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Investor behavior towards IPOs in Kenya: An Empirical Evaluation of the Factors influencing Investor Behavior in Kenya

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ABSTRACT

The period 2000-2013 witnessed a tremendous rise in investor participation in IPOs in Kenya. A number of IPOs have resulted in over-subscription. Outstanding cases include; Kenya-Re (334%), Kengen (236%), Eveready (800%), Safaricom (363%), Mumias Sugar (200%), Access Kenya (300%), Scan Group (520%) and Telkom (300%). The purpose of this study was to empirically investigate factors influencing investor behavior towards IPOs in Kenya. The study had, as its target population people residing in Kenya who have previously participated in any one or more of the following IPOs; Mumias Sugar, Safricom, Kengen, Telkom, Eveready, Kenya- Re, Access Kenya, and Scan Group. Simple Random Sampling was used to select a sample of respondents from the target population. Factor Analysis was used to analyze data collected from the respondents to generate understanding of the main motivation to the hightened interest in IPOs by investors. A number of factors thought to be driving investor's interests towards initial public offers in Kenya were identified. These factors were conveniently categorized into three in order of significance, general state of the economy, confidant's opinions, and leading communication from government sources.

BACKGROUND

Efficient stock markets are key to the development of any thriving economy. Mishkin (2001) observes that organized and well managed stock markets have the potential to stimulate investment opportunities by recognizing and financing productive projects that lead to economic activity, mobilize domestic savings, allocate capital proficiently, help to diversify risks and facilitate exchange of goods and services. Further, stock markets lead to increased economic growth through increased global and domestic risk diversification, promotion of wiser investment decisions and improved corporate governance.

Carporale and Soliman (2004) indicate that efficient stock markets provide guidelines to keeping appropriate monetary policy through issuance and repurchase of government securities in the liquid market, which is an important step towards financial liberalization. They similarly observe that, well organized and active stock markets can modify the pattern of demand for money and succeed in creating liquidity that eventually enhances economic growth.

Overall, there exists an overwhelming consensus that well functioning financial intermediaries have plaid a significant role in developing vibrant economies the world over (King and Levin, 1993).

Initial Public Offer (IPO), also referred to as a "public offering" or "flotation" refers to the process through which a company issues common stock or shares to the public for the first time (Shetty, et. al, 1995). IPOs are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned companies seeking to become publicly traded. In an IPO the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price, and time to bring it to the market.

Shetty et. al. (1995) go further to observe that an IPO can be a risky investment. For the individual investor, it is tough to predict what the stock or shares will do on their initial day of trading and in the near future since there is often little historical data with which to analyze the company. Also, most IPOs are of companies going through a transitory growth period, and they are therefore subject to additional uncertainty regarding their future value.

Financial economists have long been interested in the empirical relation between the conditional mean and the conditional volatility of excess stock market returns, often referred to as the risk-return relation. The risk-return relation is an important ingredient in optimal investment decision-making, and is central to the development of theoretical models aimed at explaining observed patterns of stock market predictability and volatility (Syndey and Serena,2005).

The last decade has seen the deepening of the African capital markets, occasioning growing interest by small and medium scale enterprises (SMEs) to offer their shares through IPOs for subscription by the public (Fintrade,2007).

INVESTORS' BEHAVIOR TOWARDS RISK

Investors' behavior towards risk can be conveniently categorized in four major ways (Shetty et al, 1995). Investors can avoid risk entirely by investing only in risk-free assets, or accept risk, but insist on compensation in the form of risk premium. Other investors, like those who buy lottery tickets exhibit a risk-seeking or risk loving tendency, and yet other investors remain indifferent to risk by failing to take into consideration risk inherent in investments before making an investment decision. The first two categories reflect investor behavior known as risk aversion. Ample empirical evidence confirms that investors are generally risk- averse (Shetty, et. al, 1995). Risk-aversion simply means that investors require higher returns on investments with higher risk. Given a choice between two assets, with equal returns and different risk levels, a risk-averse investor will select the asset with the lower risk.

