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The Initial Public Offering Decision: A Survey of Kenya Corporate Finance Officers

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Abstract
One of the most momentous events in the life of corporations is "going public". The decision to list/ or not, cannot be generalized into one single determinant for all companies: different firm characteristics and external environment attributes play a role in the choice of the better option. This paper examined the variables influencing the decision of Kenyan CFOs to conduct an IPO or to remain private. The IPO CFOs view point revealed that the most common reason for conducting an IPO at NSE was to meet financing needs, followed by the impetus given by favourable market conditions, and lastly, as an exit strategy that enables founder entrepreneurs to liquidate their investments. The quest to reduce cost of capital received less weight as an IPO motivator. When the impediments to going public were evaluated, it was the view of the non-IPO CFOs that the desire to maintain decision making control was the most critical justification. The second most common deterrent to IPO launch was the prevailing bad market conditions. The need to avoid EPS dilution, and regulatory and reporting requirements were viewed as less critical disincentives.
Keywords: Initial public offering, IPO determinants, Remaining Private, Kenya

1. Introduction

An initial public offering (IPO) refers to a company "going public". A lot of research work on "going public" has been done in the developed countries (See Pagano et al., 1998; Brav and Fawcett, 2006; and Ahmad-Zaluki, Campbell and Goodacre, 2007). These studies have provided vital information on understanding the rationale behind going public. Many companies have used this information to shape their funding decisions thereby accessing advantages provided by the pool of IPO funds. Perhaps the abundance of information regarding IPOs is contributory to the vibrancy of the IPO market in developed markets

The Nairobi Securities Exchange (NSE) was constituted in 1954 to help finance companies and provide a market for their securities. To date 65 companies in a wide range of industries have listed their shares. In addition, NSE lists also corporate and treasury bonds, preference shares and debentures. With a market capitalization of about KES 900 billion as at July 2015, it is one of the largest exchanges in East and Central Africa region, although it remains relatively small compared to developed market like New York Stock Exchange (NYSE) American Stock Exchange (AMEX), NASDAQ, and Tokyo Stock Exchange, and even Johannesburg Stock Exchange or the Cairo Stock Exchange.

Although the benefits of listing are evident and there are many success stories of IPOs across the world, yet a significant number of companies have opted to remain private, which suggests that this option also has some benefits compared to going public.

The state of the IPO market in emerging markets, especially Africa, is quite the opposite of what obtains in developed markets. Despite all the administrative, fiscal and tax incentives, IPOs are relatively, few and far in between. In Kenya, the number of companies listed at the Nairobi Securities Exchange has stagnated for the past two decades. The NSE has 65 quoted companies currently, 24 of these companies were listed since the year 2000, while about 10 firms have been de-listed over the same time.

Worldwide evidence records finance, reputation, encashment and signaling as some of the stimuli for listing public (See Brav and Fawcett (2006) Zingales (1995) Chemmanur and Fulghieri (1999) Maksimovic and Pichler (2001). On the other hand, Brav et al. (2006) and Booth (2007) cite loss of control, loss of privacy, underpricing and listing expenses are given as deterrents to going public.

Related local studies are few. Maina (2004) investigated the performance of IPOs in the after-market; Ndegwa (2006) has documented the factors affecting the development of the Nairobi Securities Exchange, While Ndatimana (2008) analyzed the IPO underpricing phenomenon at the NSE.

This study aims to document the reasons influencing the listing and the non-listing alternatives by firms in Kenya. The study contributes to existing literature by adducing evidence from company CFOs as to the factors motivating the decision to go public (or remain private) for large corporate entities in Kenya.

2. Related Theories and Literature

2.1 IPO Theories

Various theories have been advanced to explain the motives behind the listing decision among corporate firms. We revisit some of the theories that have a bearing to this study.

