Developing Country Studies
ISSN 2224-607X (Paper) ISSN 2225-0565 (Online)
Vol.5, No.7, 2015

Drivers for Issuance of Corporate Bonds by Listed Companies in Kenya

Samuel M. Ngugi
Dedan Kimathi University of Technology,P.O. Box 657, 10100, Nyeri Kenya
samngugi47@gmail.com

Dr. Francis Ofunya Afande, PhD., FCIM (UK).
Dedan Kimathi University of Technology,P.O. Box 657, 10100, Nyeri Kenya
offunya@gmail.com

Abstract
Purpose: The study sought to examine the motivations for issuance of corporate bonds among the firms listed on the Nairobi Stock Exchange. The study was guided by the following specific objectives: (To examine how reputation influences issuance of corporate bonds in Kenya: to examine how reputation influences issuance of corporate bonds in Kenya; to analyze the influence of liquidity incentives on issuance of corporate bonds in Kenya; and to assess the influence of indicators of net worth for the company on the issuance of corporate bonds in Kenya.
Methods: A descriptive survey focusing on all the 56 firms listed on the Nairobi Stock Exchange as at 31st December 2011 was undertaken. Primary data was collected from the Heads of Finance of the various companies with the aid of a semi-structured undisguised questionnaire with both open ended and closed questions. Data was analyzed by employing descriptive statistics such as percentages, frequencies and tables. Computation of frequencies in tables, charts and bar graphs was used in data presentation. In addition, the researcher used standard deviations and mean scores to present information pertaining to the study objectives. The information was presented and discussed as per the objectives and research questions of the study.
Results: Findings of the study indicate that reputation and liquidity incentives influence issuance of corporate bonds. The findings indicate that companies float bonds to get cash to solve liquidity problems. In addition liquidity depends on long term investments and good liquidity in the market reduces the cost of funding. Net worth indicators have a very low influence on the issuance of a corporate bond; majority of the respondent considers debt and equity as a ratio influence the issuance of bonds.
Keywords: *Corporate Bonds, Listed Companies, Corporate Bonds, Stock Market*

DEFINITION OF TERMS

Corporate Bonds: Corporate bonds are debt instruments that are issued by corporations considered to be publicly held (McGee, 2002).
The Stock Market: is a market which deals in the exchange of shares of publicly quoted companies, and government, corporate and municipal bonds among other instruments for money (Nairobi Stock Exchange, 2011)

LIST OF ABBREVIATIONS

AIMS	Alternative Investment Market Segments
CAPM	Capital Asset Pricing Model
CBK	Central Bank of Kenya
CMA	Capital Market Authority
GDP	Gross Domestic Product
IFC	International Finance Corporation
IOU	I Owe You
IPO	Initial Public Offer
MIMS	Main Investment Market Segments
NPV	Net Present Value
NSE	Nairobi Stock Exchange
OECD	Organization for Economic Cooperation Development
OTC	Over-The-Counter
RBA	Retirement Benefits Authority
SPSS	Statistical Package for Social Sciences
SPV	Special Purpose Vehicles

1.0 INTRODUCTION

1.1 Background of the Study

1.1.1 Corporate Bonds

Corporate bonds are debt instruments that are issued by corporations considered to be publicly held (McGee, 2002). Generally, a corporate bond is issued as a means of raising necessary funds to allow the company to engage in an expansion project, or to address other corporate projects that are anticipated to increase the profitability of the company over the long term. According to McGee, the expectation is that the corporation will begin to benefit from the project before the bond issue matures, allowing the company to comfortably honor both the face value of the bond and any accrued interest due to the bondholders. According to Emerick & William (2004), purchasing a corporate bond is usually accomplished through investment brokers. However, it is also possible to acquire a bond issue from a secondary market as well. In general, choosing to purchase the corporate bond through a broker will mean paying the current par value associated with the bond. A third option is to invest in a mutual fund that focuses on the purchase of corporate bonds as part of the fund strategy. Investors who prefer to leave most of the investigation into bond issues with the managers of the mutual fund often favor this approach. There are five main classifications of issuers representing various sectors that issue corporate bonds: public utilities; transportation companies; industrial corporations; financial services companies; and conglomerates. Such issuers may be locally owned or foreign owned companies (Chordia *et al.,* 2003).

Why does a firm issue bonds and what influences that decision? In the presence of information asymmetries in capital markets, firms prefer internal to external finance, but at some point as firms grow, self-funding typically becomes insufficient to finance their investment projects and so they turn to sources of external finance either from the markets for equity and debt or banks (Calomiris *et al.,* 1995). Most models of firm finance assume that firms require some external finance, from either banks or financial markets, to pursue investment projects and that is available subject to minimum standards of creditworthiness in the eyes of the lender. If creditworthiness grows with size and age then this might suggest that there is simply a life-cycle effect that influences a firm's decision to issue bonds, and if this were the case, in an asymmetric information world, net worth would be an important determinant of that decision. In this paper we argue that there is more to the story. The evidence in Datta *et al.* (2000), who discuss the factors influencing firm's decisions to enter the public debt market for the first time, and more recently, Hale & Santos (2003), who have addressed the timing of the firm's decision to issue a debt IPO argue that reputation, liquidity as well as firm size and market conditions influence the decision. We attempt to shed further light on the question of the determinants of bond influence by considering the role that financial characteristics, reputation in the bond market, and liquidity incentives motivate firms to raise finance from the repeated issues in the bond market. The current study therefore extends Datta *et al.,* (2000) and Hale & Santos (2003) by considering factors that influence firms decisions beyond the bond IPO.

1.1.2 Nairobi Stock Exchange

The Nairobi Stock Exchange (NSE) was established in 1954 as a voluntary association of stockbrokers registered under the Societies Act. The NSE currently has 54 companies with equity listings in the Main and Alternative Investment Market Segments (MIMS and AIMS). There is also a third segment for trading of government and corporate bonds and other fixed-income securities market segment - the FISMS. A fourth segment for trade of derivative instruments is envisioned for the near future. The total equity market capitalization of these 564 companies as at June, 2011 was KShs 1.3 trillion. In 1994, the NSE was at its peak and was rated by the International Finance Corporation (IFC) as the best performing market in the world with a rate of return of 179% in US Dollar terms. At that time, the NSE had a market capitalization of KShs 137 billion (equivalent to US $ 3.1 billion at the then prevalent exchange rate of KShs 45 to 1 US$).

The Stock Market is a market which deals in the exchange of shares of publicly quoted companies, and government, corporate and municipal bonds among other instruments for money[1]. The Kenyan stock market; the Nairobi Stock Exchange, which was formed in 1954 as a voluntary organization of stockbrokers, is now one of the most active markets in Africa. It is located on 2nd Floor, Nation Centre on Kimathi Street, in Nairobi. Nairobi Stock Exchange is Africa's fourth largest stock exchange in terms of trading volumes, and fifth in terms of market capitalization as a percentage of GDP. According to the Nairobi Stock Exchange report (December, 2007), as a capital market institution, the Stock Exchange plays an important role in the process of economic development: It helps mobilize domestic savings thereby bringing about reallocation of financial resources from dormant to active agents; Long-term investments are made liquid, as the transfer of securities (shares and bonds) among the participating public is facilitated; The Exchange has also enabled companies to engage local participation in their shares ownership, thereby giving Kenyans a chance to own shares of reputable firms; Companies can also raise extra finance essential for expansion and development.

[1] Nairobi Stock Exchange, 2011

1.2 Statement of the Problem

Corporate bonds issuance remains one of the greatest enigmas of modern finance. Hasbrouck and Duane (2001) argued that there was no convincing explanation for issuance of corporate bonds. To resolve the dividend puzzle, Chen *et al.,* (2005) conclude that the cardinal thrust of academic research must turn toward learning about motivation and on what perceptions this motivation is based. There is scarcity of literature on corporate bond issuance. Related studies undertaken in Kenya include the following: Previous studies indicate that there is a life cycle in the firm's financing behavior. Firms borrow from banks initially but may later go to public debt markets for debt finance. This sequence is often described as the "pecking-order" hypothesis of Myers and Majluf (1984). This raises the question of what influences a firm's decision to issue public debt. Strikingly, little research has been devoted to bond IPOs, in sharp contrast to equity IPOs. This is somewhat surprising given that bond financing is more important for firms than equity financing in terms of the dollar value of funds raised. In this paper we attempt to shed some light on this question.

Ayieye (2004) studied the factors considered by individual investors in investing shares of companies quoted at the NSE; Gakuru (2004) focused on the relationship between stock returns & bond returns in the NSE; Njogu (2003) studies the price impacts of commercial paper issue announcement. a case of quoted companies which have issued commercial papers in Kenya; Muriuki (2003) focused on the determinants of priority structure of corporate liabilities for firms quoted at the NSE; Mbugua (2003) focused on the factors influencing development of the corporate bond market in Kenya; Abai (2003) studied the determinants of corporate debt maturity structure for companies quoted at the NSE; Ng'ang'a (2000) focused on commercial paper as a source of finance for Kenyan companies

None of the above studies focused on factors influencing corporate bond issuance in Kenya. Whereas research has tended to focus on the technicalities of corporate bond market development in the developing countries, this study attempts to complement this work with research into the factors influencing issuance on corporate bonds in the developing countries. Referring to the experiences of Kenya, this study tries to shed light on why these markets have remained limited in size and, in comparison with equity markets, failed to expand significantly during the decade prior to the economic crisis. The study also assesses some changes brought about by the economic crisis and suggests some broad policy preconditions for corporate bond market development.

