Development of the Nairobi Stock Exchange: A Historical Perspective

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ABSTRACT

This paper explores the evolutionary process of the stock market in Kenya and identifies the institutional and policy changes that have shaped the development pattern of the Nairobi Stock Exchange (NSE). A historical perspective approach is used to trace developments in the regulatory system, trading system, market membership, composition of market investors and taxation policy. Three phases in the development process of the stock market are identified and distinguished by their unique institutional and policy environment characteristics. These phases are the initiation stage, the formalization stage and the revitalization/ restructuring stage. The initial stage is mainly characterized by dominations of foreign investors in share trading and spontaneous growth. The formalization stage saw the adoption of a self-regulatory framework with efforts to increase the participation of local citizens in share trading especially in the post-independence period. This is also the period when the Government adopted a controlled policy regime and implemented tax policies that penalized share returns more than returns from other financial assets. Further, the Nairobi Stock Exchange which had served as a regional market among the East African states lost its market share with the break-up of the East African Community. Partially because of these developments, the stock market was characterized by a state of dormancy during this phase. This gave way to the revitalization stage where efforts were made to strengthen the institutional infrastructure and also to enhance the policy environment in order to facilitate growth of the stock market.

Abbreviations

AIM	Alternative Investment Market
AKS	Association of Kenya Stockbrokers
ATS	Automated Trading System
CDS	Central Depositing System
CIC	Capital Issue Committee
CMA	Capital Markets Authority
CMDC	Capital Market Development Committee
DvP	Delivery versus Payment (system)
EAC	East African Community
EADB	East African Development Bank
EALA	East African Legislative Assembly
EASRA	East African Member State Securities Regulatory Authorities
FISM	Fixed Income Securities Market
IFC	International Finance Corporation
IPO	Initial Public Offer
LSE	London Stock Exchange
MIM	Main Investment Market
NSE	Nairobi Stock Exchange
NSSF	National Social Security Fund
RBA	Retirement Benefits Authority
SEC	Security Economic Commission
USAID	United States Agency for International Development

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1. Introduction

The Nairobi Stock Exchange (NSE) has a long history that can be traced to the 1920's when it started trading in shares while Kenya was still a British colony (IFC/CBK, 1984). While share trading was initially conducted in an informal market, there was a growing desire to have a formal market that would facilitate access to long-term capital by private enterprises and also allow commencement of floating of local registered Government loans. The NSE was constituted in 1954 as a voluntary association of stockbrokers registered under the Societies Act (NSE, 1997a). The newly established stock exchange was charged with the responsibility of developing the stock market and regulating trading activities. Despite its history, however, the stock market is yet to make significant contribution in the development process. The question of interest to research is what defines the development path of the stock market? Does it mimic development paths of other developed or emerging markets?

The development path of stock markets in both the emerging and developed world indicates an evolutionary process where changes in institutional infrastructure and the policy environment are witnessed as efforts are made to facilitate the growth of the stock market. The evolutionary process indicates graduation from non-formal markets to formal organizations without a regulatory body and then establishment of a statutory body in the reform/restructuring process. The establishment of a statutory body is aimed at enhancing the confidence of investors. While statutory regulatory bodies in most developed markets are set up to resolve the conflict of interest in the self-regulation framework, most of the emerging markets are establishing such bodies as part of the revitalization reform process.

It is argued that protection of investors encourages participation in share trading and enhances the development of financial markets (La Porta *et al*, 1998). It is also indicated that countries that protect shareholders have more valuable stock markets, large number of listed securities per capita and a high rate of Initial Public Offers (IPOs). Further, it is observed that protection of investors and quality of law enforcement as proxy for governance have predictors power on the extent of market declines during crises and even better than macroeconomic variables (La Porta *et al*, 2000). Ensuring investors' confidence enhances investors' participation in the market activities and encourages saving and channeling of savings into productive real investment, therefore fostering capital accumulation and efficiency in investment and real sector development. It is however debatable whether protection of investors promotes market efficiency.

In addition, it is argued that information disclosure enhances market efficiency by providing informed traders with costless information that ensures market efficiency (Georgakopoulos, 1996). For example, it is observed that securities may deviate from their fundamental values because of irrationalities in the market, including uninformed trading or noise trading. This type of trading interferes with the optimality of market allocation of capital among competing firms. Therefore, it is important that disclosure rules are tightened, especially for the benefit of transient institutional investors who require more accurate prices.

The evolutionary process is also characterized by a shift in trading system from a periodic auction system to a continuous trading system. Trading system defines the price discovery process or the transformation of latent demand of investors into realized transactions (Madhavan, 1992). The evolutionary process of trading system also indicates a shift from manual to electronic and centralized settlement clearing.[1] It is

[1] Garman (1976) observes an evolutionary pattern in adoption of trading system for the US stock market in response to growth in trading volume; this saw a shift from periodic to continuous trading system. Amihud *et al* (1997) note the tendency for emerging markets to shift from periodic to continuous trading in the revitalization process.

argued that a trading system that enhances efficiency in the price discovery process, provides liquidity at low costs, and has no excess volatility is more desirable for the development of the stock market (Amihud, *et al* 1990, and Bessembinder and Kaufman, 1997). High liquidity, it is observed, enhances long-term investment by reducing the required rate of return and by lowering the cost of capital to the issuers of securities. An efficient price discovery process enhances the role of the market in aggregating and conveying information through price signals, therefore making prices more informative.

This paper traces the development path of the Kenya stock market focusing on the evolutionary process of the Nairobi Stock Exchange (NSE). The main motivation of this paper is the indicated relationship between policy environment and adequacy of the institutional infrastructure and the growth path of stock markets. A historical perspective approach is used in tracing developments in the institutional infrastructure and policy framework. By understanding the development path of the stock market, this study serves as a pointer to the factors that explain the observed performance of the stock market.

The remainder of this paper is structured into four sections. Section 2 covers the period before the formalization of the regulatory system, while section 3 covers the reform process. Section 4 provides a discussion on the response of the market to the various changes while section five provides conclusions that can be drawn from this analysis of the development of the Nairobi Stock Exchange.

2. Pre-reform Period: 1920s-1989

This period preceded the revitalization reforms and can be divided into various development stages defined by specific institutional characteristics. Stage one is the initiation period before formalization of share trading (1920s-1953) while stage two (1954-1963) is the period when the market was formalized but before the political independence. The post-independence period which constitutes stage three (1964-1970) was the period before the Government made the first attempt to regulate the operations of the market. During stage four, the Government established the Capital Issue Committee (CIC) as a first attempt to oversee the operations of the stock market. These four stages are analysed in order to identify the major institutional and policy differences during the various stages of the development of the NSE.

2.1 Stage I (1920s-1953): Inception

Share trading was initiated in the 1920s when Kenya was a British colony. Stage I, the initiation stage of the NSE, covers the period before the establishment of a formal stock market. This period is mainly characterized by informal share trading with no formal rules or regulations to govern trading activities (IFC/CBK, 1984). Trading in shares was based on a gentleman's agreement where standard commissions were charged and clients were obliged to honor their contractual commitment of making good delivery and settling of relevant costs. There was no physical trading floor or specialized stockbrokers. Share trading was a part time job for accountants, auctioneers, estate agents and lawyers who met to exchange prices over a cup of coffee (Parkinson, 1984 and Munga, 1974). The first stock brokerage firm was established in 1951 by Francis Drummond. Foreign investors dominated share trading mainly because they had the know-how of operating organized capital markets and also because their high income sufficiently permitted them to accumulate savings and investment in securities (Aworolo, 1971). Participation of local citizens was very limited, accounting for about 5%, mainly because of their low-income and statutory restrictions during the pre-independence period.