2.1.1 Cost of Capital Theory
This theory was reinforced by several scholars (e.g. Scott 1976, and Modigliani and Miller (1963). The literature on this theory argues that firms conduct a public offering when external equity will minimize their cost of capital, thereby maximizing the value of the company. Other scholars have also argued in support of this theory. Myers and Majluf (1984) and Myers (1984) further argue that companies have a pecking order of financing starting with internal equity, debt financing, and then external equity.
2.1.2 Exit Strategy Theory
The proponents of this theory argue that firms go public with a motive of providing an avenue for existing shareholders to cash out. Zingales (1995) and Mello and Parsons (2000) argue that an IPO allows insiders to cash out. Similarly, Ang and Brau (2003) demonstrate that insiders opportunistically sell shares in the IPO for personal gain. Black and Gilson (1998) support this theory arguing that IPOs give venture capitalists the opportunity to exit, providing an attractive harvest strategy.
2.1.3 Acquisition Theory
This theory postulates that IPOs facilitate takeovers and acquisition by companies going public. Zingales (1995) argues that an IPO can serve as the first step towards having a company taken over at an attractive price. In support of this theory, Brav et al. (2003) argue IPOs are important because they create public shares for a firm that may be used as ―currency‖ in either acquiring other companies or in being acquired by other companies in a stock deal.
2.1.4 Strategic Move Theory
This theory argues that firms may go public as a strategy move to gain positive publicity that comes with an IPO. Maksimovic and Pichler (2001) assert that firms conduct IPOs to capture a first-mover advantage. They suggest that an IPO can increase the publicity or reputation of the firm going public. Bradley, Jordan and Ritter (2003) show that analyst recommendations are often biased upwards after an IPO. Similarly, Chemmanur and Fulghieri (1999) argue that IPOs broaden the ownership base of the firm. This in turn increases the firm visibility in the public domain.
2.1.5 External Monitoring Theory
This theory suggests that firms may go public to increase the level of external monitoring. The firm's commitment to meet regulatory and disclosure requirements of the stock exchanges increases transparency and lowers the agency costs between managers and majority shareholders. Jensen and Meckling (1976) argue that increased transparency and market scrutiny facilitates better corporate governance when there is separation between ownership and control. They argue that a publicly listed firm becomes subject to increased scrutiny by analysts and market participants that imposes discipline on managers for performance. It also facilitates better corporate governance by allowing firms to device incentives such as stock option plans to align managers' interests with those of shareholders.
2.1.6 Windows –Of- Opportunity Theory
This theory argues that managers use their superior information to select the timing of IPO and exchange listing, opportunistically to take advantage of temporary favourable market conditions and to capture attractive stock prices. Several studies (Ritter (2003), Ritter (1991)) have documented clustering of IPOs during strong industry and market conditions as well as long run underperformance following initial public offerings across both the US and other countries.
2.1.7 Funding for Growth Theory
This theory suggests that businesses will go public to raise new money to finance new growth opportunities in the environment. Ritter and Welch (2002) argue that most firms go public primarily to raise new capital for growth. Similarly, other studies by various scholars have supported this notion. Kim and Weisbach (2005) provide evidence consistent with this theory in a study of a sample of IPOs conducted between 1990 and 2003 in 38 countries. They document that almost all firms raise substantial amount of new capital in the IPO, although European firms also sell a relatively large portion of their existing shares. They also report that new funds raised in the IPOs are used for a variety of purposes including financing growth and rebalancing leverage

2.2 Related Literature
2.2.1 Why List
Various studies have been done in various countries regarding reasons why companies decide to go public.

Modigliani and Miller (1963) argue that firms conduct a public offering when external equity will minimize their cost of capital thereby maximizing the value of the company. This reasoning suggests that at some point in a firm's life, external equity financing could be needed to achieve an optimal capital structure. This position is also echoed by Myers (1984) that firms have a pecking order of financing: internal equity, debt financing and then external equity. Kim and Weisbach (2005) documented that issuance of primary shares is correlated with higher repayment of debt and increase in cash and more subsequent capital raising through seasoned equity offers, which is consistent with rebalancing capital structure.

Raising finance for growth is cited by many companies as the main reason for going public. In a survey of European CFOs, Bancel and Mittoo (2008) identified financing growth as one of the most important benefits of an IPO. CFOs of small firms seek public listed to enable them access enhanced financing to fund their projects. Kim and Weisbach (2005) discovered that issuance of primary shares is correlated with higher increases of investments, and from their sample, 79% of all capital raised through IPOs was from sale of primary shares, concluding that capital raising was an important motive of the going –public decision.

Zingales (1995) argues that an IPO allows insiders to cash out. In this way, insiders opportunistically sell shares in the IPO for personal gain. The insiders could be individuals or venture capital firms eying exit opportunities.