1.3 Purpose of the Study

The study sought to examine the factors influencing issuance of corporate bonds by listed companies in Kenya as at 31st December, 2011.

1.4 Objectives of the Study

The study was guided by the following specific objectives:

(i) To examine how reputation influences issuance of corporate bonds in Kenya
(ii) To analyze the influence of liquidity incentives on issuance of corporate bonds in Kenya
(iii) To assess the influence of indicators of net worth for the company on the issuance of corporate bonds in Kenya.

2.0 LITERATURE REVIEW

2.1 The Concept of Corporate Bonds

Corporate bonds (also called corporates) are debt obligations, or IOUs, issued by private and public corporations. According to Glosten & Lawrence (1988), companies use the funds they raise from selling bonds for a variety of purposes, from building facilities to purchasing equipment to expanding the business. When you buy a bond, you are lending money to the corporation that issued it. The corporation promises to return your money, or principal, on a specified maturity date. Until that time, it also pays you a stated rate of interest, usually semiannually. The interest payments you receive from corporate bonds are taxable. Unlike stocks, bonds do not give you an ownership interest in the issuing corporation (Fleming, 2003). Corporate bonds are one of significant capital market instruments and at the same time a potential source of company finance. They are long-term, mass issued, tradable, debt securities issued by corporate bodies, confirming the obligation of an issuer to pay the bondholder revenues and pay off the nominal value under set terms.

2.2 Type of Corporate Bond Issuers

There are five main classifications of issuers representing various sectors that issue corporate bonds: public utilities; transportation companies; industrial corporations; financial services companies; and conglomerates. Such issuers may be locally owned or foreign owned companies (Chordia *et al.,* 2003).

2.2.2 Basic Terms of Corporate Bonds

Maturity - One of the key investment features of any bond is its maturity. A bond's maturity tells you when you should expect to get your principal back and how long you can expect to receive interest payments. One of the

most difficult risks for investors to understand is that posed by "call" and refunding provisions. If the bond's indenture (the legal document that spells out its terms and conditions) contains a "call" provision, the issuer retains the right to retire (that is, redeem) the debt, fully or partially, before the scheduled maturity date. For the issuer, the chief benefit of such a feature is that it permits the issuer to replace outstanding debt with a lower interest- cost new issue (Chordia *et al.,* 2000).

According to Piqueira (2004), a call feature creates uncertainty as to whether the bond will remain outstanding until its maturity date. Investors risk losing a bond paying a higher rate of interest when rates have declined and issuers decide to call in their bonds. When a bond is called, the investor must usually reinvest in securities with lower yields. Calls also tend to limit the appreciation in a bond's price that could be expected when interest rates start to slip. Because a call feature puts the investor at a disadvantage, callable bonds carry higher yields than noncallable bonds, but higher yield alone is often not enough to induce investors to buy them. As further inducement, the issuer often sets the call price (the price investors must be paid if their bonds are called) higher than the principal (face) value of the issue. The difference between the call price and principal is the call premium.

According to Prowse (1998), corporate bonds, in general, are divided into three groups:

Short-term notes - Maturities of up to 5 years
Medium-term notes/bonds - Maturities of 5–12 years
Long-term bonds - Maturities greater than 12 years

Structure - Another important fact to know about a bond before you buy is its structure. With traditional debt securities, the investor lends the issuer a specified amount of money for a specified time. In exchange, the investor receives fixed payments of interest on a regular schedule for the life of the bonds, with the full principal returned at maturity. In recent years, however, the standard, fixed interest rate has been joined by other varieties. The three types of rates you are most likely to be offered are these:

Fixed-rate - Most bonds are still the traditional fixed-rate securities described above; Floating-rate - these are bonds that have variable interest rates that are adjusted periodically according to an index tied to short-term Treasury bills or money markets. While such bonds offer protection against increases in interest rates, their yields are typically lower than those of fixed-rate securities with the same maturity; and Zero-coupon - These are bonds that have no periodic interest payments. Instead, they are sold at a deep discount to face value and redeemed for the full face value at maturity.

2.2.3 Benefits of Investing in Corporate Bonds

According to OECD (1994), investors buy Corporate Bonds for a variety of reasons:

Attractive yields: Corporate Bonds usually offer higher yields than comparable-maturity government bonds. This high-yield potential is generally accompanied by higher risks. Yield is a critical concept in bond investing, because it is the tool you use to measure the return of one bond against another. It enables you to make informed decisions about which bond to buy. In essence, yield is the rate of return on your bond investment. However, it is not fixed, like a bond's stated interest rate. It changes to reflect the price movements in a bond caused by fluctuating interest rates (OECD, 1994).

Dependable income: People, who want steady income from their investments, while preserving their principal, include Corporate Bonds in their portfolios. Like all bonds, corporate bonds tend to rise in value when interest rates fall, and they fall in value when interest rates rise. Usually, the longer the maturity, the greater the degree of price volatility. By holding a bond until maturity, you may be less concerned about these price fluctuations (which are known as interest-rate risk, or market risk), because you will receive the par, or face, value of your bond at maturity. Some investors are confused by the inverse relationship between bonds and interest rates - that is, the fact that bonds are worth less when interest rates rise; safety - corporate bonds are evaluated and assigned a rating based on credit history and ability to repay obligations and the higher the rating, the safer the investment; diversity - corporate bonds provide the opportunity to choose from a variety of sectors, structures and credit-quality characteristics to meet your investment objectives; and marketability - if you must sell a bond before maturity, in most instances you can do so easily and quickly because of the size and liquidity of the market (OECD, 1994).

2.3 Corporate Bonds Issuance

2.3.1 Corporate Bonds from the Point of View of Capital Demand

A real and optimal structure of financial sources is a topical problem about which there has been a lively discussion. There are vast discrepancies between the opinions on the shares of internal and external, one's own or extraneous financial sources. Holmstrom and Tirole (1997), state that 60 to 90 % of financial needs in developed countries of European Union and Northern America are financed from undistributed profits, i.e. from one part of internal finance sources. However, the role of depreciation write-offs as an indispensable part of internal financial sources should not be ignored.

2.3.2 Potential of Using Corporate Bonds from the Point of View of an Issuer

From the point of view of an issuer, i.e. a company, corporate bonds represent an alternative source of financing. Issuing corporate bonds can be used firstly for cash flow improvement, secondly for financial structure optimization, however also within ownership restructuring (*Choe et al.,* 1993). Cash flow improvement can be achieved also by applying measures in terms of profit rate (decreasing costs and increasing returns), property (particular parts of property control including receivables) and further by gaining external financial sources of both a long-term and a short-term nature. Corporate bonds are one of alternative external long-term sources.

Corporate bonds represent an instrument that can be used by company managements for implementing both the rule of a horizontal property-financial structure and the rule of a vertical financial structure, however also for meeting the effort to reach an optimal financial structure. Currently, though, the financial sources selection by Kenyan company managers complies with a hierarchical order theory; companies generally prefer financing from internal sources and if they are forced to use external finance sources, they prefer gaining money from credits or issuing corporate bonds to gaining it from share emissions. Within a process of ownership restructuring corporate bonds can be applied in integrations in a form of acquisitions. They can also be used by strategic alliances based on a common property – either in a form of a holding or a joint venture. Corporate bonds may play their roles even in other types of ownership restructuring that may rest in an exchange of convertible corporate bonds for shares or in setting up a claim with put bonds. Corporate bonds can be used as an active or preventive tool for protection against a hostile takeover.

2.3.3 Advantages and disadvantages of corporate bonds

Using corporate bonds is both advantageous and disadvantageous for a company as an issuer.

The advantage of issuing corporate bonds: The advantages of issuing corporate bonds can be seen in achieving a higher degree of company capital structure flexibility, and a company is thus more able to react promptly to constantly changing conditions, which consequently leads to generating larger financial sources.

We can claim that corporate bonds can present an instrument of increasing of company competitiveness and can contribute to creation of competitive advantage (Liu et al, 2004). Another advantage means that corporate bonds emissions can make up a considerable amount of money provided by a large number of creditors. As a consequence of a risk distribution among a large number of creditors the bond emission is a lower costs alternative in comparison to bank loans under a certain debt level condition. Also a procedure used by certain foreign companies in terms of reaching and maintaining an optimal financial source structure is worth mentioning (Levin *et al,* 2004).Companies first accept bank loans, and that is to the degree to which the loan is cheaper and otherwise more advantageous than bonds emissions. Then they issue bonds and use a part of the gained finance to paying loans and other liabilities off, which increases the ability to accept other bank loans. After reaching the top limit of bank loans a company issues bonds again and the cycle repeats itself. In the third cycle a company issues shares and a part of sources is used for paying off the bank loans, paying off the bonds and the rest is used to finance a further development. Then a company increases bank loans and the cycle repeats itself again.

