

Analysis of Factors Affecting Security Trading In Investment Banks in Kenya

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Abstract

Security trading is the main function of an investment bank. It is therefore the process through which financial asset of any kind is traded. This paper is aimed at analyzing the various factors affecting security trading in investments banks in Kenya. The specific objectives which affect security trading in the investment banks include; legal and the regulatory framework, insider trading, taxation of investment income and the public knowhow on security trading. In summary, the researcher found out that compliance to CMA and having proper corporate governance structures are ways through which an investment bank is said to function in accordance to the laid down legal and regulatory framework. It was also found out that insider trading and taxation greatly affects the volume of securities to be traded in an investment bank. Poor literacy level, information inadequacy and lack of accessing the so needed information are some of the factors that affect public knowledge on security trading in investment banks. In conclusion, Legal and Regulatory framework, Insider trading, Taxation of investment income and public knowhow affects security trading in an investment Bank.

Keywords: Security Trading, Insider Trading, Financial Asset, Investment banks

1. Introduction

Investment banking is a specific type of banking institution that is involved with the creation of capital for the other companies, governments and others types of entities through the returns accrued from the sale of shares and bonds (Liaw, 2012). Stock exchanges' on the other hand grew from early trading economic activities in agricultural and other commodities across continents, where, in some other countries, the use of promissory notes was a common mode used for payment of goods and services rendered. Most traders in European fairs in the Middle East areas of the world found it convenient to use credit, which required supporting documents such as drafts, notes, and bills of exchange as a mode of payment. This growth of trade created a need for banks and insurance companies globally. Thus, political developments made the government to seek new sources of funds through the combination of expanding activities due to capital shortages, this therefore stimulated the early issuers of government securities, banks, insurance companies, and some great trading companies from the existing exchanges for commercial bills and notes to the use of securities and bonds. The transition therefore was easy and logical for the establishment of stock market (World Bank, 2014).

In Africa, a case of Ghana, Capital Market has not yet played an important role in capital mobilization. The main source of capital is from the donors, thus additional capital is urgently required for growth of the GDP. Central to the efficient functioning of the Capital Markets is the development of the stock market which is used to mobilize huge savings for investment opportunities. The development of the investment banks in Ghana has been affected by the much needed improvement of security trading in the country. Factors such as regulatory and legal framework have proved to be a lot difficult to be implemented on the upcoming investment banks and security exchange in Ghana. The enforcement of these laws is difficult, thus the development of these banks is seen as slow throughout Ghana and Africa as a whole (Ngugi & Njiru, 2005).

Although the Kenyan security market and investment banking is relatively more developed than those of many countries in Africa, especially the East and Central Africa, it has far much fewer securities and investors compared to many developed markets. The financial products traded at the Nairobi Stock Exchange are the variable income securities (shares) and (bonds) fixed income securities (NSE, 2015) Investment banks play an essential part in the financial sector in the modern economy especially in the developing countries. There are approximately 14 investment banks and 9 stockbrokers in Kenya and licensed by the regulator CMA. The four Primary Business segments that investment banks participate in include; Asset Management, Brokerage, Corporate Advisory and underwriting (NSE, 2015). Kenya has only one stock market known as the Nairobi Securities Exchange (NSE) formerly known as Nairobi Stock Exchange which mainly deals with security trading activities.

In today's world, every investor is aiming at making profits from all available angles. These investors seek financial advice on security trading from the investment banks to maximize their returns. Odundo, (2004) noted that over the years investment banks have evolved rapidly in the sub Saharan Africa this is brought about by the high demand for investment banks. Although investors see security trading in an investment bank as a great avenue for wealth creation through returns, there are various factors that affect security trading in investment banks, these include: legal and regulatory framework, insider trading, public knowhow and taxation of investment income. These factors negatively affect the volumes of securities forecasted to be traded in a given

year in an investment bank.

It's noted that in an investment bank, the legal and regulatory framework is key in maintaining the operations and management of the bank and where these laws are not strictly followed cases of insider trading, lack of corporate governance and no code of conduct is seen as a menace in the bank that needs to be addressed. Information asymmetry to the general public is also another factor that affects the operations of an investment bank. This is brought about by the lack of proper channels used in dissemination of information to the public so that they may be able to make informed decisions on the securities they want to buy or sell. According to Kibuthu, (2005) study on the factors that affect investment decision In a stock market she noted that the developing countries are less informed investors compared to those from developed countries. This clearly shows that public knowhow is still a factor that affects security trading. In the recent past, taxation of investment income (capital gain tax) was seen as a problem faced by brokers in Kenya even though the government sees it as a method through which it can raise revenue. By increasing the rate of taxation, the returns reduces and therefore chances are that the investment bank will start running at a loss or be unable to meet its short or long term goals.