IPOs may facilitate takeover activity. Zingales (1995) argues that an IPO can serve as a first step towards having a company taken over at an attractive price. Brav et al. (2003) reinforce this view and state that IPOs may be important because they create public shares for a firm that may be used as currency in either acquiring other companies or in being acquired in a stock deal. Rosen, Smart and Zutter (2005) observed that banks that chose to go public faced a higher probability of being acquired in subsequent years than the banks that remained private. They also found out that the IPO banks put themselves in a better position to acquire other banks

Bancel and Mittoo (2008) also identified enhanced visibility and prestige one the most important benefits of an IPO. Brav and Fawcett (2006) found out that high-tech firms view an IPO more as a strategic reputation-enhancing move than as a financing decision. IPOs also serve as strategic moves. According to Chemmanur and Fulghieri (1999), IPOs broaden the ownership base of the firm. Firms may conduct IPOs to capture a first- mover advantage. This can increase the publicity and reputation of the firm that is going public.

Bradley, Jordan, and Ritter (2003) show that analysts 'recommendations are often biased upward after an IPO. Analyst coverage may thus motivate a firm to go public especially for companies that intend to use the market in future to finance projected growth.

Good market and industry conditions also play a key role in making the decision to go public. The degree of perceived IPO benefits is considerably higher during bull periods, consistent with the study done by Lerner (1994) and Ritter and Welch (2002), supporting the observation that many IPOs happen during the "hot periods".

2.2.2 Reasons Why Companies Stay Private

Despite all the advantages of going public, many firms still choose to remain private. Many reasons have been advanced by researchers to explain why the firms adopt this position.

According to Brav and Fawcett (2006), it was established that maintaining decision-making control is the most important issue in deciding whether to stay private or not. The paper also reported the need to avoid ownership dilution as the reason why many private entities shy away from going public. This aspect was strong among old companies and companies with conservative management (Brav and Fawcett (2006).

Bad market and industry conditions also play a key role in making the decision to go public or remain private. The degree of perceived IPO benefits is considerably higher during bull periods, consistent with the study done by Lerner (1994) and Ritter and Welch (2002). Market and industry conditions largely determine the degree of success an IPO is likely to have. Hence if the fundamental market and industry conditions are not right, many CFOs will prefer to avoid the scourge of IPO underpricing and remain private.

Listing of companies comes with some level of disclosure requirements that firms must fulfill. Company information thus disclosed could be used by competition to the detriment of the entity going public. Reluctance to disclose vital company information discourages companies from going public. Booth (2007) adds another twist by indicating indirect costs of an IPO, which include exposure to shareholder lawsuits and management distraction. Aslam and Kumar (2007) argue that firms with relatively high information production costs such as young or smaller companies will prefer to remain private.

Jensen (1986, 1993) argues that low financial visibility is correlated with lower liquidity, reinforcing the view that such firms are likely to remain private. He also argues that low growth firms with large cash position relative to market capitalization are likely to remain private. This stems from the view that they can support any new growth opportunities as and when they arise.

While the need for capital for expansion drives companies towards going public, in cases where the corporate entity has strong capital base to support its expansion plans, the likelihood of it remaining private is high. The availability of alternative financing from banks and venture capitalist, and owners may delay the listing decision.

The costs of going public have also been noted to be a concern for CFOs. Specifically, auditing and underwriting fees make up the most explicit costs of going public. Other incidental costs such as promotion add to the list of deterrents. Brav et al. (2006) contend that the financial costs of public listing – both registration and ongoing administrative costs – are very high, thus, most companies cannot afford public listing until a certain stage of their lifecycle.

3. Methodology and Sample

In this study we conduct an empirical test that relies on the comparison between companies that list their shares

(go public) and the ones that do not (stay private). During the period 2000 to 2016 24 companies were listed at NSE. We sought to match these firms with unlisted firms with the same characteristics as the listed firms. There were many unlisted companies registered during the sample period. To conduct the test and eliminate the effect of unlisted companies dominating the sample, we compiled a matching sample of not public companies using Kenya Company database. We use 1:1 matching where each case has one control observation, i.e. for each listed company in the sample an unlisted company which is incorporated in the same industry with the observation year which corresponds to the IPO year of its matched listed company and minimally different book value of assets was selected. The firm-level data for both listed and unlisted companies were obtained for the year prior to an observation year (which is a year before an IPO for listed and a year before an IPO of a matched listed firm for unlisted firms). As a result, 24 unlisted companies were selected.