Risk-averse behavior is mainly evident in the pricing of securities in the stock market (Fintrade, 2007). Historical studies of security prices and rates of return have revealed that riskier securities generally sell at lower prices and produce higher returns than less risky ones. Since risk-averse investors demand higher risk premiums on riskier assets, they must promise higher minimum expected returns to induce investors to commit funds. To determine the risk premium for an investment, investors should know the amount of risk it involves and the price of risk.

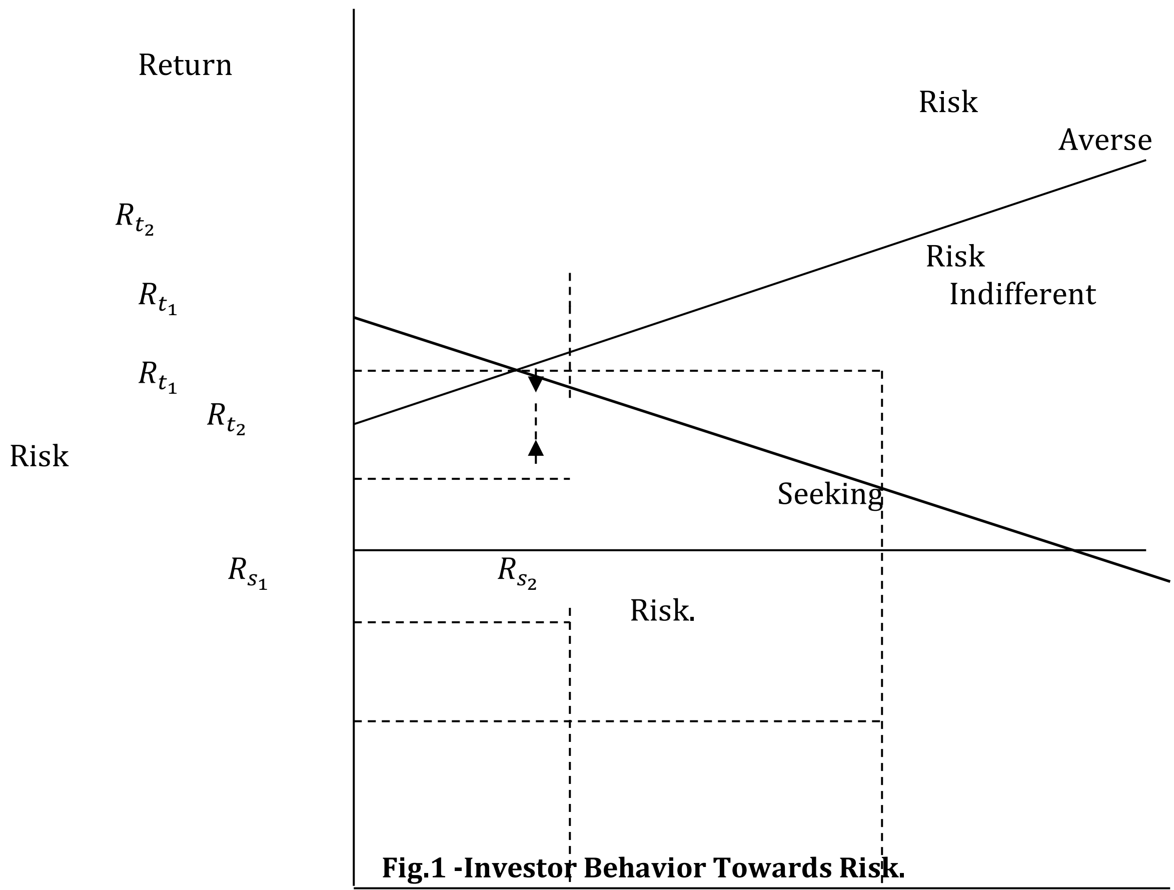

Fig.1 -Investor Behavior Towards Risk.