The investors, bank managers, tax consultants together with the legal representatives are the major officials who are affected by such catastrophes and therefore it's important for them to ensure that such factors are solved before the bank collapses. If measures are not taken to curb these factors then the return of an investor will decline, this in turn leads to an investor selling out his or her share and thus reducing after tax returns in an investment bank.

It is therefore important to note that; there is a positive relationship between legal and regulatory framework of an investment bank with security trading. There is also a positive relationship between insider trading and security trading. Security trading is hugely affected by insider trading due to information asymmetry amongst the investors. Taxation and individual investor know how negatively affects security trading in an investment bank. From the previous studies, there is insufficient literature on the factors that affect security trading in the investment banks In Kenya. This paper therefore will seek to add more literature in regards to security trading in investment banks; it will also provide recommendations and conclusions to be implemented by the investment banks. This paper therefore is divide into the following sections; introduction, literature review, research methodology, data analysis, conclusion and recommendation.

2. Literature review

2.1 Legal and regulatory framework

Legal and Regulatory framework is an important procedure conducted before or during the operations of securities exchange in an investment bank. These laws are put in place to ensure that the investment banks run effectively. Hearn and Piesse (2010) provide strong evidence in support of the importance of the nature of the Legal and Regulatory regimes in influencing liquidity and price discovery. They saw that lack of an effective Legal, Regulatory and Institutional framework weakens the effectiveness of contract enforcement and settlement process in portfolio management. Goodhart and Wagner (2012) note that, in the absence of regulation, investment banks and other financial institutions are likely to become similar for various reasons. There will be a rise in moral hazards; banks have an incentive to undertake correlated activities because in the event of joint failure they're likely to be bailed. The financial institution has a tendency of having correlated activities that tend to generate similar failures. In as much as the Capital Markets Authority has put in place legal and regulatory framework to ensure that there is an efficient way in which the investment banks can run, the regulations have proven to be difficult to be implemented. Also there are a few loopholes on the regulations of the investment institutions that is why there is an increased report of inaccuracy in security trading. Therefore this paper sought to find out that, although there are many regulations put in place, these same regulations affect the establishment of investment banks and also security trading activities as a whole.

2.2 Insider Trading

Insider trading is termed as an illegal activity that is, private information held by major stockholders that has not yet been publicly announced. Bodie, Kane and Marcus (2011) argue that Regulations on financial institutions prohibit insider trading by the investors. Insiders do exploit the information and this can be evidenced through considerable evidence of 'leakage' of useful information to some investors before any information is publicly announced. Lambert (2006) argued that the Legal treatment of insider trading is justified by the fact that price decreasing insider trading provides the needed information more significantly more than price increasing insider trading where the managers take advantage of the change in the price and thus they benefit from the change before the general public are informed about the change. In Kenya for instance; insider trading is said to affect the investor's portfolio in such a way that investors do not access the public information at the same time. Information is shared to a few investors who make an investment decision way before the information is disseminated to the public. This paper sought to find different ways in which insider trading might be curbed

without necessarily legalizing it. Investment banks solely depend on available information to ensure that the investors make better decisions and thus minimize biasness.

2.3 Public Knowhow

Information is power used by investors mainly in making rational decisions and therefore for an investor to make any investment decision, they should know more about the market, the best investment “vehicle” and the returns accrued from a particular portfolio. Scholars such as Afego (2011) give a strong view on the need for legal and regulatory framework in order to ease security trading in investment banks by making available information needed for informed decisions to be made by the public. However, this is not the case; a lot of people who want to be investors are not informed on how to go about the trade and what to expect from the investment. The illiteracy level has brought about poorly informed investors who possess little or no knowledge on the capital market. There is also lack of public knowledge on the enlightenment and awareness of security trading and the various services offered by the investment banks to ensure that information is made available to the investor on what portfolio to invest in. The regulation, legal and institutional structure has also made it so difficult for upcoming investors to access the relevant information pertaining security trading (Hearn & Piesse 2010). Different companies have different ways and modes of disseminating information to its shareholders some prefer making it available on their website, others publish their financial reports while others come up with journals and other publications, this however does not fully aid investors in making decisions because to some illiterate investors such information is not enough while others it’s not understandable and therefore public knowhow is still a major setback in security trading in investment banks.