According to Myers & Majluf (1984), a significant advantage rests in the fact that returns of corporate bonds represent a tax base and in case of a company profitability an interest tax shield can be used. Furthermore shareholders do not lose a company activity control when issuing corporate bonds, while issuing them often does not even need a collateral in a form of a property pledge (Mikkelson and Partch, 1986). It is due to say that as a consequence of an obligation to pay back the principal and returns of bonds managers get a clearer view of rate of returns and that successful issuing of corporate bonds (especially their placement) is considered a prestigious thing helping the company to gain respect by the public and business partners (Merton, 1987).

The Disadvantages of issuing corporate bonds: On the other hand, the disadvantage of corporate bonds rests in the fact that investors require a lot from credit issuer credibility, while returns and principal must be always paid in time regardless the company profit (Miller & Puthenpurackal, 2002),. A substantial disadvantage of bonds emissions lies in considerable emission costs created by costs of issue (costs directly connected with issuing corporate bonds) and costs of bonds life cycle (costs connected with the particular emission, arising in course of the life cycle and in connection to paying back the emission).

2.4 Factors that Influence Corporate Bonds Issuance

2.4.1 Reputation of the Company

Reputation of a company in the form of a track record of previous bond influences the decision of a firm to issue bonds. According to the financial intermediation literature where there are both banks and bond markets, there is a strong role for reputation especially in the Diamond (1991) model. Reputation in the Diamond sense is built by firms through repeated borrowing from banks; here the non-default reputation over many loans assists them in entering the market for bond finance, but there is no role for building reputation in the bond market directly.

Diamond (1989) considers the required rate of return on a corporate bond when investors are unable to distinguish good firms from bad firms. In this model, some firms have only positive NPV projects, others only

negative NPV projects, and a third group has the ability to choose between either. A lemons problem develops in the bond market, leading to premiums in interest rates. Over time, however, investors learn that the type one firms are more likely to repay their debt (they acquire a reputation) and that the type two firms are more likely to default, and consequently the interest rates facing type one borrowers decline. Because of the lower interest rate on safer firms' debt, the third type of firm has an incentive to become a safer firm and also build a reputation. Diamond (1991) considers the situation where the firms may also borrow in the bank loan market where costly monitoring can overcome the lemons problem.

Gorton (1996) studies Diamond's (1989) model in the context of bank notes from the free banking era. Bank notes carried the risk of default by the issuing bank and thus were routinely discounted from their face value. Gorton shows that the newer banks that had not developed a reputation experienced greater discounting on their notes than seasoned banks. Similarly, Carty (1996) shows that firms that are more well-known in the corporate bond market, because they have been in the market longer, have lower interest rates on their bonds, ceteris paribus.

Neither the bond under pricing literature nor the reputation acquisition literature considers the existence of the other mechanism for dealing with information problems. If the two are direct substitutes, and firms have frequent needs for entering the bond market, then reputation-building is likely to supersede under pricing as the main solution to resolve information problems. For a firm that has never issued in the public bond market before, under pricing is likely to be a more effective tool.

2.4.2 Liquidity Incentives

Liquidity is the ability of a market to absorb a large number of transactions without dramatically affecting price. The absence of liquidity for an asset implies difficulty in converting it into cash, and generally reduces incentives to hold the asset, unless a countervailing premium is offered (Chen *et al.,* 2002). Liquidity is to markets as oxygen is to humans only noticeable by its absence. Defining liquidity is certainly one of its easiest aspects, even though this is not necessarily easy to do in all markets, or for all instruments. It is much harder to theorize and demonstrate what underlies liquidity, and just as hard to measure it (Houweling, 2003). According to Johnson (1997), Liquidity Incentives influence the firm's decision to issue bonds. This is rooted in the limited liquidity assumption. This factor takes into account the reasonable assumption that firms and intermediaries have limited liquidity, and therefore at some point firms will be unable to obtain sufficient finance form retained profits or bank loans to proceed with investment projects. At this point the scale of the finance required will create incentives to the firm to obtain bond market finance. While firms face a shortage of internal funds to finance investment projects, there is also a shortage of funds from banks. Thus for large investment projects the firm has to tap the public bond market.

Studies such as Diamond (1991, 1993) and Stiglitz & Weiss (1981) suggest that firms have incentives to issue debt with longer maturity when liquidity risks and information asymmetry are low. In this study, we use the market value of a firm's equity to measure the impact of liquidity risk and information asymmetry on its debt maturity choice. Large firms tend to have lower default and liquidity risks and should be able to issue debt with long maturity to reduce the cost of refinancing. Large firms also have more publicly available information and the information asymmetry problem should be less severe for them when issuing long-term debt.

Theoretical models of liquidity have been prevalent in the market microstructure literature for almost three decades. However, work aiming at incorporating the impact of market structure and illiquidity on the prices of financial instruments has a much briefer history. Recent papers have strived to develop general equilibrium models where liquidity is a determinant of expected returns on assets. For example, Acharya & Pedersen (2003) derive a version of the CAPM where the uncertainty relating to both systematic and idiosyncratic changes in liquidity is incorporated. One result is that investors are prepared to pay more for securities whose returns are negatively correlated to market illiquidity, which is consistent with empirical evidence provided by Pastor and Stambaugh (2001). Although these approaches appear promising, we will now focus in more detail on recent work with a clearer bearing on fixed income markets.

A distinctive feature of most fixed income markets is that trading takes place over-the-counter in an environment dominated by a limited number of dealers. This means that finding a buyer for a given position can be time consuming and risky-often there will be no market maker who is committed to providing liquidity. One interesting approach to modeling this feature of OTC markets can be found in Duffie, Gârleanu, & Pedersen (DGP) (Duffie *et al.,* 2003). They structure the process of buyers meeting sellers as a search and bargaining game. In the simplest version of their model, agents in the economy differ along two dimensions. First, some may incur a cost of holding illiquid assets (lowtype), whereas others do not.

In another recent paper, Ericsson and Renault (ER) (2003) develop a model for the valuation of illiquid corporate bonds. They construct a partial equilibrium model of a bondholder's decision to unload his holdings either directly as a result of a liquidity shock or in anticipation of future such shocks. In addition to the risk of financial distress, the probability of a forced sale through a liquidity shock is a separate source of risk. As these two factors can be correlated, the model can be thought of as allowing the overall state of the economy to impact

both bond market liquidity and the risk of default for individual companies. When considering whether or not to sell, the bondholder faces a random number of offers from interested dealers, of which he retains the best. Furthermore, the model allows for strategic interaction between the firm's shareholders and creditors in financial distress. After a default, the firm's distressed debt is still traded and bondholders are still subjected to the risk of liquidity shocks. As a result, the linkage between the price impact of default risk and liquidity risk will depend on the way that financial distress is resolved. In the absence of bond illiquidity, creditors and shareholders can renegotiate the terms of debt to avoid a costly liquidation.

When illiquidity is added to this framework it can impact the relative bargaining strength of the two parties. If bondholders can press for immediate liquidation of the firm's assets and their bond is illiquid, their threat to do so becomes more credible. The reason is that when faced with the choice of liquidation or accepting a renegotiated debt contract, an illiquidity discount in the market for distressed debt will tilt them in favor of the former.

2.4.3 Indicators of Net Worth for the Firm

According to Tirole (2006), net worth for a company is the total assets minus total liabilities. Net worth is an important determinant of the value of a company, considering it is composed primarily of all the money that has been invested since its inception, as well as the retained earnings for the duration of its operation. Net worth can be used to determine creditworthiness because it gives a snapshot of the company's investment history and is also called owner's equity, shareholders' equity, or net assets. Smith (1986) argued that for an individual, the value of a person's assets, including cash, minus all liabilities. The amount by which the individual's assets exceed their liabilities is considered the net worth of that person.

According to Tirole (2006), the decision to access bond markets is influenced by the indicators of net worth for the firm, the reputation from previous issues in the bond market, and incentives to issue bonds from limited liquidity in financial intermediaries. It is expected that firms with higher net worth, better reputation in the form of previous issues in the market, and those firms that have greater incentives to be more likely to issue bonds. Smith, (1986), noted that larger firms, creditworthy firms, and those with less liquidity undertake initial bond issues earlier.