INVESTOR BEHAVIOR IN KENYA

Kenyans are expressing growing interest in investing in equities, especially shares, at the Nairobi Stock Exchange (NSE). Past (IPOs) including the Kenya Electricity Generating Company (KenGen) attracted massive subscriptions and huge financial investments (Fintrade, 2007). In 2007, the country's capital markets marked a milestone with the injection of 10 billion additional shares through the Safaricom IPO. Many investors in Kenya, especially the beginners, have come to overrate investment in IPOs, causing accelerated investor participation every time an IPO is declared.

Alongside these IPOs there have been increased rights issue by companies such as Kenya Commercial Bank (KCB), Diamond Trust, Housing Finance, NIC Bank, Kenya Airways, and many others. The activity at the bond market has also realized improved performance over the last few years

STATEMENT OF THE PROBLEM

Kenya's financial markets provide a suitable avenue through which the country's investment resources are mobilized. A national stock exchange in particular makes it possible for demanders of funds and suppliers of funds to interact. Further the economic development of any country hinges on the vibrancy of its national stock exchange. Investment in Kenya's stock markets has registered tremendous growth in the recent past. Although stock market participation by investors through private placements has not generated as much interest, IPOs have attracted the greatest interest among investors (both individual and institutional). This is demonstrated by over-subscriptions realized through the Kengen (337%), Safaricom (532%), Telkom (300%), Eveready (800%), Mumias Sugar (200%), Kenya-Re (334%), Scan Group (520%), Access Kenya (300%) IPOs, among others. In fact, a close examination of the NSE in the context of Kenya's development indicates that the NSE has failed to make enough issues to satisfy savers' demands.

However market fundamentals like the NSE (20) share index and collapsing brokerage firms have indicated dwindling prospects at the National Securities Exchange. Although the NSE's contribution to economic growth has been positive, its performance compared to other renowned African Stock Exchanges like the Nigeria Stock Exchange, Gaberon Stock Exchange, and Johannesburg Stock Exchange in terms of contribution to GDP has largely been poor. Returns from investment in stocks of listed companies accruing to investors in terms of earnings per share, dividends, and capital gains, have been low and fundamentally erratic. Investors on the other hand have maintained hightened interest in IPOs in Kenya, raising fundamental questions regarding the rationality of Kenyan investors. Of interest is, why do Kenyan investors show very high and sustained interest in the country's stock markets? How do Kenyan investors perceive investment risk vis-a-vis investment return? Why do Kenyan investors crowd the country's stock markets even when obvious risks face their investments? This study was therefore designed to undertake an empirical investigation of the factors thought to be influencing investor behavior towards IPOs in Kenya.

Objectives of the Study

The main objective of this study was to undertake an empirical investigation of factors that influence investor behavior towards IPOs in Kenya.

METHODOLOGY

A survey research of the descriptive type was employed to determine factors causing accelerated investor participation in IPOs in Kenya. Mugenda and Mugenda (2003) observe that survey research is probably the best method available to social scientists and other educators who are interested in collecting original data for the purposes of describing a population which is too large to observe directly. Surveys are an excellent vehicle for the measurement of characteristics of large populations.

Kottler (1997) observes that surveys are best suited for descriptive research, while Gay (1981) indicates that descriptive research attempts to describe such things as possible behavior, attitudes, values and characteristics.

This study was conducted in Kenya and it targeted companies that floated their shares to the public through initial public offers between the years 2000 and 2013. In particular the following companies were considered key in achieving the purpose of this study as their listing attracted the greatest public interest: Telkom, Safaricom, Mumias Sugar, Eveready, Kengen , Kenya-Re, Access Kenya, and Scan group.