2.2 Stage II (1954-1963): Formalization of Share Trading

The main feature of this period is the establishment of the NSE which marked the formalization of share trading. The desire to establish a formal market was initiated by stockbrokers who desired to have a stock exchange that facilitated access by private enterprises to long-term capital. In addition, the Minister for Finance desired to have a formal market that facilitated floating of locally-registered Government loans, which would be unattractive without a stock exchange. This saw the constitution of the Nairobi Stock Exchange in 1954 as a voluntary association of stockbrokers registered under the Societies Act (NSE, 1997a). To facilitate the registration, stockbrokers obtained clearance from the London Stock Exchange (LSE), which recognized the NSE as an overseas stock exchange, effectively enabling the NSE to gain value and credibility (Munga, 1974). The newly established stock exchange was charged with the responsibility of developing the stock market and regulating trading activities.[2]

[2] The main objectives of NSE (1954) are: improving the facilities available for purchase and sale of shares; regulating the dealings of members with clients, with non-members engaged in stockbroking; standardising and reviewing charges made by members for services rendered to their clients or modify the method(s) of assessing or calculating such charges; correlating stockbroking activities of members and facilitate exchange of information with clients and to the public; co-operating with associations of stockbrokers and stock exchanges to obtain and make available to members information likely to be of advantage to them and clients; investigating, resolving, and taking steps to enforce its decisions and awards relating to any irregularities or alleged irregularities in the dealings of members with clients, with non-members engaged in stockbroking, and any disputes between members and non-members and any complaints against members by other members or any other parties, provided such disputes or complaints relate to or touch on the stockbroking business or activities of such members, among others.

With the establishment of the NSE in 1954, a self-regulatory framework was adopted whose main responsibility was to develop the stock market. The self-regulatory framework, which borrows heavily from the London Stock Exchange (LSE), is embodied in the *Rules and Regulations of NSE 1954*. The regulatory framework spelt out guidelines for primary issues, the operations of stockbrokers, and secondary market trading activities with the aim of overseeing the development of the stock market. To enforce the rules and regulations, the Exchange vested in a committee of five the powers to govern and manage the Exchange. Members of the committee had to have at least two years membership in the Stock Exchange. The committee was to ensure smooth trading activities by overseeing the activities of members, investors and the listing companies. The committee for example had powers to forbid dealings in shares of any company without giving a reason for such decision. It also had powers to approve public quotations. The committee heard and adjudicated at a fee all disputes between members and complaints against members. It also adjudicated any transactions or disputes or complaints arising out of any transaction in shares entered into by a member, even if such shares may not have received a quotation. Further, the committee provided information, for example the share prices dealt during the previous week, for publication in circulars, newspapers and other mass media.

Although the formal market opened its doors in 1954, it had no physical trading floor and no specialist. Periodic (call) auction[3] trading system,

[3] Such a system operates like a Walrasian Tatoonement for auctions. Price adjustment begins when the board is called and stockbrokers in possession of securities express their interest by signalling a bid or ask based on the perceived demand and supply and clients' instructions. When a stockbroker has buy and sell instructions he signals a sell order with higher price and a buy order with lower price. When a stockbroker wishes to execute a cross deal he signals a single price for both bid and ask and bargain slips are used as evidence of deals stock between members and also serves as memorandum for the transactions inter-brokers delivery and settlement. Theoretically, call auction market is said to be more efficient than the continuous market with its ability to enhance liquidity and reduce market volatility (Madhavan, 1992).

a variant of order-driven trading system, was adopted where transaction prices were exchanged in coffee-house forum. Business was transacted by telephone and prices determined through negotiation. No dealings were recognized except those for NSE members and fully paid shares. Brokers were free to buy or sell shares of their customers without consulting each other, provided such transactions were effected at the best possible price. Representatives of member firms met everyday for a call-over where only the active securities were called; highest limit order to buy (bid) and lowest order to sell (offer) were recorded in call-over sheet. Bid and ask prices for all securities were recorded every Thursday together with the transaction prices following the weekly call-over but only the highest prices were published. Customers were able to buy or sell shares at any time during the business day at prices established at the daily meeting.

Securities traded in the NSE during the period mainly included Government stocks, loan stocks, preferential and common share. Data available from the yearbooks indicate that loan stocks were unpopular compared to the common and preferential shares. In 1954 for example, two companies issued loan stocks worth Kshs 7.48 million as compared to 28 companies which offered preferential shares worth Kshs 90 million. Issues of Government stocks were made on the London Stock Exchange. The value of stocks increased from Kshs 84.88 million in 1953 to Kshs 95.5 million in 1954 following a listing of 12 public sector stocks and Kshs 295.5 million in 1959. When the NSE started operations, only 5.4% of Government stocks were listed; the rest had listing in the London Stock Exchange (LSE).

The number of stockbrokers increased to six in 1954, with two specialists and others carrying out stockbroking as subsidiary activities (Parkinson, 1984). In the *Rules and Regulations of NSE 1954* all individuals, firms and limited liability companies transacting brokerage business and whose applications had the approval of the NSE Committee are regarded as members of the Stock Exchange. However, to be a member, stockbrokers had to pay an entrance fee and an annual subscription fee. In addition, stockbrokers had to have at least three years working experience at senior level with a registered member of the NSE or any other recognized stock exchange. They also had to deposit with the NSE Kshs 50,000, which was refundable without interest at the expiry of probation period of at least one year as indicated in Table 1.

Stockbrokers acted as agents, buying and selling securities for their clients. They were also expected to provide information and advice to the clients and help firms (in conjunction with the underwriter) in determining a fair issue price. The *Rules and Regulations of NSE 1954* allowed stockbrokers to perform other forms of financial business such as insurance, merchant banking and corporate financial advice with the prior sanction of the committee. However, stockbrokers could not become members of any other stock exchange. Further, members were not allowed to advertise or canvass for or otherwise solicit any work forming part of the business as a stockbroker. As agents, stockbrokers' income was defined by charges set by the Stock Exchange as indicated in Table 2. The Exchange lay down minimum rates and any member charging less than the foregoing rate was liable to a fine not exceeding Kshs 2,000, or an expulsion or suspension or both as the committee may decide.

2.3 Stage III (1963-1970): Political Environment and Kenyanisation Policy

The period immediately after independence saw the Government adopt the Kenyanisation policy with a primary goal of transfering economic and social control to citizens by ensuring that majority of businesses were in the hands of citizens except where some overriding national advantage was otherwise demonstrated. Kenyanisation of businesses

Table 1: Entry requirements, entrance fee and subscription fee for members and registered agents

		1954	1989	1997
Member	Entrance fee (Ksh)	2,500	50,000	400,000
	Annual subscription fee	4,000	6,000	50,000
	Deposit	50,000 paid back with no interest after probation period	200,000 paid back with interest 3% below saving rate	
	Probation period	At least one year	At least 3 years	
	Working experience	At least three years	At least 3 years	
Registered agents	Entrance fee (Ksh)	1,000	2,500	2,500
	Annual subscription fee	800	1,000	1,000
Securities' representatives	Entrance fee for financial institutions			100,000
	Entrance fee for others			50,000
	Annual fee for financial institutions			20,000
	Annual fee for others			10,000

Source: Rules and Regulations of NSE (1954) and Rules and Regulations of NSE (1997)

Table 2: Commission rates for stockbrockers

	1954	1989	1995
On company shares and stocks	Kshs cts <1.5 10 1.5-2.5 15 2.5-5 20 5-7.5 25 7.5-10 30 10-15 35 15-20 40 Over 20 2% consideration	Kshs cts < 1.5 15 1.5-2.5 20 2.5-5 25 5-7.5 30 7.5-10 35 10-15 45 15-20 55 over 20 2.5% consideration	1st Kshs 10 million – 1.70 next 40 Million – 1.50 above 50Million – 80
On government and municipal stocks	Upto 200,000 – 1.5% Over 200,000 – 1.255	Upto 200,000 – 1.5% Over 200,000 – 1.255	Upto Kshs 1 Million – 1% Over 1 Million- negotiable
Minimum commission	Below Kshs 200 – member discretion 200-600 – Kshs 40 Over 600 – Kshs 60	Any transaction Kshs 100 < Kshs 100----member discretion	Kshs 100
Probate and portfolio	20 shs per item, minimum charge of Kshs 40 for every valuation	Kshs 30 per item minimum charge of shs 100 for every valuation	Ksh 30 per item with minimum charge of Kshs 100 for every valuation
Professional advice fee	Minimum Kshs 400 per hour	Kshs 3000 per hour	
			Fee for fixed securities 1st 50m – 0.0625% above 50m – 0.05%
Rebates	A return commission of 25% allowed to registered agents on business done for their clients at discretion of the members	A return commission of 255 allowable to be registered agents on business done for their clients at the discretion of the members	
Short-dated stock	With one year or less to maturity on nominal amount 1%	With one year or less to maturity on nominal amount 1%	
Takeovers, new issues, rights	When commission exceeds Kshs 1 million a member at his discretion may change three quarters of the normal commission.		