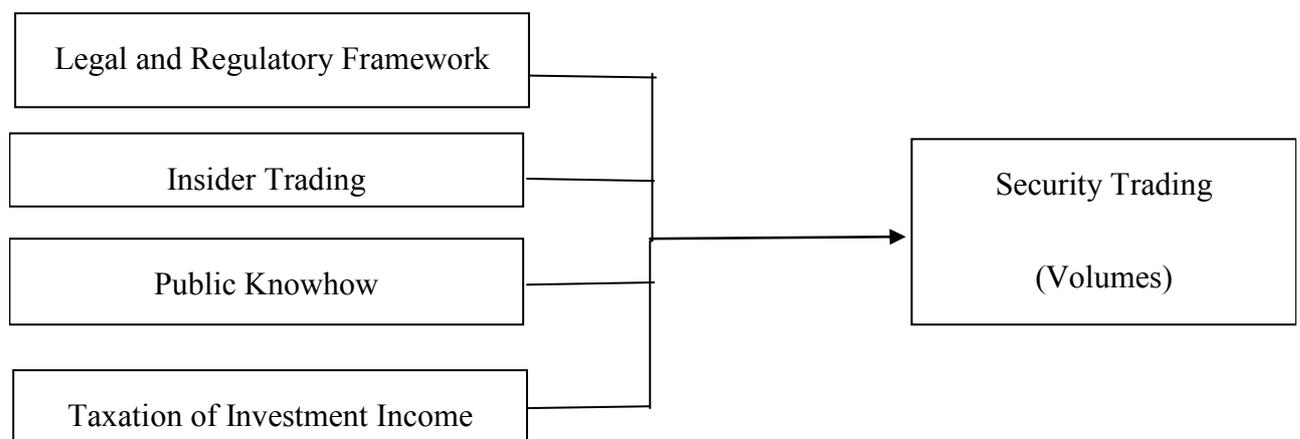
2.4 Taxation of Investment Income

There are various types of taxes that affect an individual. Taxation of investment income is an example of taxation that affects an investors’ investment. It is surprising how very few investors know how to treat this kind of taxation. Matheson (2011) found out that there are a number of taxes that are applied in practice in an investment firm. They include; currency taxation, security transaction, capital levy, among others. Treating these taxes can be a big problem to investors who don’t have any idea of how to treat them and what importance it has on increasing income to both the investor and the investment bank. The treatment of capital gains within the income tax centers wholly depends on what is really entailed by the requirement to avoid consumption of capital. According to Wagacha (2000) the taxation rates vary, therefore the different tax rate influences how different investors invest their capital and in which security they will accrue high returns. So as to have similar amount of retained earnings the pretax profit has to be higher for any investment to be worthwhile or the investors can increase their expenses so as to reduce the amount to be taxed. And therefore this paper seeks to find out whether taxation of investment income affects the volume of security traded in an investment bank in Kenya.

2.5 Conceptual Framework

The conceptual framework below shows the factors that affect security trading on the volume of securities traded in an investment bank in Kenya.

Figure 2.1 Conceptual Framework



Independent Variables

Dependent Variable

3. Research Methodology

3.1 Research Design

A research design is a framework for conducting business research project (Kothari, 2005). The type of design that was used is descriptive research design. This type of design is used because the issue to be discussed was specific in nature that is factors that affect security trading in investment bank. Mugenda and Mugenda, (2003) views descriptive statistics as an index that describe a given sample and relationship in a population.

3.2 Target Population and Sampling Procedure

A target population is a group of respondents that a researcher would like to focus on in a study, Ngechu, (2004). Therefore according to NSE, as at December 2015 the total number of licensed investment Banks are 14 and therefore the total target population under the study is 14 investment banks within Nairobi CBD. The respondents will be the legal officers, Consultants, traders, and Tax officers. According to Mugenda and Mugenda, (2003) the sample size was determined using the Cochran's formula where the total number of samples is determined and thereafter distributed amongst the investment banks that is:

$$n = Npq \times D$$

Where:

n is the desired sample size

N total population that is 196

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

q is 1-p Since p and q are unknown, they are set at 50.

D design effect (2.0)

In substitution, $n = 196 \times 50\% \times 50\% \times 2 = 98$

From the above calculations the total number of samples is 98 respondents that were used to carry out the study. These respondents were distributed amongst the legal officers, consultants, traders and tax officers' categories.