The population of interest in this study consisted all people residing in Kenya who have previously invested in one or more of the following companies: Mumias Sugar, Kengen, Safaricom, Telkom, Eveready, Kenya-Re, Access Kenya, or Scan group. Because there exists a possibility that a person may invest in one or more of the afore-mentioned companies, this population is considered largely infinite. Since the population targeted by this study is very large (>10,000) and scattered all over the country, sample size was determined using the following formula:

$$M = \frac{Z^2 pq}{d^2}$$

Where

M = the desired sample size

Z = the standard normal deviation, (Z-statistic) at the chosen confidence level

p = the proportion in the target population estimated to have characteristics being measured

q = 1-p = the proportion in the target population lacking the characteristics being measured

d = the level of statistical significance set

Mugenda and Mugenda (2003) observe that in social science research, the above formula is ideal for determining sample size, particularly when the target population is greater than 10,000.

In this study, Z=1.96, P=0.50 (50%) and d=0.05 (the desired accuracy level). So, the sample size was:

$$\mu = \frac{(1.96)^2(0.50)(0.50)}{(0.05)^2}$$
$$= 384$$

Since the target population is very large and scattered all over Kenya , and the possibility that an individual may have participated in more than one IPO, it may be practically impossible to come up with a clear cut sampling frame. This study therefore chose to focus on one case out of the eight companies or cases forming the target population. The register of subscribers who participated in the IPO of the chosen case provided a sampling frame from which the required sample of 384 respondents was selected using the simple random sampling technique. Findings from this one case were therefore generalized to apply to the entire population. Mugenda and Mugenda (2003) observe that most case studies are built on the premise that a case can be located that is typical of many other cases.

Primary data was collected using a questionnaire designed with structured questions (see appendix 1). Questionnaires were administered personally by the researcher using the drop- and pick- later method. Responses were sought from individuals/subjects who have participated in initial public offers that have been mentioned.

Factor analysis - a mathematical model which attempts to explain the correlation between a large set of variables in terms of a small number of underlying factors (Mardia, et. al, 1989) was used to analyze the respondents' rating of the possible causes to accelerated investor participation in IPOs in Kenya. The analysis was performed on 33 possible causes (see appendix 1).

RESULTS

The following results were obtained using factor analysis. Table 1 shows the components extracted and their accompanying eigen- values. Fig.2 on the other hand is a scree plot giving a graphical illustration of the extracted components and their eigen- values. Table 2 gives a summary of the key factors that have been identified to be causing heightened interest in initial public offers (IPOs) by Kenyan investors.

Table1: Eigen-values for the various factors extracted

Total Variance Explained						
Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	4.790	14.514	14.514	4.790	14.514	14.514
2	3.125	9.468	23.983	3.125	9.468	23.983
3	1.732	5.249	29.232	1.732	5.249	29.232
4	1.605	4.863	34.095	1.605	4.863	34.095
5	1.501	4.550	38.644	1.501	4.550	38.644
6	1.361	4.125	42.769	1.361	4.125	42.769
7	1.259	3.817	46.586	1.259	3.817	46.586
8	1.148	3.480	50.066	1.148	3.480	50.066
9	1.075	3.259	53.325	1.075	3.259	53.325
10	1.054	3.194	56.518	1.054	3.194	56.518
11	1.013	3.069	59.587	1.013	3.069	59.587
12	.943	2.858	62.446			
13	.900	2.727	65.173			
14	.885	2.681	67.853			
15	.817	2.474	70.328			
16	.772	2.339	72.667			
17	.737	2.232	74.899			
18	.726	2.201	77.100			
19	.692	2.096	79.196			
20	.665	2.015	81.211			
21	.633	1.918	83.129			
22	.595	1.803	84.932			
23	.572	1.732	86.664			
24	.538	1.631	88.295			
25	.526	1.594	89.889			
26	.503	1.525	91.414			
27	.471	1.426	92.840			
28	.456	1.383	94.223			
29	.433	1.313	95.536			
30	.402	1.218	96.754			
31	.378	1.144	97.898			
32	.359	1.088	98.986			
33	.335	1.014	100.000			
Extraction Method: Principal Component Analysis.						