Source: Rules and regulations of NSE (1954, 1997) involved transfer of existing firms to citizens and the creation of new enterprises in the hands of citizens. Foreigners held majority interest in companies if sufficient capital was not available from domestic sources or so long as other advantages to the country, such as technology and skills, could only be obtained this way. This was achieved through trade licensing legislation under which lists of businesses owned by non-Kenyans and targeted for transfer to Kenyans by sale within a specified period were published periodically. Kenyans able to take over such businesses were provided with loan assistance by the Government. Therefore, the Kenyanisation policy saw a change in the ownership structure of various businesses. The previously foreign-dominated market saw an increased share of locally-controlled firms.

In addition, to protect the interest of foreign investors in Kenya, the Government passed the Foreign Investment Protection Act (1964), where any proposed foreign investment contributing significantly to development got approved status certificate and owners were allowed to repatriate earnings and capital whenever they wanted. This Act was not nullified by the introduction of exchange control over sterling transactions in 1965 where the latter saw holding back of country money that was previously moving to build assets abroad.

For sometime, the NSE operated as a regional market in East Africa where public sector securities included issues by the governments of Tanzania and Uganda (the East Africa Community). In addition, a few of the listed industrial shares were those of companies registered in Tanzania and Uganda. This was facilitated by maintenance of a common market with free movement of capital, and maintenance of common exchange regulations regarding capital movements to countries outside East Africa (Aworolo, 1971). However, with the changing political regimes among East African Community members, there was need to formalize arrangements governing the relations among members in the East Africa Common Market. A first attempt was in 1964 with the

Kampala Agreement but little was achieved. The East Africa Community Treaty was signed on 1 December 1967 and covered trading arrangements not implemented with the Kampala Agreement of 1964. However, the nationalization measures undertaken by Tanzania in February 1967 and the unilateral decision by Uganda and Tanzania to be excluded from the Scheduled Territories for Exchange Control created uncertainties.[4] As a result, transactions between Kenya and the two countries were subjected to the normal exchange control regulation, which curtailed free movement and squeezed the scope of the stock market.[5] It also meant delisting of companies listed in the Nairobi Stock Exchange and originating from Uganda and Tanzania.

2.4 Stage IV (1971-1989): Capital Issue Committee and Taxation Policy

In this period, the Government made a first attempt to directly monitor the operations of the stock market in an effort to ensure that capital raised in the market was not used for investment outside the country. Tight taxation policies were implemented to reduce repatriation of funds by foreigners and to raise Government revenue. However, it was felt that taxation policy changes adopted in the 1970s discriminated the share earnings against other financial assets and also heightened the

[4] The Scheduled Territories of Exchange Control consisted of Kenya, Tanzania and Uganda as members of the East African Community. It was based on an arrangement that currencies of the three countries would be exchanged freely and at par within these countries.

[5] The Economic Survey (1968) for example indicates that for a short period, Tanzania government imposed exchange control restrictions against Kenya and Uganda which meant evolving new procedures for making and receiving payments. To restrict capital flight, the Bank of Tanzania suspended the arrangement where Tanzania notes were not redeemed in Kenya and Uganda. With nationalization, Kenyan banks found themselves without correspondent in Tanzania and therefore with no channel of remitting funds or sending cheques and bills for collection in Tanzania.

barriers of listing new issues. For example, dividend income was double-taxed and because dividends were not deductible expenses, corporate earnings distributed as dividends had a high effective tax rate. This made it more expensive for corporations to provide adequate after-tax-return on equity and therefore the preference for debt financing. In addition, corporations were not allowed to deduct expenses of raising share capital of debenture issues from taxable income. As such, the high expenses of raising finance and the non-deductibility of these expenses were clear disincentives for raising equity through public issues. The effective corporate tax was also high and tended to significantly reduce the returns on shareholders.

The Government made a first attempt to regulate the stock market with the establishment of the Capital Issue Committee (CIC) in 1971. The idea was aroused from the observed practice of foreign investors in the process of Kenyanisation. In the Development Plan (1969/70), it is noted that foreign companies selling shares to local investors were following up with the request to remit the funds realized overseas. The Government did not encourage such a move unless it was intended to result to full local control of the company or the investment had the approval status. Therefore, in the Development Plan (1970/74) the Government indicated its intention to introduce legislation aimed at safeguarding the interests of the investing public. The legislation was to oversee licensing of all stockbrokers and creating of a deposit or guarantee acceptable to the Government by a stockbroker with Treasury. This was to be used for compensating investors if the stockbrokers failed to meet their obligation. It was also expected to establish a committee representating the Government and stockbrokers to control and approve new issues of company shares to the public. The proposed committee was to operate as a capital-issue committee for screening issues before they are presented to the public. The screening exercise was to involve receiving details on how funds raised by the issue would be used and the amount the company wished to repatriate after the issue had been completed. It was also to ask for all information necessary to determine the order of priority for such company issues on NSE. The committee was also to deal with applications from non-resident owned companies wishing to have more than the present allowed credit facilities. In the 1971/72 Budget speech, the Minister for Finance insisted that the NSE should be used by local companies to raise cash for capital development but the Government was not ready to allow the limited local capital to be used to finance repatriation of capital. This, it was felt, would not result in any long-term benefits but a significant loss of short-term balance of payment. However, the Government welcomed the idea of Kenyan capital going into partnership with foreign capital to finance further development of enterprises in Kenya. Consequently, the CIC was set up in 1971 under the Ministry of Finance, consisting of representatives from the Treasury, the Ministry of Commerce and Industry and the Central Bank of Kenya. The key responsibility of the committee was to advise the Ministry of Finance on terms, priority and timing of all new public issues of equity, rights issues to existing shareholders in publicly-traded companies, debentures and loan issues. It also had the responsibility of approving the price of issues, timing of sales and allotment of the issues between institutions and individuals, and also between residents and non-residents. However, there was no clear criteria on which decisions were made. Lack of full information had a great impact on the ability of firms to raise capital publicly.

Further, to control movement of funds outside the country, a tight tax policy was adopted. In 1971 for example, the Government imposed a 12.5% tax on dividends and interest paid by corporations to residents and non-residents. In addition, a 20% tax on all fees and royalties payable to non-residents was imposed. The capital gain tax was aimed at generating additional revenue and curb excessive speculation. Further, in the 1974/75 fiscal year, the rate of tax on dividend paid to non-residents was raised from 12.5% to 15%; the rate of withholding tax on resident dividends also went up to 15%. To encourage the inflow of capital, the Central Bank in 1974 allowed foreign-controlled companies to turn more to overseas markets for financial requirements. Local borrowing was restricted to 20% of investment for a few exceptions. To ensure compliance, the Central Bank withdrew permission for foreign firms to remit interim dividends or profits prior to the finalization of the annual accounts of their firms. The Bank also withdrew the general permission for local borrowing by firms whose non-resident ownership exceeded 15%. The withholding tax paid by non-residents was raised from 15% to 20% and interest rate from 12.5% to 20%. Stamp duty was raised to 3% in the 1973/74 period while withholding tax for dividends was raised to 15% in 1974/75. In June 1975, a capital gain tax of 36% was introduced. This was progressively reduced by 50% in 1981 and 25% in 1982.[6] To boost growth of the stock market, there was need to put in place tax incentives, including suspension/elimination of capital gain taxes, withholding taxes on dividends and making public offer expenses tax-deductible. Therefore, in the 1985/86 fiscal year, capital gain tax was suspended on the ground that tax inhibits capital and share mobility and therefore economic growth.

During the period, there was no major change in the composition/range of securities issued in the stock market. However, there was a rise in the proportion of Government stocks listed in the NSE. The ratio increased from 5.4% in 1954 to 13% in 1959, while in 1969 all Government

[6] The 1981/82 adjustments made on the capital gain tax saw only 50% of the net gains subjected to corporation tax such that with a corporation tax of 45%, only 22.5% of net gains was paid as tax by company. For individuals, tax on gain was progressive for 10% up to 35%. In addition, withholding tax on investment shares was reduced from 35% to 15% aiming to boost stock exchange (IFC/CBK, 1984).

securities were listed in the NSE. This followed the takeover by the Central Bank of the administration of the local register of Government stocks in July 1968, including the Nairobi register of stocks issued in London stock market. By 1968, the number of listed public sector stocks was 66 of which 45% were for Kenya government, 23% Tanzania government and 11% Uganda government. By 1969, the amount of London-issued stocks on the Nairobi register was Kshs 3 million compared to Kshs 1.4 million in 1963, indicating a shift of Kshs 1.8 million of which Kshs 0.8 million was due to imposition of exchange controls against sterling area in 1965.