Data was collected using a questionnaire that elicited responses from selected company CFOs. Respondents were stratified so that responses were analyzed based on whether the Company was listed or unlisted. The respondents needed to indicate the degree of agreement with various reasons underlying the position of their firm as unlisted or listed. These possible reasons had been compiled through extensive literature review and pretested for reliability.

The survey method allowed us to directly ask CFOs why they go public and compare their responses to existing theories. Managers were asked to rank the various motives that potentially had influenced their decision to go public. The Non-listed mangers were also presented with a menu of questions to assess the motivation for remaining unlisted. The questions were compiled from literature review of relevant sources which resulted in the following list of questions (See Table 1).

A two-stage procedure was applied to test statistical significance. The Friedman test was followed by the Wilcoxon pair-by-pair post-hoc test. This procedure was necessary to compare average ranks among items, while basic assumptions for ANOVA (e.g., normal distribution, interval scale) were not held. Applied tests are nonparametric and no additional assumptions about the nature of distribution need to be met.

Table 1: Sample questions administered to CFOs of Listed and Non-listed Companies

Rational for Listing		Rationale for Remaining Private	
1	Raising new capital to finance growth opportunities	**1**	Maintaining decision-making control
2	Creation of shares for acquisition purposes	**2**	Avoiding ownership dilution
3	Taking advantage of favourable industry and market conditions	**3**	Bad Company and industry conditions
4	Reduction of cost of capital	**4**	Avoiding disclosure of company information to competition
5	Enhanced reputation and publicity	**5**	Stringent reporting requirements by regulatory authorities
6	Enhanced external monitoring	**6**	Capital adequacy
7	Provide an exit avenue for existing shareholders	**7**	Dilution of earnings of existing shareholders
8	To elicit favourable analyst rating	**8**	Stringent listing conditions
		9	Reputational and public image problems

CFOs were asked to rank the above (in Table 1) motives that potentially had influenced their decision to go public or to remain private. The results of the survey are presented in Tables 2 and 3 for decision to list, and in Tables 4 and 5, for the decision to remain private.

4. Data Analysis and Discussion

4.1 Data Analysis- Going Public

For the listing decision, Tables 2 and 3 indicate that the most important driver for the decision to go public was the need for capital. This factor was ranked number one 40 percent of responding managers and enjoyed the highest average rank, at 3.65. The finding is in line with Szyszka (2014) and aligns with the theory that firms go public when their financing needs exceed internal sources and debt capacity.

The second most important factor by average rank was the need to enhance the reputation and publicize the company. The market place presence and its stature in the industry would receive a boost by the company listing on the stock exchange.

Taking advantage of favourable market and industry and providing an avenue to existing original shareholders to profitably liquidate their investment in the firm came in close together in third and fourth place. Managers tend to time a public offer to coincide with favourable market conditions. It is also to be expected that investment "angels" and venture capitalist would prefer to withdraw through a floatation of their shares in the stock exchange. The motive of minimizing cost of capital was also ranked highly.

Least weighty among managers were desire for favourable analysts rating and creation of shares for takeover. The low ranking of the two IPO drivers could be due to their practical relevance in Kenya Where the takeover market is relatively undeveloped. These factors had the worst average rank, were below all other averages, and significantly below item (I) and (V). Over 30 percent of managers identified them as the least important,

Table.2. Rank distribution among items and rank parameter

Question: The decision to go public resulted from:

		Percentage of answers indicating rank value						Rank statistics	
Items		**1**	**2**	**3**	**4**	**5**	**N**	**Mean**	**Standard deviation**
I.	Raising new capital to finance growth opportunities	**10**	**15**	**15**	**20**	**40**	**20**	**3.65**	**1.42**
II.	Creation of shares for acquisition purposes	**45**	**40**	**20**	**20**	**15**	**20**	**2.50**	**1.24**
III.	Taking advantage of favourable industry and market conditions	**10**	**20**	**25**	**15**	**30**	**20**	**3.35**	**1.39**
IV.	Reduction of cost of capital	**20**	**30**	**5**	**10**	**35**		**3.10**	**1,65**
V.	Enhanced reputation and publicity	**10**	**15**	**25**	**25**	**25**		**3.40**	**1.31**
VI.	Enhanced external monitoring	**30**	**20**	**25**	**15**	**10**		**2.55**	**1.36**
VII.	Provide an exit avenue for existing shareholders	**10**	**20**	**20**	**25**	**25**		**3.35**	**1.35**
VIII.	To elicit favourable analyst rating	**35**	**25**	**20**	**10**	**10**		**2.35**	**1.35**