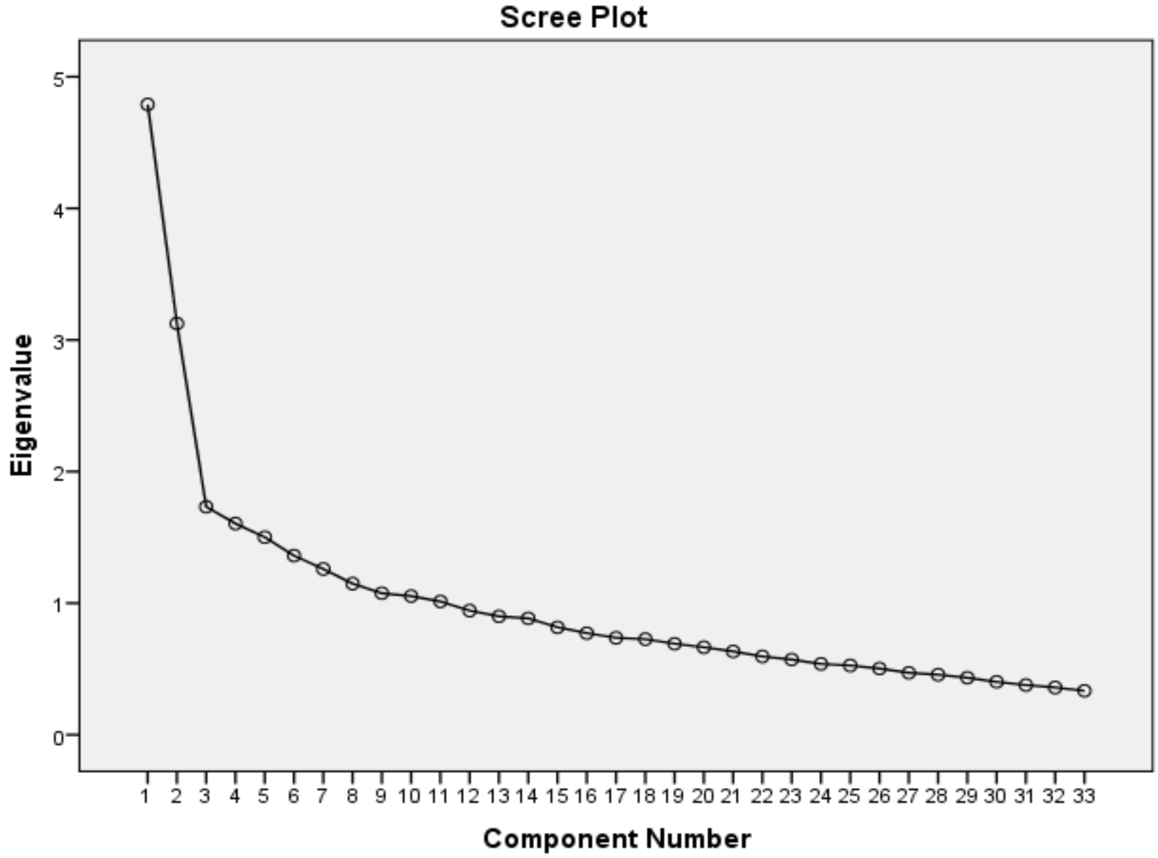

Figure 2: Scree plot for the various factors

Table 2: Summary of factors influencing investor participation in IPOs in Kenya

Factor	Eigen-Value	Variables	General Explanation
1.	-4.790	-Expected losses from other investments/sectors	-uncertainties in other sectors
2.	-3.125	-Family member opinion/advice -Friend/coworker recommendation -Broker recommendation	-third party advise
3.	-1.732	-Firms status in the industry	-just to associate with a successful company
4.	-1.605	-Minimizes risk -Ease of sub firm borrowed funds -Firms product/service attractive	-need to minimize investment risk
5.	-1.501	-Firms status in the industry	-just to associate with a successful company
6.	-1.361	-Ease of obtaining borrowed funds	-availability of investment funds
7.	-1.259	-Low returns from other sectors -Expected losses from other investment -Ease of obtaining borrowed funds	-uncertainties in other sectors
8.	-1.148	-Statements from state officials	-information from policy makers
9.	-1.075	-Firms products and services attractive	-need to associate with a firm's products
10.	-1.054	-Reputation of firms slerelends	-to associate with superior managerial acumen
11.	-1.013	-Statements from state officials	-information from policy makers