Table 3.1 Target Population and Sample size

Category	Target Population	Sample size	Frequency
Legal Officers	28	14	14.3
Consultants	56	28	28.6
Traders	84	42	42.9
Tax Officers	28	14	14.3
Total	196	98	100

Source: Authors' Computations, (2017)

3.3 Data Collection

Data collection instruments are tools that the researcher uses in gathering information from the respondents. The tool used in this paper was questionnaires. It was influenced by the objective of the study, the target population or the geographical scope. Therefore, it was used in collecting quantitative data from the respondents (Saunders et al., 2009). Questionnaires are suitable for this study because of the following reasons: time saving, maintenance of confidentiality of the information, and no room for interview bias.

3.4 Data Analysis

Data, as guided by the objectives of the study, was analyzed using descriptive statistics. It involves the use of mean and standard deviation to analyze collected data. According to Mutai (2005), the method does not demand laborious computations. In addition the study was analyzed using the multiple regression analysis. The regression formula to used was as follows;

$Y = B_0 + B_1X_1 + B_2X_2 + B_3X_3 + B_4X_4 + \epsilon$ Where; Y= Security Trading, X_1 = Laws and Regulations, X_2 = Insider Trading, X_3 = Public Knowhow, X_4 = Taxation of Investment Income, While $B_1 B_2 B_3 B_4$ are the regression coefficient and ϵ is the Error term

4. Data analysis

The total numbers of investment banks were 14. The research was conducted on a sample size of 98 respondents of the investment banks out of which 82 respondents completed and returned the questionnaires. The response rate therefore was 83.67%. Mugenda and Mugenda (2003) stated that a response rate of 70% and above is good for statistical reporting.

4.1 Legal and regulatory framework

Table 4.1 Legal and Regulatory Framework

Legal and Regulatory framework	Mean	Std deviation
legal and regulatory framework affect security trading in investment bank	4.071	.4746
The investment banks comply with the laws and regulations of security trading	4.286	.6112
There are Fair trading practices in the bank	4.429	.5136
The bank holds self-assessment of good governance	4.214	.8018
The bank conducts regular supervision and risk management so as to enhance performance	4.214	1.0509

Source: Author's Computations (2017)

From the results in Table 4.1 above; the respondents agreed to the fact that legal and regulatory framework affects the volume of security trading; mean 4.1, the investment banks comply with the laws and regulations of investment banks in regards to security trading; mean 4.2, there are fair trading practices in the bank; mean 4.4, the bank holds self assessment of good governance once in a while; mean 4.2 and the investment bank holds regular supervision and risk management so as to enhance performance a mean of 4.2.

4.2 Insider Trading

Table 4.2 Insider Trading

Insider Trading	Mean	Std deviation
Insider trading affects security trading in investment bank	2.087	.9002
To what extent does insider trading affect security trading	1.870	.8689
The bank regularly hold self-assessment for insider trading	1.870	.7570
The bank protect investors information	1.826	.9367
The investment bank Promptly discloses price sensitive information	1.957	.7057
An effective prohibition of insider trading promotes investor confidence	1.478	.5931

Source: Author's Computations (2017)

From the results tabulated in Table 4.2 above, it's noted that the respondents agree that insider trading affects security trading in investment banks to a great extent; mean of 2, the investment banks regularly holds self assessment for insider trading; mean 1.8, the bank protects investors trading information; mean 1.8, the investment bank promptly discloses price sensitive information; mean 1.9, an effective prohibition of insider trading promotes investors' confidence; mean 1.5.

4.3 Public Knowhow

Table 4.3 Public Knowhow

	Mean	Std deviation
Public knowhow affects security trading in investment bank	1.742	.4448
the investment bank conducts public awareness forums	1.677	.7478
There is an greater extent of literacy level of the investors	1.806	.4774
There is public access information within the investment bank	1.935	.8538

Source: Author's Computations (2017)

According to the results in Table 4.3 above, the respondents agreed that public know how affects the volume of security traded to a very great extent, a mean of 1.7, the investment bank conducts public awareness forums mean 1.7, there is a greater extent of literacy level of the respondents; mean 1.8, the investment banks conducts public awareness forums, mean 1.9.

4.4 Taxation of Investment Income

Table 4.4 Taxation on Investment Income

Taxation	Mean	Std deviation
Taxation affects security trading in investment bank	4.000	.9608
The investment bank adheres to the minimum taxation requirement	4.357	.4972
The investment bank conducts public awareness in regards to taxation	4.571	.6462
The investment bank does not have tax penalties	3.429	.8516

Source: Author's Computations (2017)

From the data collected, Table 4.4 above shows that taxation affects security trading in investment banks; mean 4.0, the investment banks adhere to the minimum taxation requirement; mean 4.3, the investment bank conducts public awareness in regards to taxation; mean 4.6, the investment banks o not have tax penalties; mean 3.4.

