhibited a seismological pattern after listing where it remains relatively stable for one year after listing, then deteriorates from an increase to a decline in the following years. As a result the average net profit margin of 22.23% decreases to 21.03% after the company was listed. Scan group recorded a decline immediately after listing then rises slightly in the last year under study. As a result its average rises from 4.12% to 5.78% after listing. Equity's and Access Kenya net profit margin increased after listing then declined in the next two years under study. However the average of all the companies studied increased from 9.98% before listing to 13.91% after listing.
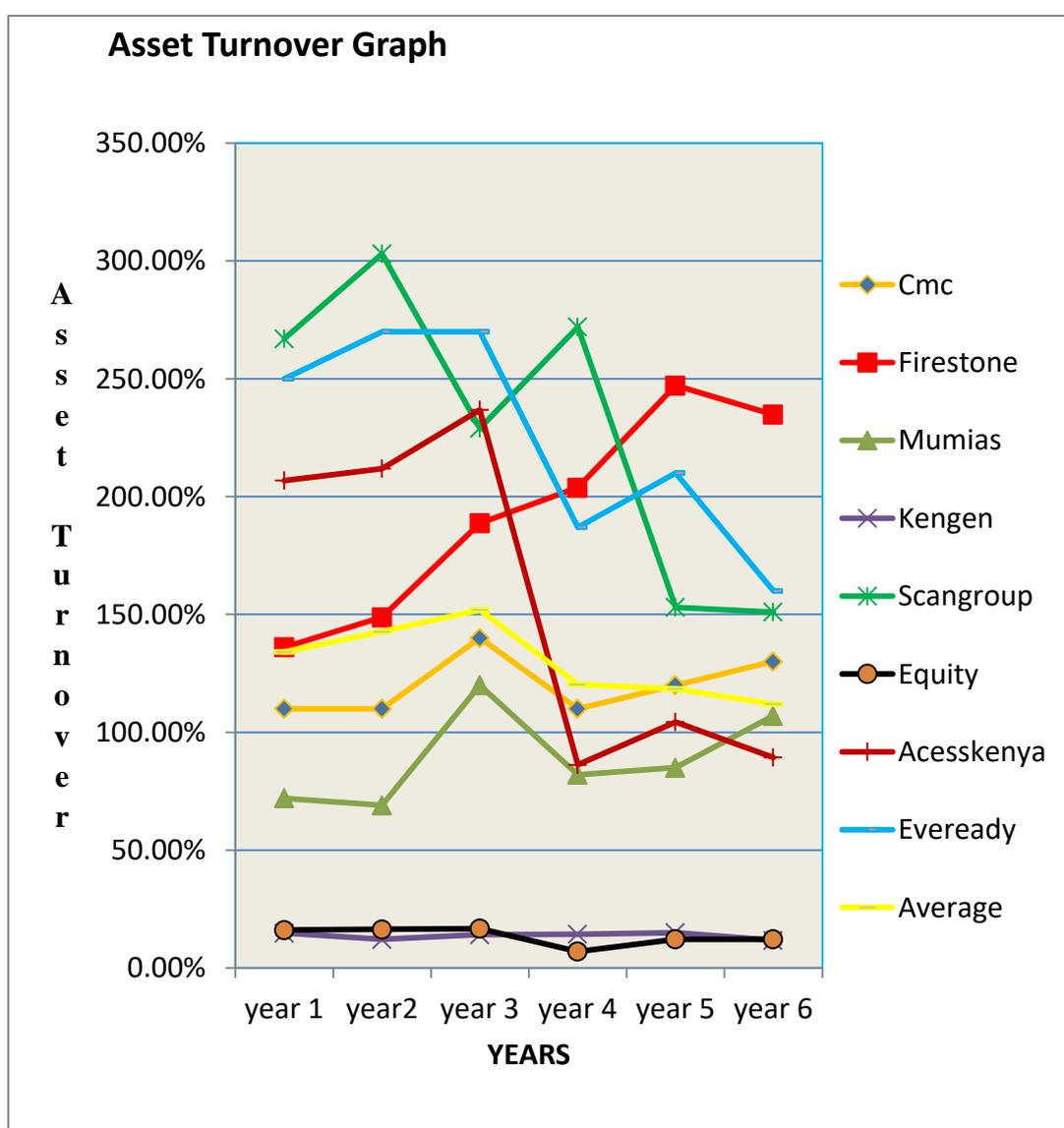
3.5 Asset Turnover:

Figure 3: Asset turnover graph

Asset turnover is a financial ratio that measures the efficiency of a company's use of its assets in generating sales revenue or sales income to the company. CMC and Mumias records a decrease in asset turnover immediately after listing then increases steadily in the following two years under the period of study. Firestone increases in the first two years after listing then

drastically declines. Kengen and Equity exhibit a slight decrease one year after listing then increases slightly and remained stable in the last year of study. Scan group portrays a seismological pattern where it increases immediately after listing then decrease and in the last year under study remains stable. Scan Group performance decreased from 289.70% to 192% after listing. Access Kenya drastically decreases immediately after listing then slightly increases followed by a slight decrease in the last year of study. This causes its average to decrease to 93.30% after listing from 218.5% before listing. Eveready decreases immediately after listing then increases in the next year followed by a decrease in the last year of study. This causes the average after listing to decrease from 263.30% before listing to 185.70%. On average, the companies studied exhibited a consistent decrease in the asset turnover which resulted to decrease from 145.92% before listing to 104.90% after listing.

4. CONCLUSION

This study implemented four profitability ratios; ROE, ROA, asset turnover and net profit margin. The results show that the average ROA increased from 10.44% before listing to 11.39% after listing. This implies that the assets' ability to generate profit increases as a result of stock market listing. This is an indicator of an increase in financial performance. The second measure was ROE. The average ROE of the companies under study decreased from 29.65% before listing to 17.5% after listing. This shows deterioration in the profits earned by company using the shareholders investments. The third measure is net profit margin. On average the studied companies recorded an increase from 9.98% before listing to 13.91% after listing. This shows an improvement in the companies' ability to control cost as a result of stock market listing. The last measure is asset turnover. On average the studied companies decreased from 145.92% before listing to 104.9% after listing. This shows that the companies' asset ability to generate revenue decreases as a result of stock market listing.

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