DISCUSSIONS

In general a number of factors thought to be driving investor's interests towards initial public offers in Kenya were identified. These factors were conveniently categorized into three in order of significance.

1. General state of the economy: a number of determinants in this category included
    - Expected losses from other sectors or investments. Investors had the feeling that investing in other sectors would result into losses accruing to their investments. For avoidance of risk, investors chose to invest in IPOs. This factor ranked highly among factors that were thought to be influencing investor participation in IPOs in Kenya.
    - Firm's status in the industry or economy: investors were influenced by the firm's earning power, reputation of shareholders, superiority of the firm's products, and/or services.
    - Strengths/versatility of the economy's financial institutions. This influenced investors drive towards IPOs as it led ease of accessing investment funds by investors.
2. Confidant's opinions: This factor ranked second in terms of influencing investor participation in IPOs. This factor a rose from three perspectives;
    - Family members prompting
    - Friends/ coworkers' recommendations, and
    - Brokerage firms' recommendations
3. Strong communication from government sources: government policy to borrow internally and frequent divestiture programs are often accompanied by advice to the nationals to invest in the local stock exchanges.

CONCLUSIONS

The above factors have been identified as key in influencing investor participation in initial public offers (ipos) in Kenya. It is not very clear if the same results will obtain in other countries. This study recommends studies of this nature in other jurisdictions as this will lead to widened knowledge in this subject.

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APPENDICES

Below are some of the factors thought to be key in influencing investor participation in IPOs in Kenya. Kindly indicate by ticking the extent to which these factors influenced your decision to invest in the IPO you participated in.

Key: 4 – To a very great extent 3 – To a greater extent
2 – To a little extent 1 – Not a factor at all

	Possible factors	1	2	3	4
1.	Need to enjoy dividends	☐	☐	☐	☐
2.	Need to enjoy capital gains	☐	☐	☐	☐
3.	Just to have an active saving	☐	☐	☐	☐
4.	Need to have an investment	☐	☐	☐	☐
5.	Need for association with Company	☐	☐	☐	☐
6.	Have surplus funds	☐	☐	☐	☐
7.	Have Access to funds	☐	☐	☐	☐
8.	Lack of entrepreneurial ability	☐	☐	☐	☐
9.	Lack of other alternatives	☐	☐	☐	☐
10.	Peer Influence	☐	☐	☐	☐
11.	Lack of skills to start own investment	☐	☐	☐	☐
12.	Firm's industry bright	☐	☐	☐	☐
13.	Firm itself having bright future	☐	☐	☐	☐
14.	Confidence in National Economy	☐	☐	☐	☐
15.	Firm Management good	☐	☐	☐	☐
16.	Firm has history of posting profits	☐	☐	☐	☐
17.	To get rich quickly	☐	☐	☐	☐
18.	Stock market quality	☐	☐	☐	☐
19.	History of the firm's stock	☐	☐	☐	☐
20.	Efficient stock markets in Kenya	☐	☐	☐	☐
21.	Condition of Financial statements	☐	☐	☐	☐
22.	Affordable share prices	☐	☐	☐	☐
23.	Statements from state officials	☐	☐	☐	☐
24.	Reputation of firm's shareholders	☐	☐	☐	☐
25.	Firm's products and services Attractive	☐	☐	☐	☐
26.	Broker recommendations	☐	☐	☐	☐
27.	Friend / co-worker recommendation	☐	☐	☐	☐
28.	Family member opinion/ advice	☐	☐	☐	☐