Government stocks attracted very low returns and were unpopular in the private sector. For example, in 1954 they attracted 2.5-3.0% interest rates, increasing to 6.5% in 1965 and remaining almost constant at 6% between 1967 and 1973. The period of maturity increased overtime where it ranged between 5 and 10 years in 1965, 6 and 18 years in 1967 and was over 20 years in 1970, showing a shift to long-term funding. Most of the stocks were taken up by agencies controlled by the Government and those directed by the Government to invest in these securities. For example, there was an increase in holding of Government stocks by the insurance companies in 1965. This followed Government policy of encouraging more insurance funds to be invested locally, therefore covering local liabilities with local assets. This was also enhanced by the introduction of exchange control which prohibited the transfer of life insurance premium abroad (Government of Kenya, Economic Survey, 1969). However, the National Social Security Fund (NSSF) which was established in 1966 became a major holder of Government stocks and dominated the market from 1969.

Despite the efforts made to promote the EAC, Uganda imposed exchange controls on Tanzania and Kenya in 1970. This meant that payment to residents required authorization from the Bank of Uganda and Uganda notes were not to be exported. This hindered intra-trade in East Africa and when the EAC finally collapsed in 1975, the Uganda government compulsorily nationalized companies which were either quoted or subsidiaries of listed companies.

3. Revitalization Process

Despite the efforts made to promote growth of the capital market and the financial sector in general, the contribution of the sector to economic development was viewed as unsatisfactory as the economy hanged on the balance with dwindling inflow of foreign savings. Consequently, the Government viewed the reform of the sector as the best option especially if the economy was to shift its reliance on domestic resources to finance domestic investment (Government of Kenya, 1974/78). Despite the Government realizing that the capital market was playing an insignificant role in the development process in the early 1970s, as characterized by weak development of financial institutions and a thin and inactive stock market, revitalization reforms were only implemented in the 1990s following the IFC/CBK (1984) study whose recommendations became a blueprint in the reform process. The Government reaffirmed its commitment to the reform process in *Sessional Paper No. 1 of 1986* (GoK, 1986). The recommendations emphasised the need to develop money and capital markets by diversifying money market instruments and removing taxation differences between the debt and equity finance in order to achieve diversity in the sector. Another proposal made was the need to establish a regulatory authority with the powers to provide regulatory measures for improvement and proper functioning of a fair and orderly market. The reform process was implemented simultaneously with the overall financial sector reforms aimed at enhancing efficiency in the price discovery process, reducing transaction costs, facilitating competitiveness and increasing liquidity. A statutory regulatory framework was adopted during the reform period charged with the responsibility of protecting the interests of investors in addition to developing the stock market.

3.1 Statutory Regulatory Framework

A statutory regulatory framework was established as part of the on-going capital market reforms in an effort to strengthen the regulatory infrastructure.[7] The establishment was recommended by the IFC/ Central Bank of Kenya study (1984) and reaffirmed in the *Sessional Paper No. 1 of 1986*. In order to establish a regulatory body, a legislation was adopted to facilitate formulation of rules and enhancing the effectiveness and efficiency of the operations of the Capital Market Authority (CMA). The Authority was established in 1990 through the Capital Market Authority Act (Cap 485A). The process involved the Government setting up a Capital Market Development Advisory Council in November 1988 whose role was to work out modalities for establishing the CMA. In November 1989, the Bill was passed by Parliament and the CMA was constituted in January 1990 and inaugurated in March 1990. It is important to note that while statutory regulation is desirable to provide necessary oversight of the market and ensure its stability by *inter alia* preventing conflict of interest, it should complement rather than substitute self-regulation (Akamiokhor, 1996).

The main purpose of setting up the CMA was to have a body specifically charged with the responsibility of promoting and facilitating the

[7] In developed stock markets, a similar trend exists where securities' regulatory bodies are set up mainly to curb specific abuses that occurred in an already developed market and not necessary with the primary aim of developing the market. The London Stock Exchange, for example, established a market regulator with the Big Bang in 1986 after being operational since 1773 (Akamiokhor, 1996). The argument was that the self-regulatory framework was designed to protect the interest of members and could not at the same time protect the public against its members. The NYSE established a SEC with an aim of restoring confidence among investors after the stock market faced crises in 1929. Market regulation is geared towards protecting the integrity of the market place, member firms and the customer, with more emphasis on protection of investors, ensuring fairness, market integrity and minimisation of systemic risk.

development of an orderly and efficient capital market in Kenya.[8] As spelt out in the Capital Markets Authority Act (Cap 485A, 2(11)) the aim of the CMA is to develop all aspects of the capital market with particular emphasis on the removal of impediments and the creation of incentives for long-term investment in productive enterprises. It also targets to protect investors' interests by operating a comprehensive fund to cushion investors from financial loss arising from the failure of a licensed broker or dealer to meet contractual obligations.

The CMA is composed of eleven members who include: the Chairman, who is a non-executive member appointed by the President on recommendation of the Minister for Finance; six members who include professionals in law, business, accountancy, finance and insurance and appointed by the Minister for Finance; the Chief Executive who is appointed by the Minister for Finance; and three permanent members, that is the Permanent Secretary (Treasury), the Governor of the Central Bank of Kenya, and the Attorney General. Except for the three permanent members, the rest are appointed for a three-year period and are eligible for re-appointment.

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[8] Established regulatory bodies in emerging markets are charged with the responsibility of regulating and developing the stock market. In developing the market, regulatory authorities are charged with the responsibility of improving the regulatory environment in order to provide adequate return on equity investment and assuring its comparability with other savings' instruments. Such bodies are also responsible for ensuring sustainability of market liquidity by enhancing supply and demand for securities and also encouraging the development of securities' intermediaries such as stockbrokers and underwriters/merchant banks. The authorities are also charged with the responsibility of enhancing diversity of financial assets by encouraging issue of a broader range of securities. In regulating the market, the authority aims to ensure proper functioning of a fair and orderly market with tight disclosure rules for both corporate and market information; adequate organization and self-regulatory duties of the exchange, registration of securities' professionals and protection of investors. While the development task is taken as an overriding objective, the regulatory role is implemented when it is demonstrably necessary and if it is not going to affect the development of the market. It is however important that the rules made do not over or under-regulate the market, but should be targeted to encourage innovativeness and competitiveness and maintain high standards of business conduct.

Efforts were made to make the regulatory body financially independent. As indicated in the CMA annual report (1990/91 and 1991/92), the main source of revenue for CMA when it was established was limited to licensing fees of market players and this was not adequate to meet its operational costs. The Government was therefore financing a significant proportion of the CMA activities, which was supplemented by substantial donor support from the United States Agency for International Development (USAID). However, there was growing need to make CMA self-financing and reduce its reliance on the Treasury. In the 1995 CMA (Amendments) Act, the Authority was allowed to collect fees from the market to finance its operations. A framework to facilitate the charge of fee for its services was developed and in January 1996, the CMA was allowed to levy charges on public issues, bonuses, rights and private placement by public companies. The new fee structure was gazetted in July 1997 empowering the CMA to charge fees for its services mainly from public issue stock exchange transactions and licensing. At the same time, the Government in 1996 exempted the Authority from the State Corporations Act (Cap 446 of the Laws of Kenya) to facilitate flexibility and enhance autonomy in discharge of its operations. This saw the dependencies on the exchequer reduce from 100% to less than 28% by end of June 1998. The CMA took a zero-based budgetary approach which required each budget item to be reviewed and justified afresh every financial year regardless of the position of expenditure or revenue in the previous years (CMA Annual Report, 1997/98). The charges, however, seem to have substituted the taxation relieves for both the listed companies and investors. As a result, the effective withholding tax was more than the set 7.5% while the listing costs were still high though tax-deductible for firms intending to go public.