2.5 Constraints to the Development of a Corporate Bond Market

Kenya's underdeveloped corporate bond market has distorted the financing structure in the economy, which poses a threat to financial stability, as well as to social and economic development. Setbacks and mistakes had their roots in the specific circumstances of the past. According to Acharya and Lasse (2005), even today, some of these mistakes may still be impeding the development of the corporate bond market in Kenya:- The administrative allocation of quotas for issue size and number of issuers was mandated by the central government to provincial and lower-level governments; Administrative allocation of quotas was often used as a relief measure for financially distressed enterprises; The absence of a credit rating system made it impossible for investors to obtain a clear idea of risks; There was a lack of information disclosure to investors, due to (i) inadequate accounting and external audit standards and (ii) lack of regulatory emphasis on proper disclosure by issuers as well as prudent analysis by investors; Administrative pricing of corporate bonds and price controls failed to reflect risks, thereby preventing effective risk management by issuers and investors:

Authorities required bank guarantees for corporate bond issuance and still do so today. Since issuance quotas were administratively allocated and prices controlled, and neither information disclosure nor credit ratings were available, bank guarantees seemed to be the natural solution. However, once guaranteed by a bank, the product was no longer a standard corporate debt but, rather, akin to a high-yield deposit at a commercial bank; Bond issues were targeted at retail rather than institutional investors, who were capable of risk assessment; Effective market discipline was not established. Market forces can discipline both the issuance and trading of corporate bonds as investors exercise their judgment in the choice of products - thereby giving them the final say on issue conditions, prices and consequences of default. Lack of effective market discipline can lead to recourse to administrative means, which can give rise to a series of problems.

In addition, in order for the OTC market to play a dominant role, a proper trading mode should be established to ensure proper assessment of counterparty risks and pricing flexibility; Investor education was not sufficient. To a large extent, many investors used to treat corporate bonds as just another savings deposit product. Whenever a default of corporate bonds occurred, they would turn to government agencies and demand redemption by underwriters. Moreover, the protection given by local governments to bond investors undermined the incentive for them to evaluate the risks involved; The current Bankruptcy Law did not provide investors with effective liquidation as a form of recourse in the event of default. In China for instance, the residual assets - and even the issuer - could often simply disappear without going through legal procedures (Pastor *et al,* 2003). Although we have been working hard on a new bankruptcy law, the current one does not provide adequate protection for creditors; The underwriter's role was not properly defined. Underwriting and redemption typically came under the umbrella of central planning and administrative intervention. Furthermore, the underwriter was

considered liable when the issuer failed, an arrangement that blurred distinctions between the underwriter, sales agent and redemption agent; and Administrative intervention was even stronger in cases of corporate issuer default. The default of a corporate issuer was not dealt with according to market principles; rather, for reasons of social stability, the underwriter would be requested to issue bonds on its own to meet the obligations of the corporate issuer -with the consequence that the liability of the default issuer was transferred to the underwriter. The problems of some securities companies undergoing liquidation or restructuring were partly attributable to the burden they had to shoulder for the defaulted corporate issuers.

Regarding the formal procedures for the local issuance of corporate bonds, the approval process in Kenya is a bit lengthier than in other countries in the region with prosperous financial markets. Another restraint on market development is the fact that corporate bonds are currently not listed in the Nairobi Stock Exchange (NSE). Listing these bonds in the NSE would accomplish two important goals to promote this market: first, it would provide a valuable safeguard for small investors, and secondly, it would promote the standardization and flow of information through disclosure requirements, which in turn would enhance the price discovery process (Park & Rhee , 2006).

To foster the development of a corporate bond market, the authorities should consider: increasing the cap on a companies' permissible amount of outstanding debt (currently set to equal the company's paid-up capital); reducing the time necessary to obtain approval from the CBK and the Treasury to issue corporate debt ; reducing the number of track-record years required for a company to be able to issue debt (at the time of writing, a company needed a track record of at least five years of); and facilitating the listing of corporate bonds in the KSE in order to broaden the bond market, safeguard small investors interests, and promote the standardization and flow of information through disclosure requirements (Schinasi & Smith, 1998).

2.6 Corporate Bond Market in Kenya

According to Myers (1977), there are several good reasons for developing bond market. The most fundamental reason is to make financial and capital market more complete by generating market interest rates that reflect the opportunity cost of funds at each maturity. This is essential for efficient investment and financing decisions. Moreover the existence of tradable instruments helps risk management. Further the use of financial guarantees and other types of underwriting is becoming increasingly common in corporate debt market as financing deals become more complex (Pagano *et al.,* 1998). If borrowers have available to them only a narrow range of instruments (in terms of maturity and currency) then they can be exposed to significant mismatches between their assets and their liabilities.

The risks entailed by such mismatches have to be managed and the ability to do so will often depend on whether certain exposures can be adequately hedged (Kaplan &Zingales, 1997). Liquid markets help capital market participants to hedge their exposures. If bond market is not well developed for instance firms may have to finance the acquisition of long-term assets by incurring short-term debts. As a result their investment policies may be biased in favor of short-term projects and away from entrepreneurial ventures. According to Krishnaswami *et al.,* (1999), the relationship between intermediation through banks and disintermediation through capital markets is controversial. Even in developed economies this two rather distinct systems have grown up one where capital markets are very important and one where banks dominate. A question that arises concerns the role commercial banks can play in developing our bond markets. The view that increased corporate bond issuance just takes away profitable business from commercial banks is oversimplified.

One implication often drawn from developed market experience is that a key prerequisite for the development of a corporate bond market is the existence of some form of independent credit risk assessment. How successfully can this be done and reinforced in our capital market is yet to be seen besides having only one approved South Africa based Credit Rating Agency by Capital Market Authority (CMA). But let me quickly point out that the Athi River Mining Limited five-year unsecured corporate bond issued on strength of its grade A investment credit rating from the Global Crediting Company of South Africa is a step in the right direction. The question for the policy makers is: can independent credit rating be reconciled with provisions that allow some regulators of institutional investors i.e. Central Bank, Commissioner of Insurance, Retirement Benefits Authority (RBA) etc to themselves determine credit ratings of the debt instruments “their” firms can invest in?

Central bank of Kenya has multiple interests in the development of bond markets. At a fundamental level the government Treasury bond helps to fund budget deficits. It is important to note that Central Bank of Kenya has increased its issuance of long-term Treasury bonds currently with 12-year tenor thus increasing the maturity period of government debt. Also Central Bank acts as agents for the government in various aspects of the management of government debt. They oversee clearance and settlement system and they are responsible for the stability of the financial system often directly supervising banks. This multiplicity of interest means that the policy issues that arise are very diverse.

Though Kenya’s financial sector is well diversified, it needs to be developed further. The banking sector is dominated by ten largest commercial banks, which accounts for over 77% of all deposits held by

banking institutions. Insurance and banking sector's are quite competitive, but need to be restructured so that we have competitive bidding for government Treasury bills auction. The assertion is that "limiting" participation in the Treasury bill auction to only a few players would restrict competition and consequently the result not market driven. A developed Treasury bond market has a direct impact on the capital market. The two sectors could be strengthened through more mergers and consolidations, which will ensure efficient competition and further deepening of the capital market

Without a functioning bond market firms lack a clear measure of the opportunity cost of funds. They will rely on commercial banks for debt financing. The same constraint that prevents the development of bond markets also leads banks to prefer short term credit which implies higher risks for business. The government massive infrastructure development i.e. reconstruction of our depilated roads network can be privately funded. Often in such cases the commercial feasibility depends on the funding structure that minimizes considerably risks. This requires long term (usually 20 years or longer) flexible or fixed interest rate, attractively priced debt instruments. Debts of this nature can be provided by a liquid traded bond.

Moreover in the 2005/2006 budget speech by the Minister of Finance securitization based on bankable assets were a given a boost particularly for institution offering infrastructural services to raise long term capital by encouraging such institution to set up special purpose vehicles (SPV) for the purpose of issuing asset backed securities. The Minister's proposal that income from SPV to be exempted from income tax is highly commendable. Now that the Minister paved the way in the budget speech we would see more of structured corporate bonds issued through a special purpose vehicles (SPV) i.e. securitization of credit card receivables, infrastructure bond and mortgage backed bonds in our capital market. It is equally important to note that the limited role of corporate bond market is a function of how companies have been financing their investments projects-especially medium to long term fixed investments. The yield of a bond has to compensate investor for the opportunity cost of funds, default and liquidity risk If the return of the bond is distorted among clients and there is no active secondary market investors will be reluctant to participate in the development of the corporate bond market. In any case a flourishing corporate bond market contributes to deepening of the capital market, is a source of fund for infrastructure and facilitates competition in the financial services. With developed bonds market banks can price debt more efficiently.