Respondents were required to order all the above-mentioned items. The highest rank was assigned the value 5 and the lowest was assigned the value 1. No ties were accepted. Cases with missing values were excluded.
S o u r c e: own elaboration.

Table.3. Results of Friedman and Wilcoxon test

Question: The decision to go public resulted from:

Friedman Test statistic value: 3.1449: p-value:0.01446

Wilcoxon post-hoc paired test

ITEMS	I	II	III	IV	V	VI	VII	VIII	
I	x								
II	**	x							
III			x						
IV				x					
V		**			x				
VI	*				*	x			
VII							x		
VIII	***			**				x	

Note: The null hypothesis for the Friedman test stated that the difference between the mean rank profile and the global mean rank (equal to 3) is zero. The null hypothesis for the Wilcoxon post-hoc test stated that the mean difference between a given pair is zero. Item numbers correspond to the numbers in the previous table. Table 2 above presents relationships between all pairs of items in terms of statistical significance in mean rank difference: ***, ** and * indicate significance at the level of 0.01, 0.05 and 0.1, respectively. Empty cells indicate no significant difference.

The Friedman test documents p-value of 0.01446 which is significant and allows further multiple comparisons testing. However, the Wilcoxon shows only one significant difference at 1 percent level i.e. between questions (I) and (VIII), three significant difference at 5 percent level i.e. between (II) and (V) and (V), one significant difference at 10 percent level i.e. between questions (IV) and (V). Therefore, the results of the survey in the respect to differences in ranks should be treated with some statistical caution. Overall, the survey documents that the most vital reason to go public is financing need. However, firm-specific and market-specific timing to capitalize potentially high firm valuations also seem to play an important role. These practices harm new long-term investors to a company while benefitting those who owned the firm before going public. However, this impact is only true if managers can time IPOs in this manner. It is one thing to state in a survey that one wants to capitalize on the

good historical results of the firm or to take advantage of a good market situation. It may be another, much more difficult, thing to be able to choose the moment for an IPO that would, in fact, maximize firm value and allow the company to raise equity at the minimal cost. Not only do managers lack access to all relevant timing information (for example, they cannot predict how a market will perform even in the short-term), but also, they may be subject to behavioral biases themselves.

4.2 Data Analysis- Remaining Private

Table 4. Rank distribution among items and rank parameters

Question: The decision to remain private was motivated by:

		Percentage of answers indicating rank value						Rank Statistics	
ITEM		1	2	3	4	5	N	Mean	Standard deviation
I.	Maintaining decision-making control	15	15	20	30	30	20	3.70	1.17
II.	Avoiding ownership dilution	20	30	20	20	10	20	2.70	1.30
III.	Bad Company and industry conditions	15	20	35	15	15	20	2.95	1.28
IV.	Avoiding disclosure of company information to competition	25	20	10	20	25	20	2.80	1.58
V.	Stringent reporting requirements by regulatory authorities	35	20	15	15	15	20	2.55	1.50
VI.	Capital adequacy	15	10	15	20	30	20	3.30	1.49
VII.	Dilution of earnings of existing shareholders	25	25	20	20	10	20	2.65	1.35
VIII.	Stringent and expensive listing conditions	10	25	20	35	10	20	3.10	1.21
IX.	Reputational and public image problems	25	30	20	15	10	20	2.55	1.32

Table.5. Results of Friedman and Wilcoxon test

Question: The decision to remain private resulted from:

Friedman Test statistic value: 3.1629: p-value:0.02156

Wilcoxon post-hoc paired test

ITEMS	I	II	III	IV	V	VI	VII	VIII	IX
I	x								
II		x							
III	*		x						
IV				x					
V					x				
VI		**	***			x			
VII							x		
VIII	**							x	
IX									x

Note: The null hypothesis for the Friedman test stated that the difference between the mean rank profile and the global mean rank (equal to 3) is zero. The null hypothesis for the Wilcoxon post-hoc test stated that the mean difference between a given pair is zero. Item numbers correspond to the numbers in the previous table. Table 2 above presents relationships between all pairs of items in terms of statistical significance in mean rank difference: ***, ** and * indicate significance at the level of 0.01, 0.05 and 0.1, respectively. Empty cells indicate no significant difference.