To meet its developmental role, the CMA (Amendments) Act of 1995 spelt out regulations providing for foreign investors' participation in the domestic capital market. This facilitated the expansion of market scope. In 1997, guidelines to govern the issuance of corporate bonds and commercial paper were issued in order to facilitate diversity of financial assets traded in the market. To facilitate its regulatory role, the 1996 review spelt out the requirements on take-over, mergers and de-listing to protect minority shareholders. The CMA also issued guidelines to promote good corporate governance practices by listed companies through the constitution of audit committees in January 1999. Further, in July 1995, the CMA established the investor compensation fund aimed to compensate traders for financial losses arising from the failure of a licensed broker or dealer to meet contractual obligations.[9]

In 1998, the CMA published new guidelines on the disclosure standards by listed companies which required them to form audit committees composed of non-executive directors with knowledge of business and accountancy. The disclosure requirements were meant for both public offerings of securities as well as continued reporting obligations, among others.

3.2 Trading System

In November 1991, share trading moved from coffee-house to floor-based open outcry system. The open outcry system was opted for to

[9] The compensation fund is financed as follows. First, every licensed stockbroker is required by law to maintain with the Stock Exchange an irrevocable bank guarantee by a commercial bank for Kshs 1.5 million which could be used to settle any inter-broker or third party claims arising from day to day unsettled trades. Second, the NSE is required to maintain another level of compensation which is paid by buyers and sellers of securities at a rate of 0.01% of the consideration. The fund could be used when bank guarantee is not adequate. Third, the CMA (Amendment) regulation of 1995 requires every buyer/seller of securities to pay 0.01% of the consideration to the investor compensation fund. This fund is accessible if the first and second compensations are fully utilized and a legal proceeding bankruptcy of liquidation proceedings against the licensed person are complete and net losses determined.

enhance transparency by according all brokers an equal opportunity to bid for securities and also to enhance handling of the growing trading activity. This followed the recommendations made by the IFC/CBK (1984) study justifying that since brokerage businesses were conducted behind closed doors, the stock exchange had not been able to generate adequate public awareness and confidence in the buying and selling of securities. The trading system, it was felt, did not guarantee that the prices obtained by buyers and sellers are best since all buying and selling interests did not get exposed to one another.

With the new trading system, trading took place on Mondays to Fridays between 10.00 a.m. and 12.00 noon except for public holidays or any other closures approved by the Board of Directors of the NSE. Potential buyers and sellers contacted stockbrokers directly or through registered agents and gave their buying or selling orders. Foreign institutional investors were supposed to have a current custodian account with a Kenyan banking institution. Then, stockbrokers through their authorized representatives took the customers' orders to the trading floor where deals were transacted using open outcry auction. Trading board lot was in terms of one hundred shares or units while trading was effected to and from the trading board on the trading floor and no private negotiation was permitted. Only when bid price was equal to or up to two spreads away from the offer price is transaction effected. There were daily limits on movements of quotations whether bid or offer set at 15% of opening bid or offer prices. No bid or offer quotations were more than six spreads from the last quotation appearing on the trading board for that security (NSE, 1997b). The following were the bid spreads set for shares, stocks, rights, options and other securities: for less than Ksh 20 the spread was 5 cents; Ksh 20-Ksh 50 was 25 cents; Ksh 50 –Ksh 100 was 50 cents; and over Ksh 100 was 100 cents.

The manual system of clearing and settlement lengthens the financial transaction period. As noted in the NSE Annual Report (1998), excluding any unforeseen bottlenecks, transfers are usually affected within a week or two following transactions. Such a long period implies that investors waste a lot of time in between the actual sale and its confirmation, which could adversely affect the liquidity and efficiency of the stock market. Lack of a central depository system was therefore seen as inhibiting the liquidity of the stock market.

A proposal was made to install the Central Depositing System (CDS) in 1995 following a feasibility study which identified the urgent need for CDS as a critical factor among three critical issues. The other two issues included the need to establish an enabling legislation to ensure best practice and the need to acquire the best technology. A draft Bill was submitted to the Attorney General for finalization in March 1996. Installation of a CDS was aimed at enhancing liquidity and efficiency in the trading system by reducing the period of delivery and settlement. This, it was hoped, would facilitate electronic transfer of ownership without the physical movement of such certificates, minimizing systemic risk and the settlement period and ultimately increasing trading volume. The main aim of the CDS was to shorten the registration process, boost liquidity in the market, increase market activity, reduce market risk, attain international standards and deliver the NSE mission statement.

Three years down the line, little had been achieved. The newly appointed Executive Director of NSE attributed the delayed implementation to lack of proper CDS project planning. To this effect, the CDS project was launched with a detailed timetable of events. A decision was made to lay down the infrastructure of a CDS company while awaiting the passing of the Bill. The NSE also engaged in lobbying Members of Parliament to pass the CDS Bill promptly when it is presented before them. In laying the infrastructure for a CDS company, it was agreed that shareholders of the company would pay 1% of capital upon signing of the agreement and 10% upon the Bill obtaining Presidential assent, while the balance would be called up by the directors as the need arises. The shareholders included: the NSE, Citibank, Kenya Commercial Bank, Apollo Insurance, IFC Jubilee Insurance, stockbrokers and the Cooperative Bank (which was showing interest). On 7 March 2000, five core shareholders signed an agreement and paid up 1% of the share capital. The Central Depository and Settlement Corporation Limited (CDSC) was incorporated under the Companies Act (Cap 486) on 23 March 1999. The Bill passed its seconding reading in Parliament in April 2000 and the draft CDS Bill was tabled in Parliament in December 1999. However, Parliament went on recess before debating the Bill. In June 2000, registrars, custodians and stockbrokers hosted by the NSE management held a workshop to brainstorm on the best practice in the interim period prior to implementation of the CDS. The aim was to create an even understanding by all market players of the new changes and benefits thereof and prepare them for the high pace needed in the automation process. The request for proposals for CDS and ATS was then floated on 20 June 2000. On 1 July 2000, the chief executive of the NSE made a presentation on the proposed new system of delivery, settlement and registration of securities as a precursor to the implementation of the CDS. Bids from 11 prospective suppliers of CDS and electronic trading system were opened on 17 July 2000. This was followed by a workshop for stockbrokers, custodians, registrars, and back-office personnel aimed at enhancing the goodwill of all stakeholders with formal awareness campaign. Further, the immobilization of over half a million share certificates held by investors so as to propel the department from a semi-computerized division in settlement cycle to a settlement and registration company for all listed securities was launched. This saw the introduction of delivery versus payment system (DvP) on 1 August 2000. With this system, the market faced a main challenge of settling transactions within 5 days of trading occurring and providing shareholders with their shares within 7 days of settlement, creating an environment of a smooth transition to an electronic based settlement and registry. The main aim of the DvP system was to enhance investor confidence and liquidity by making the settlement period shorter and safe. It was also aimed at moving the market close to a CDS environment of T+3 by shortening the period within which certificates are issued and centralizing registration at the NSE. The system was also aimed at enabling brokers to concentrate on core business by taking over post-trading back-office tasks at the NSE. The CDS Act was passed by Parliament and received Presidential assent paving way to implementation of the CDS on 18 August 2000. Opening of bid proposals submitted by the four shortlisted suppliers of CDS and ATS followed on 25 September 2000. However, there were further technical complications that saw the process delayed.

3.3 NSE Membership

The NSE was registered as a limited company under the Companys Act in 1991. With the 1994 CMA Act (Amendments), it became mandatory that a stock exchange approved by the CMA was to be a company limited by guarantee. The NSE Board was expanded from the original five members to incorporate the interests of other market players in the decision-making process. The new Board comprised of 5 brokers drawn from the main brokerage firms, 2 members from listed companies and 3 members to represent investors' interests. In the NSE rules and regulations of 1997, it is observed that no dealer or stockbroker would be granted membership unless they possess a license to operate as a broker or dealer. Listing of companies saw change in requirements and procedures over time. Before the reform period, for example, firms were required to have a minimum of Kshs 2.9 million issued and paid-up capital and to make a public offer of not less than 20% of the authorized capital, or shares with a nominal value of Kshs 1 million, whichever was less.