Broader use of corporate bonds in Kenya is impossible without making a number of changes that will involve, for one thing, the legislative and procedural areas (amendments to selected rules of law, ensuring effective functioning of the court structure, another possibility is also creating a specialized court for the capital market), then the areas of the capital market (ensuring better transparency and maximum possible information openness, and that, among others, with help of modern information and telecommunication technologies, connecting the Nairobi Stock Exchange with other leading stock exchanges or finding new ways of using debentures for securitizing of assets, for example), but also the corporate field (particularly successful restructuring, or enhancement of the information facilities of the company), and the macro-economic situation in Kenya (especially creating a stable market environment or changing the pension scheme, which will use bonds as a suitable investment instrument)

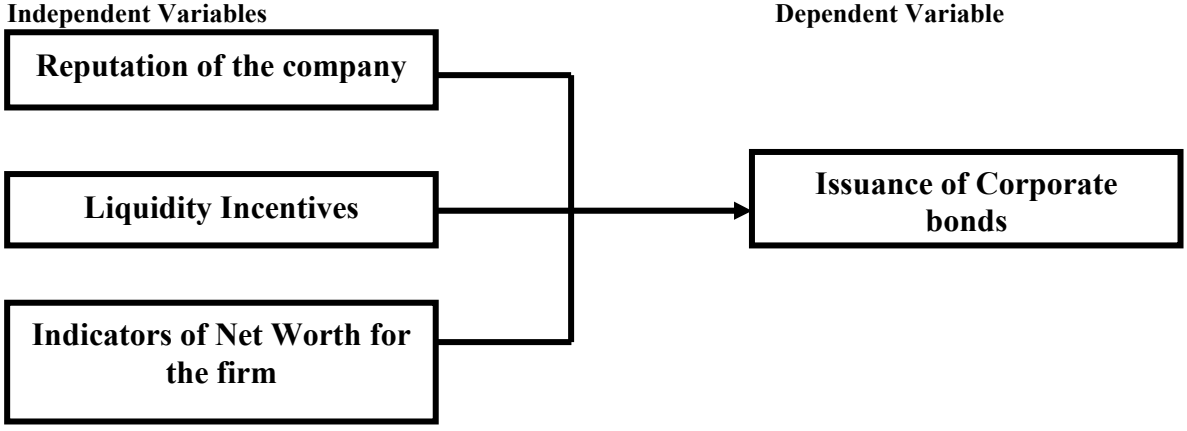

Figure 2.1: Conceptual Framework

2.8 Conceptual Framework

In the presence of information asymmetries in capital markets, firms prefer internal to external finance, but at some point as firms grow, self-funding typically becomes insufficient to finance their investment projects and so they turn to sources of external finance either from the markets for equity and debt or banks.

2.8.1 Reputation of the Company

Firms that have previously had a successful bonds issue are more likely to issue bonds again based on previous

experience. The bonds issued are also likely to attract interest in the market because of the reputation gained from previous issue of corporate bonds.

2.8.2 Liquidity Incentives

Given that resources are scarce, leading to limited liquidity faced by firms that would like to expand or divest, firms are forced to seek additional funds from external sources. Considering the assumption that firms and intermediaries have limited liquidity and as such, firms may at some point be unable to obtain sufficient finance from retained profits or bank loans to proceed with investment projects, the firms resort to issuing corporate bonds.

2.8.3 Indicators of Net Worth for the Firm

Firms that are credit worth may at times face a shortage of internal funds to finance investment projects whose cost implications may be such that the banks may not be able to meet the financial requirements. Therefore, the net worth of the firm, coupled with the shortage of funds in the banks to meet the obligations, the firm decides to tap the public bond market. If creditworthiness grows with size and age then this might suggest that there is a life-cycle effect that influences a firm's decision to issue bonds

3.0 RESEARCH DESIGN AND METHODOLOGY

3.1 Research design

Research design provides the glue that holds the research project together. A design is used to structure the research, to show how all of the major parts of the project, which include the samples or groups, measures, treatments or programs, and methods of assignment that work together to try to address the central research questions (Brown *et al,* 2003). A descriptive survey was used to undertake the study. The method permits gathering of data from the respondents in natural settings. Descriptive designs result in a description of the data, whether in words, pictures, charts, or tables, and whether the data analysis shows statistical relationships or is merely descriptive. "What" questions invariably lead to descriptive designs? Descriptive research is designed to describe the characteristics or behaviors of a particular population in a systematic and accurate fashion. Survey research uses questionnaires and interviews to collect information about people's attitudes, beliefs, feelings, behaviors, and lifestyles.

Descriptive design was preferred because no matter what method is chosen to collect the data; all descriptive designs have one thing in common: they must provide descriptions of the variables in order to answer the question. One of the most useful methods of numeric analysis available is statistics and this study used this method to describe and make inferences about measurable characteristics of a large group based on measurements from the representative sample of the population. In particular, frequency distribution which was used in this study is intended to show the distribution (or the count) for each business entity to clearly spell out to what extent each of the various factors influences that particular company's social responsiveness activities.

3.2 Population of the study

The focus of the study was all the companies listed on the Nairobi Stock Exchange as at 31st December 2011. A census was undertaken since the firms are only 56 (Appendix I) and all have offices located in strategic areas within the Central Business District and its environs. The respondents were the heads of Finance function of the various respondent organizations.

3.3 Data collection

Primary data was collected from the Heads of Finance of the various companies with the aid. The researcher hand delivered the questionnaires to the Finance Managers. A letter of introduction and questionnaire was enclosed in an envelope to be delivered to the respondents or attached on the questionnaire, in the case of use of email. In addition, the researcher made telephone calls to the respective respondents to further explain the purpose of the study and set a period of time for the completion of the questionnaires. The questionnaire was pre-tested on ten randomly selected respondents to enhance effectiveness and hence data validity.

3.4 Data analysis and presentation

For purposes of the current study, the data was analyzed by employing descriptive statistics such as percentages, frequencies and tables. Statistical Package for Social Sciences (SPSS) was used as an aid in the analysis. The researcher preferred SPSS because of its ability to cover a wide range of the most common statistical and graphical data analysis and is very systematic. Computation of frequencies in tables, charts and bar graphs was used in data presentation. In addition, the researcher used standard deviations and mean scores to present information pertaining to the study objectives. The information was presented and discussed as per the objectives and research questions of the study.

4.0 RESULTS AND ANALYSIS

4.1 Factors influencing issuance of corporate bonds

Whether the organization has issued corporate bonds: The respondents were asked to indicate whether their respective organizations had ever issued corporate bonds. The responses are summarized and presented in table 4.1 below.

Table 4.1: Whether the organization has issued corporate bonds

Response	Frequency	Percentage
Yes	37	16
No	6	84
Total	**43**	**100**

Reasons for not Issuing bonds: The respondents who indicated that their respective firms did not issue corporate bonds were further asked to give reasons for non-issuance of corporate bonds. Various reasons were given for non-issuance of corporate bonds. These include the following: issuance of bonds as a form of financing is not attractive due to the fact that there are other cheaper alternatives; deposit is a better source of funds than bonds; some companies were newly listed companies and issuing a bond was not an option for them; some companies have not had any bigger plans to necessitate the issuing of a bond for financing while; and the existing shareholders are able to provide enough funds needed for any capital expenditures.

Whether the organization plans to issue bonds in future: The respondents were also asked to indicate whether their respective organizations planned to issue corporate bonds in future. The responses are summarized and presented in table 4.2 below.

Table 4.2: Whether the organization plans to issue bonds in future

Response	Frequency	Percentage
Yes	9	21
No	34	79
Total	**43**	**100**

Effect of reputation on Issuance of corporate bonds: In order to meet the first objective of the study, "to determine how reputation influences issuance of corporate bonds in Kenya", the respondents were asked various questions.

Whether reputation influences issuance of corporate bonds: Firstly, the respondents were asked to indicate whether reputation influences issuance of corporate bonds. The responses are summarized and presented in table 4.3 below.

Table 4.3: Whether reputation influences issuance of corporate bonds

Response	Frequency	Percentage
Yes	23	54
No	20	46
Total	**43**	**100**

Reasons for reputation influencing issuance of corporate bonds: Secondly, the respondents who indicated that reputation influences issuance of corporate bonds were further asked to indicate the reasons for their answer. The responses are summarized and presented as follows: borrowing is a perception driven exercise, particularly, the borrowers must be able to know about the company and its operations and their effectiveness, good reputation is therefore important in ensuring that a bond issue is successful; the company's name is image driven and public perception affects company performance, hence the ability to issue a bond successfully; credit rating of a company's performance determines whether a company can issue a bond or not; favorable credit rating ensures that a company is in the good books of the borrowers and can therefore meet its obligations to a reliable extent; good reputation sells everything that the company is willing to sell, these include not only the products offered but also the borrowing facilities such as bonds and shares; reputation affects investor confidence, and hence the borrowing and as a result bond issuance; and public perception is key for successful bond issuance as the public is likely to be more enthusiastic to buy bonds from companies with good reputation.

The extent to which reputation affects issuance of corporate bonds: The respondents were asked to indicate the extent to which reputation affects issuance of corporate bonds by ticking as appropriate along a five point scale. The responses are summarized and presented in table 4.4 below.

Table 4.4: Extent of effect of reputation on Issuance

Extent of effect	Frequency	Percentage
Great	15	35
Very low	10	23
Very great	9	21
Moderately	6	14
Low	3	7
Total	**43**	**100**

Effect of Profitability ratios on bond issuance: The respondents were also asked to indicate the extent to which they agree or disagree on the effects of various factors of reputation on the issuance of bonds by their companies. The responses are summarized and presented in table 4.5 below.