The results of the survey of the reasons that deter listing are presented in Tables 4 and Table 5 indicate that the most important driver for the decision to remain private was the need to maintain decision making control. This factor was ranked number one by 30 percent of responding managers and enjoyed the highest average rank of 3.70. The second most important factor by the average rank 0f 3.30 was having adequate financing from other sources. This implies that companies making reasonable profits can retain them to fund internal generated growth

and need not do an IPO. It was the most important reason for 30 percent of firms remaining private. Stringent and expensive listing requirements, and bad company and market conditions, came in third and fourth respectively as dampeners of the listing decision at average rank of 3.10 and 2.95 respectively. Avoiding disclosure of private was a significant consideration in remaining private. On the other end of the spectrum, reporting requirements, and reputational concerns were the least worrying problems in the remaining private decision, with each scoring an average rank of 2.55.

The aggregate results denote that maintaining decision-making control is the most important issue in deciding whether to stay private. Two other issues received mean scores above 3.0: having adequate finance, and the expenses of listing and compliance with regulatory reporting. Avoiding disclosure of company information to competition which has received higher ranking in most other studies (Szyska, 2014), did not fare as prominently in our findings perhaps reflecting the low levels of intellectual capital in the business operations in Kenya. In sum exogenous factors did not play a decisive role in the non-listed decisions.

It is also evident that based upon the other conditioning variables, desire to maintain decision-making control is most influential among firms that are larger, older, and outside the high-tech environment—firms predisposed to entrenched management. Older companies also place greater emphasis on avoiding ownership dilution. Clearly, some companies perceive themselves as poorly positioned and less inclined to take advantage of an IPO. Further, some firms that are desirous to go public are deterred by poor market conditions and other factors that increase the cost of an IPO.

The Friedman test documents p-value of 0.02156 which is significant and allows further multiple comparisons testing. However, the Wilcoxon shows one significant difference at 1 percent level i.e. between questions (VI) and (III), two significant difference at 5 percent level i.e. between (IV) and (VIII), one significant difference at 10 percent level i.e. between questions (III) and (I). Therefore, the results of the survey in the respect to differences in ranks should be treated with some statistical caution. Overall, the survey documents that the most vital reason to go public is financing need. However, firm-specific and market-specific timing to capitalize potentially high firm valuations also seem to play an important role. These practices harm new long-term investors to a company while benefitting those who owned the firm before going public. However, this impact is only true if managers can time IPOs in this manner. It is one thing to state in a survey that one wants to capitalize on the good historical results of the firm or to take advantage of a good market situation. It may be another, much more difficult, thing to be able to choose the moment for an IPO that would, in fact, maximize firm value and allow the company to raise equity at the minimal cost. Not only do managers lack access to all relevant timing information (for example, they cannot predict how a market will perform even in the short-term), but also, they may be subject to behavioral biases themselves.

5. Conclusions

CFO survey responses indicate that academic theories regarding the IPO process are generally well-grounded and are borne, to a great extent, in practice.

Regarding the decision to list, the most important motivations include the need to raise new capital to finance new growth opportunities. Companies in growth industries find going public as the main avenue through which they can finance new projects and publicize themselves and their products. Consistent with “hot period” vs “cold period” dichotomy, CFOs considered prevailing market conditions and mood in the timing of the launch an IPO. Surprisingly, minimizing the cost of capital is not among the three most important motivations for going public.

CFOs of companies remaining private cited the necessity of preserving decision-making control and ownership as the main stimulus. However, having adequate alternative financing sources (retentions and loans), and adverse market circumstances strongly influences CFO perceptions regarding the risks and difficulties encountered in going public.

The success of an IPO depends upon the manager ‘s ability to make timely and accurate decisions, while ensuring that the competitive edge of the firm is maintained. Further, the findings of the survey underscore the need for a market that is operationally efficient, is supported by appropriate relevant laws and charter and is technologically advanced.

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