In July 1994, stock brokerage firms were increased for the first time with licensing of seven more stockbrokers. An additional eight stockbrokers were licensed in June 1995 and with the suspension of one stockbroker, the total number of stockbrokers was twenty. The expansion of brokerage firms was meant to enhance competitiveness in trading. This followed the peaking of stock price in February 1994 to 5030, which may have created an incentive to share in the profits. In March 1997, stockbrokers formed the Association of Kenya Stockbrokers (AKS) with the objective of developing a code of conduct, promote professionalism, and establish examinable courses for its members as well as facilitate liaison with the CMA and the NSE. In 1993, the CMA increased the initial paid up capital for stockbrokers from Kshs 100,000 to Kshs 5 million while that for investment advisors was set at Kshs 1 million.

In addition, there were considerations to encourage participation of foreign brokers and fund management companies in the domestic capital markets through joint ventures. This proposal was subject to a minimum of 51% local shareholding for brokerage firms and 30% for fund management companies. The idea was to facilitate the transfer of skills and technology into the local market, encourage portfolio investment into the domestic market, and help position Kenya globally within the competitive financial markets (CMA Annual Report, 1997/98). There were proposals to establish merchant banks to promote underwriting services and a rating agency. This was motivated by the fact that as markets became more sophisticated in terms of range of products and activities, demand for accurate information and risk assessment by investors increased in order to provide objective analysis and rating of listed securities.

There were also plans to license market dealers at the stock exchange as part of measures to enhance liquidity. The CMA Amendment Act 1994 provided for licensing of dealers; one dealer was licensed in 1999.

The dealer applied to be an investment bank in May 2002 without taking deposits but to provide investment advisory services. Another stockbrokerage firm, Hak securities, was allowed to operate as an investment bank after fulfilling the requirements. Licensing of investment advisors was passed in 1994/95 and nine investment advisors were licensed to provide vital services to investors as professional analysts and portfolio managers. By 1997, the number of investment advisors had increased to 19.

In addition, in the 1997/98 period, Foreign Fund Managers and Investment Advisors were allowed to participate in the local capital markets by acquiring beneficial ownership in local stockbroking firms and fund managers; precisely up to 49% in the case of brokers and up to 30% for fund management companies. The aim was to induce specialized expertise in fund management and foreign investible funds to start flowing into local markets.

3.4 Foreign Investors

During the revitalization period, capital controls were relaxed for offshore borrowing in February 1994 subject to quantitative limits. Complete liberalization of offshore borrowing was implemented in May 1994, while some restrictions on inward portfolio investment were lifted in January 1995, therefore allowing participation of foreign investors in the Nairobi Stock Exchange trading under guided policy.

The following are the rules set for foreign portfolio investors in the Nairobi Stock Exchange as contained in the Kenya Gazette Supplement of January 1995:

- No foreign security (capital market instrument) which is not listed in the securities' exchange in Kenya shall be offered for sale or exchange without the approval of the CMA.

- No person shall offer for sale any capital market instrument registered outside Kenya except with the approval of the CMA.
- A listed company should maintain a register of shareholders of ordinary shares showing the amount of ownership by individual citizens of Kenya, institutions registered in Kenya, and foreign investors.
- A foreign-controlled company shall not be eligible for further investment by foreigners other than through a new issue of shares.
- Any issuer making an issue of shares to the public (primary market) may offer part of the shares for subscription by foreign investors but this should not exceed 20% of the issued share capital.
- Every capital market instrument issued outside Kenya and approved by the CMA for sale in Kenya other than unit trusts and mutual funds licensed by the Authority shall be listed with a securities exchange in Kenya.
- Every share certificate registered in the name of a foreign investor shall be held by an authorised depository.

Foreign investors were permitted up to 20% of equity for inward portfolio investment, that is aggregate of each stock and a 2.5% limit for individual investors. This was revised upwards in July 1995 so that the individual investor limit was increased to 5% while the aggregate was set at 40%. On 26 July 2002, new foreign investor regulations were established where a 25% minimum reserve of the issued share capital was for locals while the balance of the 75% was a free float for all classes of investors. The 25% minimum reserve applies during initial public offerings (IPOs) and Government of Kenya privatizations.

Foreign investors' trading recorded a peak of 52.5% of the total market trading in December 1996 while a consistent downward trend was recorded from June 1997.[10] Initially, when foreign investors were allowed to trade in January 1995, a slow growth in foreign trading was recorded. However, inflow of foreign trade increased tremendously with the increased limit of foreign participation in July 1995. There was tremendous growth in foreign investors' activities, increasing from 3% in 1995 to 44% in June 1997, with a peak in December 1996 of 52.5%. It is therefore tempting to conclude that market performance during the 1996-1997 period was to a large extent controlled by foreign operations.

The remarkable performance of foreign trade was short-lived as the ratio to total trade declined to 2% in August 1997 before recording a net-outflow of 42% in September 1998. Across the sectors, the agricultural sector lost foreign trading especially in 1998, and this was coupled with a decline in performance of the sector. The financial sector seemed to take the remnant of the foreign trading although growth of the sector took a downward trend. Distribution of shareholders between locals and foreigners indicated that the majority of shareholders were locals (in a sample of 38% of the listed companies). The skewed distribution in shareholding was indicated across the listed companies where the top 20 shareholders, representing 6% of the total shareholders, held more than 50% of the shares (from a sample of 57% of the listed companies analyzed). The trading volume results show that the activities

[10] The impact of foreign investors on the performance of the stock market is however not clear. It is for example observed that greater foreign participation in the market reduces price volatility. De Santis and Imrohoroglus (1997) explain that new investors broaden the market, dampening the effect of order flow shocks on prices and may also make prices efficient by increasing the precision of public information regarding fundamental values. Sellin (1996), however, regards foreign investors' participation as noise trading, therefore a source of excess volatility in the market. Moreover the general literature on capital flows indicates that when capital flows are push-factor driven then they are more volatile.

of the secondary market were however dominated by the minority shareholders. For example, the average number of shares per deal was estimated at 2,452 shares in 1998, a drop from 3,293 in 1997, while the average value of the deals was Kshs 162,385 in 1998 and Kshs 195,551 in 1997. It would therefore seem that the top shareholders controlling over 50% of company shares are inactive in the secondary market, showing preference for dividend income to capital gains. This may explain the low liquidity in the secondary market and low supply of securities for trading.

3.5 New Listings

With the reform process, the paid-up capital increased to Kshs 20 million in 1997 and then to Kshs 50 million in 2000 as indicated in Table 3. However, to reduce the listing costs, the Government provided various tax incentives where, for example, costs of initial public offerings for shares, debentures and bonds were made tax-deductible expenses; this was announced during the 1991/92 fiscal year. Further, during the 1997/98 budget speech, all the costs incurred by companies in the process of acquiring international credit rating were made tax-deductible. The aim was to enable firms' access to cheaper funds from foreign capital markets by for instance floating debt securities offshore. However, part of these benefits were crowded out by the costs charged by the CMA on market participants; this, together with other listing requirements, failed to significantly cut down the entry barrier for new companies.

The procedure for company listing changed as the Government increased its involvement in market activities. For example, while before 1971 a firm needed only the approval of the NSE, the listing firm now had in addition to receive the approval of the committee in order to list in the NSE . With the review of the *Rules and regulations of NSE 1954* in 1989, a listing company had in addition to notify the NSE on any