Table 4.5: Effect of Profitability ratios on bond issuance

Reputation factors	N	Minimum	Maximum	Mean	Standard deviation
Gross profit	41	2.00	5.00	4.0488	0.94740
Interest as a percentage of gross profit	41	2.00	5.00	3.8780	0.92723
Return on assets = net earnings/total assets	43	2.00	5.00	3.8372	0.87097
Return on equity = net earnings/total net worth	43	2.00	5.00	3.7442	1.00221
Times interest earned = net earnings before interest and tax/interest expenses	43	2.00	5.00	3.6047	1.07215
Months in backlog = backlog/1/12	42	1.00	5.00	2.8095	1.08736
Backlog to working capital = backlog/working capital	42	1.00	5.00	2.7857	0.97620

Findings in table 4.6 above show that factors such as gross profit, interest as a percentage of gross profit; return on assets; return on equity and times interest earned ratio have an effect on the issuance of bonds, this is because, the mean scores are above 3.5, this can be rounded off to 4.

Effect of liquidity incentives on Issuance of corporate bonds: In order to meet the second objective of the study, "to analyze the influence of liquidity incentives on issuance of corporate bonds in Kenya" the respondents were asked various questions.

Whether liquidity incentives influence firm's issuance of corporate bonds: Firstly, the respondents were asked to indicate whether liquidity incentives influence firm's issuance of corporate bonds. The responses are summarized and presented in figure 4.1 below.

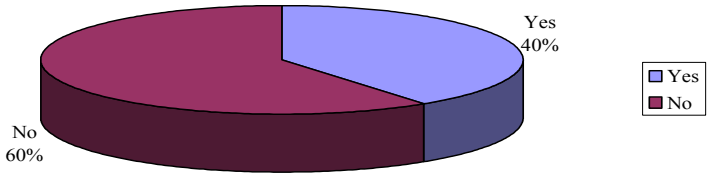

Figure 4.4: Whether liquidity incentives influence firm's issuance of corporate bonds

Explanation for why liquidity influences bond issuance: Secondly, the respondents whose answer to the above question was "yes" were further asked to give an explanation. The findings show that a good liquidity position means the firm can take care of both current and future obligations. Given that liquidity is the ability of the firm to meet its obligation, it is usually guarded to ensure smooth running.

Extent to which Liquidity incentives influence issuance of bonds: Thirdly, the respondents were asked to indicate the extent to which liquidity incentives influence issuance of bonds by ticking as appropriate along a five point scale. The responses are summarized and presented in table 4.6 below.

Table 4.6: Extent to which liquidity incentives influence issuance

Response	Frequency	Percent
Very low	22	51
Great	14	33
very great	3	7
Low	3	7
Moderately	1	2
Total	**43**	**100**

Effects of Liquidity ratios on bond issuance: The study further investigated the effects of liquidity ratio on bond issuances. The responses are summarized and presented in table 4.7 below.

Table 4.7: Effects liquidity ratios on issuance

Liquidity Ratios	N	Minimum	Maximum	Mean	Std. Deviation
Current ratio = current assets/current liabilities	38	1.00	5.00	2.7105	1.31330
Quick ratio = cash and cash equivalences + short term investments + Net trade receivables/current liabilities	38	1.00	5.00	2.6579	1.54703
Days of cash	38	1.00	5.00	2.4737	1.40918
Working capital turnover = revenue/working capital	38	1.00	5.00	2.3947	1.42449

Influence of Indicators of Net worth on Issuance of bonds: In order to meet the third objective of the study, "to assess the influence of indicators of net worth for the company on the issuance of corporate bonds in Kenya", various questions were posed to the respondents.

Whether indicators of net worth influence issuance of bonds: The further investigated whether indicators of net worth influenced issuance of bond. The responses are summarized and presented in figure 4.2 below.

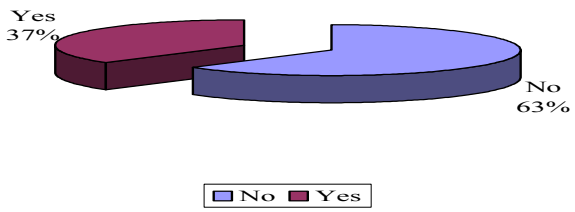

Figure 4.2: Whether indicators of net worth influence issuance

Why indicators of net worth influence issuance of bonds: The respondents were asked to provide the reasons for indicating that indicators of net worth influence issuance of corporate bonds. The findings show that firms that post tax return before financing is attractive, and would attract high interest from investors. Net worth also indicates the ability of the firm to continue operating in the future and to meet its obligations, it also influences market targeting. Net worth also influences the purchase of market targeting and the purchase of bonds. The respondent also indicated that the more the net worth, there is a better chance of bond performance in case of issuance; this is because net worth shows the stability of the firm.

Extent to which indicators of Net worth influence firms listed: The study also sought to know the extent to which indicators of net worth influences firms listed. The responses are summarized and presented in table 4.8 below.

Table 4.8: Influence of net worth on issuance

Response	Frequency	Percent
Very low	19	44
Great	13	30
very great	4	9
Low	4	9
Moderately	3	7
Total	**43**	**100**

Effect of leverage Ratios on bond issuance: The respondents were provided with some of the indicators of the net worth for the company which influence the issuance of corporate bonds and asked to indicate the

extent to which they agree or disagree that each of indicators influence corporate bonds in their respective firms. The responses are summarized and presented in table 4.9 below.

Table 4.10: Effect of leverage ratios

Leverage ratios	N	Minimum	Maximum	Mean	Standard Deviation
Debt to equity/total asset worth	42	2.00	5.00	3.7619	.93207
Revenue to equity=Revenue /total net assets worth	42	1.00	5.00	3.2619	1.26991
Fixed assets ratio=net fixed assets/total net worth	41	1.00	5.00	3.0244	1.15082
Assets turnover=Revenue/Total assets	42	1.00	5.00	2.9286	1.19741

4.2 Interpretations

4.2.1 Factors influencing issuance of corporate bonds

These findings indicate that corporate bonds are not a popular option for most firms who are looking for additional funds. This could be attributed to the fact that issuance of corporate bonds there are cheaper alternatives in the market besides the fact that shareholders have the ability to raise the required additional capital.

Effect of reputation on Issuance of corporate bonds: Majority of the respondent firms were of the view that reputation influences issuance of corporate bonds. This could be attributed to the fact that borrowing is a perception driven exercise and as such, the borrowers ought to fully understand the firm's operations. The firm's name is image driven and public perception affects company performance, hence the ability to issue a bond successfully. Reputation affects investor confidence, and hence the borrowing and as a result bond issuance. The findings further show that factors such as gross profit, interest as a percentage of gross profit; return on assets; return on equity and times interest earned ratio have an effect on the issuance of bonds.

Effect of liquidity incentives on Issuance of corporate bonds: The findings show that majority of the respondents were of the view that liquidity incentives influence the issuance of corporate bonds. A favorable liquidity position means the firm can take care of both current and future obligations. Given that liquidity is the ability of the firm to meet its obligation, it is usually guarded to ensure smooth running. The findings also indicate that current ratio, days of cash and working capital turn over affects the issuance of bonds.

Influence of Indicators of Net worth on Issuance of bonds: The findings show that majority of the respondents were of the view that net worth does not influence the issuance of bonds. In addition, the post tax return before financing is attractive, and would attract high interest from investors. Net worth also indicates the ability of the firm to continue operating in the future and to meet its obligations, it also influences market targeting. Net worth also influences the purchase of market targeting and the purchase of bonds. The respondent also indicated that the more the net worth, there is a better chance of bond performance incase of issuance, this is because net worth shows the stability of the firm.

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of Findings

The study found that there were various industries and sectors, among the listed industry sectors included advertising and media, airline industry, Alcoholic and beverage, banking, finance and investment, Energy, Hoteliers, internet service providers, manufacturing and telecommunication. The study further found that majority of the companies operated in Kenya for a long period. The study further found that majority of the firms was predominantly local.

It was also revealed by the study that majority of the companies had many employees .while majority of the respondent had worked in the organizations for a duration of 5 years. The study also found that most of the firms have not issued corporate bonds; this shows that corporate bonds are not a popular option for most firms who are looking for additional funds as the issuance of bonds as a form of financing is not attractive due to the fact that there are other cheaper alternatives. The banking industry had argued that deposit is a better source of funds than bonds. Other companies stated that they are newly listed companies and issuing a bond was not an option for them. Some companies have not had any bigger plans to necessitate the issuing of a bond for financing, while in some firms the existing shareholders are able to provide enough funds needed for any capital expenditures

The study also found that majority of the firms do not plan to issue bonds, this was due to the reasons mentioned above. The study further found that reputation of the firm influenced issuance of corporate bonds, it was further revealed by the study that borrowing is a perception driven exercise, particularly, the borrowers must be able to know about the company and its operations and their effectiveness, good reputation is therefore important in ensuring that a bond issue is successful, the study also found that company's name is image driven

and public perception affects company performance, hence the ability to issue a bond successfully. In addition credit rating of a company's performance determines whether a company can issue a bond or not, particularly, favorable credit rating ensures that a company is in the good books of the borrowers and can therefore meet its obligations to a reliable extent, In addition good reputation sells everything that the company is willing to sell; this includes not only the products offered but also the borrowing facilities such as bonds and shares. It was further revealed Reputation affects investor confidence, and hence the borrowing and as a result bond issuance. It was also found that Public perception is key for successful bond issuance; the public is likely to be more enthusiastic to buy bonds from companies with good reputation.