4.5 Regression Variables

This study was further analyzed by use of multiple regression analysis. This analysis is an extension of simple linear regression and it's used in predicting the value of variable based on the variables under study. The variable to be predicted is the dependent variable. The researcher therefore used the statistical package for social sciences SPSS to code, enter and compute the measurements of the multiple regressions for the study. 95% was used as the confidence interval for the dependent variable. R indicates the highest degree of correlation. Coefficient of determination (R^2) explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable that is explained by all the independent variables.

Table 4.5 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.796 ^a	.633	.470	1.2089960

a. Predictors: (Constant), Taxation on investment income, insider trading, legal and regulatory framework, public knowhow

Source: Author's Computations (2017)

From the Table 4.5 above the independent variables under study influence 63.3% of the volume of security traded in investment banks in Kenya this is represented by R square. 36.7% are other factors that are not studied in this research work.

Table 4.6: Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	16.313	6.921		2.357	.043
1 Legal & regulatory framework	.370	.117	.665	3.176	.011
Insider trading	.410	.315	.330	1.301	.226
Public knowhow	.199	.119	.433	1.668	.130
Taxation on investment income	.089	.310	.062	.288	.780

a. Dependent Variable: security trading

Source: Author's Computations (2017)

Multiple regression analysis was used to determine the extent to which each independent variables influences dependent variable or the volume of security traded in the investment banks. As per the SPSS generated table above, the regression equation used is:

$$(Y = 16.313 + 0.37 X_1 + 0.41 X_2 + 0.199 X_3 + 0.089 X_4 + \epsilon)$$

Where; Y is the dependent variable (Security Trading), X is the independent variables; X_4 Taxation on investment income, X_2 insider trading, X_1 legal and regulatory framework, X_3 public knowhow. The researcher found out that when the dependent variables are a constant zero the independent variable will be 16.313. This shows that when these factors are improved the volume of security traded will also increase. At 5% level of significance and 95% Level of confidence that is 0.011 is the significant level of Legal and regulatory framework, 0.226 is the significant level of Insider trading, 0.130 is the significant level of Public knowhow and 0.780 is the significant level of Taxation on investment income. Hence the most significant factor is the public knowhow.

4.6 Summary of Findings

The study found out that legal and Regulatory framework affect security trading in investment bank in Kenya. That despite the fair trading practices within the investment banks, changes made on the legal aspect of security trading affects the volume of the securities traded. From the study carried out, it was found out that insider trading affects the volume of securities to be traded in an investment bank through leakage of important information to a few traders who end up using it to their advantage leading to a variance in the returns on investment. This affects security trading to a great extent. Further the study found out that taxation greatly affects security trading in an investment bank. For instance, when capital gains tax was re introduced in the market, the investors saw it as a double tax on them and thus this discouraged many investors and also affected the stoke brokers who threatened to go on strike. From this study, the researcher found out that it's important for the public to have a clear view on the securities to be traded and the returns versus the risk implications on buying or selling of a particular security. Lack of information has made it impossible for potential investors to venture into security trading some view it as a get rich quickly scheme and some find it difficult to access information needed for trading.

5. Conclusions

In conclusion, security trading affects the volumes of securities traded in an investment bank. There are various factors that affect security trading and these factors include; Legal and regulatory framework, Insider trading, Public Know how and Taxation of investment income. And therefore if such factors are curbed then it means more investors will be attracted with security trading. The respondents also agreed that these factors have acted as a menace to security trading. It is therefore important to note that; there is a positive relationship between legal and regulatory framework of an investment bank with security trading. Where the laws are adhered to security trading is not affected in anyway and vice versa. There is also a positive relationship between insider trading and security trading. Security trading is hugely affected by insider trading due to information asymmetry amongst the investors. Taxation and individual investor know how negatively affects security trading in an investment bank. High taxation policies demoralize investors into venturing into security trading and where the investor is uninformed then he or she makes uninformed decisions.

6. Recommendations

This study recommends that investors should be more willing to do further research and analysis on the market trend and base their security trading decision on first hand information. Also the investment bank should carry out more awareness on insider trading, security trading and taxation so that every investor within an investment bank has an idea of the market trends and the information that is available. The investment bank should adhere to the laws and regulations of the investment banks and the security market so that they are not caught on the wrong side of the law.

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