Table 3: Financial obligations for new listing

	1954	1989	1997	2000 MIMS	AIMS
Minimum issued and fully paid capital	At least Ksh 2m and shares to have a nominal value of Ksh 5	Ksh 2m	Ksh 20m	Ksh 50m	Ksh 20m
Amount of issued capital	Amount issued not <20% of authorized capital or shares to nominal value of Ksh 1m, whichever is less	Not <20% or nominal value of Ksh 1 million whichever is less	Not <20% of its paid-up share capital held by not <300 shareholders.		
Hearing fee	Ksh 1000 payable for the 1st issue when application is submitted by the sponsoring broker	0.1% of the issue nominal value of securities to be listed subject to a minimum fee of Ksh 50,000 and max. fee of Ksh 500,000	0.2% of the value of securities to be listed minimum Ksh 200,000 and maximum Ksh 2.5 million	0.1% of nominal value of additional securities to be listed subject to min. Ksh 50,000 and max. 500,000	0.1% of nominal value of additional securities to be listed subject to min. Ksh 25,000 and max. 250,000
Fees	Ksh 1000 for each class of shares or debentures paid to exchange within 30 days of quotation being granted.	0.025% of the value of each class or debentures minimum Ksh 3000		Initial fee of 0.06% of value of securities to be listed subject to a min. of Ksh 200,000 and max. of Ksh1.5m	Initial fee of 0.06% of value of securities to be listed subject to a min. of Ksh 100,000 and max. of Ksh 1m
Addition quotation	Ksh 1000	0.05% of the issue nominal value of securities to be listed subject to a min. fee of Ksh 25, 000 and max. fee of Ksh 100,000	0.1% of the market value minimum Ksh 100,000 and maximum 1 million		
Annual quotation fee	Less Ksh 1m – 1000 1m to 2m – 1400 2m to 3m – 1800 3m to 4m – 2200 4m to 5m – 2600 5m to 7.5m – 3200 7.5m to 10m – 4000 Over 10m – 6000	0.01% of the total market value of the quoted securities subject to a minimum fee of Ksh 3,0000	0.05% of the market capitalization of listed securities minimum Ksh 200,000 and maximum 2 million		
			Offer for sale fees payable by a holder of large block of securities in a listed company offering to sell the block to public investors. 0.15% of the market value of the securities being sold subject to a min. 200,000 and max. 1m		

information necessary to enable the shareholder and public to appraise the position of the company and to avoid the establishment of a false market in its securities. Listed firms also had to announce through the sponsoring broker any mergers and take-overs when negotiations are at an advanced stage and apply for a temporary halt of dealings if this may lead to a very damaging sharp movement in share prices.

The NSE has also witnessed changes especially following the reform strategy launched on 8 May 2000 by the CMA for reorganizing the stock market. The reforms were aimed at responding to the changing needs of the market and the economy as well as deepening the capital market. The restructuring of the market was aimed at catering for the specific needs of different issuers. Three segments were established and launched to the NSE Board on 5 February 2001. The three segments include the Main Investment Markets (MIMs), the Alternative Investment Markets (AIMs) which targets the small and medium-sized companies with potential to grow, and the Fixed Income Securities' Markets (FISMs).

3.6 Regional Market

There are presently on-going efforts towards integrating and harmonizing the operations of the East Africa economies. A lot of effort has been put in establishing an appropriate infrastructure that would facilitate the establishment of an East African Regional Capital Market. This would harmonize the legal and regulatory framework, trading system, and the taxation policy. It is hoped that a unified East Africa stock exchange will be established to take advantage of the large population estimated at 80 million people. A regional market would facilitate access by companies to a greater pool of resources; ease of cross-border listing of securities; increase liquidity; and enhance diversity of investors' risk. In addition, a large capital market would attract foreign investors. In March 1997, the East Africa Member State Securities Regulatory Authorities (EASRA) was formed through a memorandum of understanding between the securities' regulators of Kenya, Uganda and Tanzania. While the EASRA initially comprised of the regulatory authorities, the opening of stock markets in Tanzania and Uganda implied that membership was extended to the stock exchanges. Further, during a meeting on 11 August 2000 Ministers of Finance for Kenya, Uganda and Tanzania proposed the establishment of the Capital Market Development Committee (CMDC) as a separate committee under the EAC framework. This was endorsed during the 31 August 2000 meeting of the council of ministers. The main aim is to harmonize policies and proposals of importance to the capital markets of the three EAC countries. Further, the East African Legislative Assembly (EALA) was launched on 30 November 2001 by the three East African heads of state.

3.7 Securities

In an effort to deepen the capital market, corporate bonds were introduced. There was also a move in 1997 for NSE to work towards introduction of collective investment vehicles (unit trusts and mutual funds) and other corporate bonds including revenue bonds, mortgage-backed securities and other viable instruments. The same emphasis is made in the 1999 report where establishment of collective investment vehicles like unit trusts, mutual funds and other formal investment clubs would allow investors' access to a fully diversified investment in a single unit, greatly enhancing their ease of access to the market. Corporate bonds[11] were introduced in the market on 22 November 1996 when the East Africa Development Bank (EADB) bond was issued at a price of 99% to raise Kshs 600 million. It was traded in denominations of Kshs 1 million with an interest of 1.2% points above the prevailing 91-day Treasury bill rate. The bond was redeemed in six semi-annual installments. Coupon interest payments were made quarterly in arrears. The bond can be purchased/sold on the secondary market through the NSE. Corporate bonds were traded in denominations of Kshs 1 million with settlement in T+7 days. The Government targeted to issue three one-year floating bonds and the first issue was made in April 1997 with a subscription of 2.6 billion out of the Kshs 5 billion tendered. Low subscription was attributed to the failure of the Central Bank of Kenya to give sufficient notice for proper placement of the bond. This was a one-year maturity fixed income security with new issues floated quarterly, and with a minimum purchase in primary auction of Kshs 50,000. The nominal annual yield was indexed 2.5 points above the 12 week moving average of the 91-day Treasury bill yield and reset quarterly. Coupon interest payments were made quarterly in arrears. The bonds were purchased/sold on the secondary market through the NSE. These were traded in denominations of Kshs 50,000 with settlement in T+3 days. Interest rates on bonds were made less 15% withholding tax for Kenyan residents and less 12.5% withholding tax for non-

[11] Corporate bonds were targeted to provide long-term financing requirement. For a company to issue bond and commercial paper, it had to have a paid up share capital and reserve of not less than Kshs 50 million and would be retained at the level during the period the bond was outstanding. If the minimum paid up share capital was not met, then the issuer would obtain from a bank or any other approved institution a financial guarantee to support the issue. The issuer should have made profit at least two of the last three financial periods preceding the application for the issue. The total indebtedness including the new issue of bond should not exceed 400% of the company networth (gearing ratio 4:1 at the date of the latest balance sheet). The funds from operations to total debt for three trading periods proceeding the issue should be maintained at a weighted average of 40% or more. The minimum size of bond issue is Ksh 50 million and the minimum issuing lots Kshs 100,000-offer period in maximum 10 days, while commercial paper minimum size is Kshs 1 million.

residents. The interest on the bond issues was benchmarked on the 91-day Treasury bill rates. In 1998, the Government issued the first two-year Floating Rate Bonds as part of the objective to shift the short-term debt consisting mainly of Treasury Bills to long-term debt and also to help address the inverse yield curve. Also, in the 1998/99 fiscal year, the Government proposed the issue of tax amnesty bonds to encourage compliance with the Income Tax Act. At the same time, it was made a requirement that insurance companies invest a minimum of 25% of their gross premiums in Government securities, therefore providing liquidity for the bonds market. While the Government bond ranged between one to two years, the EADB bond was made up to three years.

Commercial paper was also explored as an alternative for short-term working capital financing by the corporate sector. However, only those companies listed at the NSE were permitted to issue commercial paper. The guidelines for issuance of commercial paper and corporate bonds were finalized in 1997.

The period 1996/97 saw the launching of investment funds and venture capital funds, including the Regent Undervalued Assets Africa Fund that applied for listing in Kenya, Botswana and Ireland. This offshore investment fund was listed in the NSE in 1997. The fund offered 10 million shares at US$ 10 out of which Kenya was allocated 10.2% to subscribe for with minimum subscription per investor fixed at US$ 100,000. Simba Fund was set up by Barring Asset Management as a regional investment fund for Africa with a resource pool of US$ 120 million. The Fund was invested in seven sub-Saharan African countries with favourable GDP growth rates. The Acacia Fund Limited was the first Kenyan venture capital fund. The Commonwealth Development Corporation with a capitalization of Kshs 1 billion promotes the Fund. The Fund was launched as a ten-year close-ended fund that would make equity investments in medium-sized companies which have the potential of being listed at the NSE. There were also efforts to help mortgage finance companies to issue asset-backed securities to facilitate increased savings in the financial assets and at the same time develop alternative financial market instruments to raise capital. The main aim was to facilitate the raising of additional long-term capital which would contribute towards the development of the housing sector.