The study further found that higher return on assets indicates that a company is a reputable avenue for investment, this is indicated by the earnings per shillings of the before interest and tax, that can be attributed to equity or capital. The study also reveals that return on equity affect issuance of bonds. Interest as a percentage of gross profit was found to indicate the number of times a company is able to cover its interest costs from the gross profit.

The study also revealed that favorable rates show that a company is able to obtain more debt and borrowing, this implies that a majority of the companies are on the affirmative that interest as a percentage of gross profit being an indicator and a factor of reputation influences the issuance of bonds. It was also found by the study that companies float bonds to get cash to solve liquidity problems, in addition liquidity depends on long term investments and good liquidity in the market reduces the cost of funding. It was also found that a good liquidity position means the firm can take care of both current and future obligations.

The study further reveals that quick ratio does affect issuance of bonds, while working capital turn over as a liquidity ratio does not affect bond issuance. As liquidity indicator and ratio, days of cash does not at all affect the issuance of corporate bonds in the market. It was further revealed that Net worth also influenced the purchase of market targeting and the purchase of bonds.

The study also found that the majority of the company's revenue to equity ratio to have neutral effect on the issuance of bonds. The study also reveals that majorities of the of the companies consider the ratio to somehow have an effect on the issuance of bonds.

5.3 Conclusions of the Study

Based on the above findings, the following conclusions are drawn:

The development of a corporate bond market is a key strategic priority for capital market development in Kenya. Although the government has made significant strides in this direction, the development of the corporate bond market still has some way to go.

The fact that majority of the respondent firms had neither issued or had any plans to issue corporate bonds in the near future implies that corporate bonds are not a popular option for firms looking for additional funds.

Reputation of the firm influenced issuance of corporate bonds. In addition credit rating of a company's performance determines whether a company can issue a bond or not. Favorable credit rating ensures that a company is in the good books of the borrowers and can therefore meet its obligations

Liquidity position influences issuance of corporate bonds. A favorable liquidity position means the firm can take care of both current and future obligations. Given that liquidity is the ability of the firm to meet its obligation, it is usually guarded to ensure smooth running.

Indicators of net worth influence issuance of corporate bonds. An attractive post tax return before financing would attract high interest from investors. Net worth also indicates the ability of the firm to continue operating in the future and to meet its obligations, it also influences market targeting.

The study further found that higher return on assets indicates that a company is a reputable avenue for investment, this is indicated by the earnings per shillings of the before interest and tax, that can be attributed to equity or capital. The study also reveals that return on equity affect issuance of bonds. Interest as a percentage of gross profit was found to indicate the number of times a company is able to cover its interest costs from the gross profit.

The study also revealed that favorable rates show that a company is able to obtain more debt and borrowing, this implies that a majority of the companies are on the affirmative that interest as a percentage of gross profit being an indicator and a factor of reputation influences the issuance of bonds. It was also found by the study that companies float bonds to get cash to solve liquidity problems, in addition liquidity depends on long term investments and good liquidity in the market reduces the cost of funding. It was also found that a good liquidity position means the firm can take care of both current and future obligations.

The study further reveals that quick ratio does affect issuance of bonds, while working capital turn over as a liquidity ratio does not affect bond issuance. As liquidity indicator and ratio, days of cash does not at all affect the issuance of corporate bonds in the market. It was further revealed that Net worth also influenced the purchase of market targeting and the purchase of bonds.

The study also found that the majority of the companies' revenue to equity ratio to have neutral effect on the issuance of bonds. The study also reveals that majorities of the of the companies consider the ratio to somehow have an effect on the issuance of bonds.

It can also be concluded that higher return on assets indicates that a company is a reputable avenue for investment. Favorable rates show that a company is able to obtain more debt and borrowing, implying that a majority of the companies are on the affirmative that interest as a percentage of gross profit being an indicator and a factor of reputation influences the issuance of bonds. The study further concludes that quick ratio does affect issuance of bonds, while working capital turn over as a liquidity ratio does not affect bond issuance.

5.4 Recommendations of the Study

5.4.1 Recommendations for Policy and Practice

Corporate bonds markets have become an increasingly important source of financing for the private sector in recent years, especially for some emerging market countries. Findings of the study indicate that not all of the financial officers of financial institutions in Kenya are familiar with the actual costs and benefits of issuing corporate bonds. Corporate bonds can be less costly than issuing shares, especially when investors are concerned about diluting ownership. Corporations must therefore balance the debt (bonds and loans) and equity (stocks). Financial managers of corporations also need to be educated with such corporate finance theories.

In addition, the inadequacy of credit rating agencies (CRAs) in Kenya should be addressed. Some investors claim this is the reason only well-known, well-established state-owned enterprises could issue corporate bonds up to now. Without CRAs financial analysts rely on the brand name of the issuer when making decisions about corporate bonds, especially the investors.

Core aspects such as improvements in market regulation and infrastructure are crucial for the development of local securities markets. The elements include benchmarking, corporate governance and disclosure, credit risk pricing, the availability of reliable trading, clearing and settlement systems, and the development of hedging instruments. Meanwhile, the demand and supply of corporate bonds are dependent on factors such as the investor base, both local and foreign, and government policies toward the issuance process and associated costs, as well as the taxation regime. The evidence also suggests that high levels of debt issuance by government could potentially crowd-out the supply of bonds by the private sector.

Previous experience suggests that the time frame required to implement the necessary reforms to fully develop corporate debt markets cannot be easily determined. In Kenya, the speed and success of such reforms would, in part, require strong political will, as well as efficient coordination and cooperation among the firms. The development of factors such as investor confidence and a stable investor base cannot be dictated by regulations. In theory, investor confidence could be fostered by providing efficient market infrastructure, promoting market integrity through strong corporate governance and investor protection, and improving market credibility through adequate disclosure and transparency.

5.4.2 Recommended Areas of Further

The findings of this study, it is hoped, will contribute to the existing body of knowledge and form basis for future researches. The following areas of further research are thus suggested: Whereas the current study focused on factors influencing issuance of corporate bonds by listed companies in Kenya, future studies should seek to establish the benefits derived from issuance of corporate bonds, the challenges faced by firms that have issued corporate bonds and the coping mechanisms they have used. In addition, while the current study focused on responses from the management of the listed companies, future studies should focus on responses from the public.

REFERENCES

Abai (2003). *The determinants of corporate debt maturity structure for companies quoted at the NSE*: Unpublished MBA Research Project, University of Nairobi.

Acharya, V. V. and Lasse, P.H. (2005), Asset Pricing with Liquidity Risk, *Journal of Financial Economics*, 77(2), 375-410.

Acharya, V.V. and Pedersen, L.H. (2003). *"Asset pricing with liquidity risk."* Working Paper, London Business School.

Ayieye, J.O. (2004). *Factors considered by individual investors in investing shares of companies quoted at the NSE*: Unpublished MBA Research Project, University of Nairobi.

Brown, M, Askew, M, Baker, d, Denvir H and Millett, A.(2003). Is the National Numeracy Strategy Research-Based, *British Journal of Educational Studies*, 46,4,362-385 (Areview of the evidence for and against the Numeracy Strategy)

Calomiris, C., Himmelberg, C. & Wachtel, P. (1995), *Commercial paper, corporate finance, and the business cycle: a microeconomic perspective*, Canergie-Rochester Conference Series on Public Policy 42, 203–250.

Carty, L. (1996). *Is there a reputation effect in the U.S. public debt market*?, Columbia University mimeo.
Chen, L.& Wei, J. (2004), *Corporate yield spreads and bond liquidity,* Working Paper.
Chen, L., Lesmond, D.A. & Wei, J.Z. (2002). *"Bond liquidity estimation and the liquidity effect in yield spreads."* Working Paper, SSRN.
Choe, H., Masulis, R.W. & Nanda, V. (1993), "Common stock offerings across the business Cycle", *Journal of Empirical Finance*, Vol. 1 pp.3-31.
Chordia, T., Roll, R.& Subrahmanyam, A. (2000). Commonality in liquidity, *Journal of Financial Economics,* 56, 3-28.
Chordia, T., Sarkar, A. & Subrahmanyam, A. (2003). *An empirical analysis of stock and bond market liquidity,* Working paper, Emory University, forthcoming Review of Financial Studies.
Datta, S., Iskandar-Datta, M. & Patel, A. (2000), some evidence on the uniqueness of initial Public debt offerings, *Journal of Finance,* 55, 715–743.
Diamond, D (1991), Monitoring and reputation: The choice between bank loans and directly Placed debt, *Journal of Political Economy,* 99, 689–721.
Diamond, D. (1993). Seniority and maturity of debt contracts. *Journal of Financial Economics*: 341-368.
Diamond, D. (1991). Debt maturity structure and liquidity risk. *Quarterly Journal of Economics:* 709-737.
Diamond, D. (1991). Monitoring and reputation: The choice between bank loans and directly Placed debt, *Journal of Political Economy,* 99, 689–721.
Diamond, D.W. (1989), Reputation acquisition in debt markets, *Journal of Political Economy,* 97, 828-862
Duffie D., Garleanu, N., and Pedersen, L.H. (2003). *"Valuation in over-the-counter markets."* Working Paper, Stanford University.
Ericsson, J. and Renault, O. (2003). *"Liquidity and credit risk."* Working Paper, McGill University.
Fleming, M. (2003), Measuring Treasury Market Liquidity, *Federal Reserve Bank of New York Economic Policy Review,* 9 (3), 83-108.
Gakuru. W.K. (2004), *the relationship between stock returns & bond returns in the NSE*: Unpublished MBA Research Project, University of Nairobi.
Glosten, L. & Harris, L. (1988), Estimating the components of the bid/ask spread, *Journal of Financial Economics,* 21, 123-142.
Gorton, G. (1996), Reputation Formation in Early Bank Note Markets, *Journal of Political Economy,* 104, 346-397.
Hale, G. & Santos, J. (2003), The decision to first enter the public bond market: The role of reputation, funding choices, and bank relationships, *Journal of Banking and Finance.*
Hasbrouck, J. & Seppi, D. (2001), Common factors in prices, order flows, and liquidity, *Journal of Financial Economics* 59, 383-411.
Holmstrom, B. & Tirole, J. (1997), Financial intermediation, loanable funds and real sector, Quarterly Journal of Economics 112, 663–691.
Houweling, P., Mentink, A. & Vorst, T. (2003). *How to measure corporate bond Liquidity.* Working Paper, Erasmus University.
Johnson, S. (1997), An empirical analysis of the determinants of the corporate debt ownership structure, *Journal of Financial and Quantitative Analysis* 32, 47–69.
Kaplan, S. and Zingales, L. (1997). Do investment-cash flows sensitivities provide useful measures of financial constraints?, *Quarterly Journal of Economics* 112, 169–216.
Krishnaswami, S., Spindt, P. and Subramaniam, V (1999), Information asymmetry, monitoring and the placement structure of corporate debt, *Journal of Financial Economics* 51, 407–434.
Levin, A., Natalucci, F. and Zakrajsek, E. (2004). *The magnitude and cyclical behavior of financial market frictions*', Working Paper 2004–70, Board of Governors of the Federal Reserve System.
Liu, S., H. Qi, & Wu, C. (2004). *Taxes, default risk and corporate bond yield spreads: A Structural approach*, Working paper, Youngstown University.
Mbugua (2003). *Factors influencing development of the corporate bond market in Kenya:* Unpublished MBA Research Project, University of Nairobi.
McGee, S. (2002).''Corporate Bonds Set to Blossom in a New Europe,'' *The Wall Street Journal,* July 22, 128-199.
Merton, R.C. (1987), "A simple model of capital market equilibrium with incomplete information", *Journal of Finance,* Vol. 42 pp.483-510.
Mikkelson, W.H. and Partch, M. (1986), "Valuation effects of security offerings and the issuance process", *Journal of Financial Economics,* Vol. 15 pp.31-60.
Miller, D.P, and Puthenpurackal, J.J. (2002), "The costs, wealth effects, and determinants of international capital rising: evidence from public Yankee bonds", *Journal of Financial Intermediation,* Vol. 11 pp.455-85.
Muriuki, J. (2003), *Determinants of priority structure of corporate liabilities for firms quoted at the NSE*:

Unpublished MBA Research Project, University of Nairobi.

Myers, S. and Majluf, N. (1984), Corporate financing and investment decisions when firms have information investors do not have, *Journal of Financial Economics* 131, 187–221.

Myers, S.C. (1977). "Determinants of corporate borrowing", *Journal of Financial Economics,* Vol. 5 pp.147-75.

Njogu, L.W. (2003). *Price impacts of commercial paper issue announcement. a case of quoted companies which have issued commercial papers in Kenya*: Unpublished MBA Research Project, University of Nairobi.

OECD (1994), "The rise of global bonds", *Financial Market Trends*, Vol. 58 pp.55-61.

Pagano, M., Panetta, F. and Zingales, L. (1998), Why do companies go public? An empirical analysis, *Journal of Finance* 53, 27–64.

Park, D. and Rhee, C. (2006), "*Building infrastructures for the Asian bond markets: settlement and credit rating*", Asian Bond Markets: Issues and Prospects, Bank for International Settlements, Basel, BIS Papers No. 30, pp.202-21.

Pastor, L. and Stambaugh, R. (2001). "Liquidity and Expected Stock Returns." *Journal of Political Economy,* 101, 323-356.

Pastor, L. and Stambaugh, R. F. (2003), Liquidity risk and expected stock returns. *Journal of Political Economy,* 111, 642-85.

Piqueira, N. S. (2004), *Stock returns, illiquidity cost and excessive trading activity*, unpublished manuscript, Princeton University.

Prowse, S. (1998), " *Corporate Governance in East Asia: A Framework for Analysis". Presented at High-Level Seminar on Managing Capital Flows*, Bangkok, 15-16 June 1998. Organized by Asian Development Bank, International Monetary Fund, World Bank and United Nations Economic and Social Commission for Asia and the Pacific.

Schinasi, G.J. and Smith, R.T. (1998), "*Fixed-income markets in the United States, Europe, and Japan: some lessons for emerging markets*", International Monetary Fund, Washington, DC, IMF Working Paper No. WP/98/173, .

Smith, C.W. Jr (1986). "Investment banking and the capital acquisition process", *Journal Financial Economics,* Vol. 15 pp.3-29.

Stiglitz, J. and A. Weiss (1981). Credit rationing in markets with imperfect information. *American Economic Review*: 393-411.

Tirole, J. (2006). *The theory of corporate finance*, Princeton University Press.

APPENDIX I: COMPANIES LISTED ON NAIROBI STOCK EXCHANGE
(Main Investments Market Segment (Mims))

Sector	No.	Company
Agriculture	1	Kakuzi Ltd.
	2	Rea Vipingo Ltd.
	3	Sasini Tea & Coffee Ltd.
	4	Unilever Tea (K) Ltd.
Commercial Services	5	Access Kenya Group
	6	Car & General Ltd.
	7	CMC Holdings Ltd.
	8	Hutchings Biemer Ltd.
	9	Kenya Airways Ltd.
	10	Marshalls E.A. Ltd.
	11	Nation Media Group Ltd.
	12	Scan Group Ltd.
	13	Standard Group Ltd.
	14	TPS Eastern Africa Serena
	15	Uchumi Supermarkets Ltd.
	16	Safaricom Ltd
Finance and Investment	17	Barclays Bank of Kenya Ltd.
	18	Centum Investment Company Ltd.
	19	CFC Bank Ltd.
	20	Diamond Trust Bank of Kenya Ltd.
	21	Equity Bank Ltd.
	22	Housing Finance Company of Kenya Ltd.
	23	Jubilee Insurance Co. Ltd
	24	Kenya Commercial Bank Ltd.
	25	Kenya Re-Insurance Corporation Ltd
	26	National Bank of Kenya Ltd.
	27	National Industrial Credit Bank Ltd.
	28	Pan Africa Insurance Holdings Co. Ltd
	29	Stanbic Bank Uganda
	30	Standard Chartered Bank Ltd.
Industrial and Allied	31	Athi River Mining Ltd.
	32	Bamburi Cement Ltd.
	33	BOC Kenya Ltd.
	34	British American Tobacco Kenya Ltd.
	35	Carbacid Investments Ltd.
	36	Crown berger (K) Ltd.
	37	E.A Portland Cement Co. Ltd.
	38	E.A. Breweries Ltd.
	39	E.A. Cables Ltd.
	40	Eveready East Africa Ltd.
	41	Kengen Ltd
	42	Kenya Oil Ltd.
	43	Kenya Power & Lighting Co. Ltd.
	44	Mumias Sugar Company Ltd.
	45	Olympia Capital Holdings Ltd.
	46	Sameer Africa Ltd.
	47	Total Kenya Ltd.
	48	Unga Group Ltd.
Alternative Investment Market Segment	49	Kenya Orchards
	50	A. Bauman & Co.
	51	City Trust
	52	Eaagads
	53	Express
	54	Williamson Tea Kenya
	55	Kapchorua Tea
	56	Limuru Tea

Source: Nairobi Stock Exchange, 31st December 2011

APPENDIX II: COMPANIES LISTED ON THE NAIROBI STOCK EXCHANGE THAT HAVE ISSUED CORPORATE BONDS UPTO DECEMBER, 2011.

1. Sasini Tea
2. Athi river Mining
3. KenGen
4. Barclays Bank of Kenya

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:
http://www.iiste.org

CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

Prospective authors of journals can find the submission instruction on the following page: http://www.iiste.org/journals/ All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

MORE RESOURCES

Book publication information: http://www.iiste.org/book/

Academic conference: http://www.iiste.org/conference/upcoming-conferences-call-for-paper/

IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digtial Library , NewJour, Google Scholar