Another factor that might affect the operations of the market is the Retirement Benefits Act (RBA Act). The enactment of the RBA Act and the NSSF Amendment Act of 1997 gave some hope to the stock market. The move to professionalise pension management was seen as crucial in developing domestic sources of long term savings for investment. It was hoped that contracted savings such as insurance and pension funds would spar growth of a vibrant bond market in Kenya and give the stock exchange a tremendous boost. It was expected that statutory institutions which have over-invested in property would readjust their portfolio towards equity in line with the 30% limit proposed by the RBA, while the requirement that all funds be managed by professionals is expected to result to more optimal asset allocation in the sector.

3.8 Taxation Policy

During the reform period, tax policy was relaxed to reduce transaction costs by providing a favourable tax regime that exempts listed securities from stamp duty, capital gain tax and Value Added Tax (CMA Annual Report, 1997/98). Tax reform also saw lowering of withholding tax dividends while the repeal of the Exchange Control Act removed restrictions on transactions for both local and foreign currencies, payments, securities, controls of imports and export, transfer and settlement of property. There were four important developments regarding the taxation policy, namely the 1990/91 policy changes on stamp duty and other transaction costs; the 1996/97 policy changes on withholding tax; and the 1997/98 restructuring of investment and fund management taxation and the 2001/2002 tax incentives for new listings.

In the 1990/91 fiscal year, stamp duty payable for retail share transfer transaction on quoted securities was abolished. In addition, a withholding tax rate of 15% on dividend income paid to residents was made final tax. This was aimed at reducing incidence of double taxation on corporate dividends and incomes to individuals arising from investment in securities. All dividend and interest income to unit trusts were made subject to withholding taxes of 15% and 10% respectively such that this was a final tax not subject to further corporate or personal tax. Further, the withholding tax on dividend income was reduced in 1992/3 to 10% and rationalized with the rate applicable to interest income.

In the 1996/97 fiscal year, withholding tax on dividend income was lowered from 10% to 5% for local investors while it went down to 7.5% for non-residents. Withholding tax on interest income was raised from 10% to 15% while withholding tax on bearer instruments and certificates of deposit was raised from 10% to 20%, and it was the final tax in both cases.

Further fiscal reforms were made in the 1997/98 period. The gains that insurance companies were making from trading at the stock market and which were previously taxable at the normal corporation tax level were exempted from tax. The aim was to release for trading large stockholdings which were in the custody of insurance companies and therefore boost the supply of securities in the market. The measure was also aimed at releasing funds held by insurance companies for investment in listed securities, therefore boosting demand in the market. In addition, sole-purpose dealers who would become tax-exempt were to be licensed with a view to enhancing liquidity in the market. In order to discourage these dealers from locking up securities, the dealers were required to trade them within 24 months from the date of purchase or else suffer taxation. Finally, in order to encourage equity in medium-sized companies with growth prospects, venture capital funds were allowed to enjoy a 10-year tax holiday on their dividend incomes. [12]

In order to encourage new listings, new and expanded share capital by listed companies or those seeking listing was exempted from stamp duty in the budget for the financial year 2000/2001 while expenses incurred by companies in having their financial instruments rated by an independent rating agency were made tax-deductible. Further, in the budget for the financial year 2001/2002, newly listed companies approved under the Capital Markets Act were to be taxed at reduced corporation tax rate of 27% as compared to the standard rate of 30% for three years following the date of listing. However, such companies should offer at least 20% of their share capital to the public. The companies that apply and are listed were to get a tax amnesty on their past omitted profits subject to making a full disclosure of their incomes, assets and liabilities during the year commencing the date of listing. The companies were to undertake to, henceforth, pay their due taxes in full. Further, a tax concession of 5% was introduced for newly listed companies for 5 years post-listing, provided the firm lists a minimum of 30% of its fully issued and authorized share capital on the Nairobi Stock Exchange. This meant that newly-listed companies pay a corporate tax of 25% compared to 30% for unlisted firms.

[12] There was also an attempt to boost the market in Government bonds. The Government floated a Eurobond in 1998 in order to reduce domestic Government borrowing. In addition, all outstanding Government overdrafts with the Central Bank were converted into marketable securities.

4. Conclusion

This study traces the development of the Nairobi Stock Exchange since the initiation period in the 1920s, with a focus on institutional and policy changes. An evolutionary process with three stages of development is portrayed. The initiation stage is mainly characterized by no formal rules and regulations and is dominated by foreign investors. In the formalization stage, a self-regulatory system is adopted while attempts are made to increase the participation of local investors by the post-independent Government. In the third stage, various institutional and policy reforms are implemented to enhance the growth of the market.

Two main factors seem to shape the development path: the political environment both at the local level and in the East African region which saw change in the policy environment and changed the composition of market participation; and secondly the macroeconomic environment which instigated the demand for locally-mobilized long term capital to enhance economic development. The extent to which the development path has influenced the performance of the market is interesting to investigate.

Considering the developments in various aspects of the market, the following patterns are indicated. First, the stock brokerage industry has expanded and diversified with the number of stock brokers increasing from 6 to 20, and licensing of stock dealers and investment banks. However, stock brokerage is yet to be fully negotiable while the role of stock brokers remains predominately that of an agent. Second, the composition of market participants shows a shift from a market dominated by foreign investors in the initiation stage to increased participation of local investors in the formalization stage (especially in the post-independence period) and re-entry of foreign investors, though at limited level, and mass education on stock market operations and assets in the revitalization stage. Third, the NSE served as a regional market for the East African states in the initial stages but the Stock Exchange lost a significant proportion of its market scope due to the political changes in these states. Attempts are however underway to establish a regional market to facilitate expansion of the NSE market. Fourth, though the diversity of securities traded is still minimal, the reform period saw efforts made to attain market depth with introduction of new instruments. This is a step forward in deepening the capital market. Fifth, while a discriminative tax policy that penalized share investors heavily was adopted in the post-independence period, an incentive-based tax policy regime was adopted in the reform period to enhance the competitiveness of the financial assets and reduce the barriers to listing new issues. Sixth, in an effort to strengthen the regulatory framework, the regulatory system has witnessed a shift from the non-formal system to self-regulatory and statutory regulatory framework. However, the effectiveness of the new regulatory framework will depend on the comprehensiveness of the regulatory framework and its enforceability. Seventh, the trading system shows a shift from the coffee-house forum to floor trading and there are attempts to introduce the delivery versus payment system with the introduction of the Central Depository System and automation of the trading cycle. The main aim is to enhance efficiency in the price discovery process and liquidity of the market. These changes mimic development paths of other stock markets in both the developed and emerging markets.

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Appendix: Chronology of events

Period	Action taken
1960s	1964: Kampala agreement
	1965: Dissolution of common currency area, passing of Central Bank Act, and exchange control on sterling transaction
	1967: Banks in Tanzania are nationalized and EAC treaty is signed in December
	Kenyanisation policy is implemented
1970s	1969/70: Lending to foreign-controlled company was raised as a concern and therefore the exchange control. All companies pay their tax at the end of the accounting year to allow even flow of revenue and more prompt payment of tax
	1970: Uganda imposes exchange controls on Kenya and Tanzania
	1971: 12.5% tax on gross dividends and interest paid by corporation is imposed to control movement of funds out of Kenya. 20% tax on all fees and royalties payable to non-residents
	Capital Issue Committee is established
	1973/74: stamp duty increases to 3%
	1974/75: Dividend tax for non-residents increases from 12.5% to 15% and for residents from 12.5% to 20%.
	June 1975: Capital gain tax of 36% imposed to generate Government revenue and curb excessive speculation
	1975/76: Collapse of the EAC followed by de-listing of firms reducing the market scope
1980s	IFC and CBK conduct a joint study on capital market development issues
	June 1985 capital gain tax suspended
1990	CMA is established, constituted in January 1990 and inaugurated in March 1990
June 1991	Stamp duties on retail shares is abolished for listed firms
	Transaction costs of public issues of shares, bonds and debentures made tax-deductible
	15% withholding tax on dividend income made final and 10% for interest income, aiming to reduce double taxation on corporate dividends and incomes to individuals arising from investment in securities
July 1991	NSE registered as a limited company
September 1991	CMA membership to IOSOC is granted as the 5th African country to secure membership
November 1991	Trading system shifted to floor trading
April 1992	Car and General reinstated to public trading list
June 1992	Withholding tax on dividend income reduced to 10%, rationalizing the rate applicable to interest income
December 1992	Trade Bank denied listing due to irregularities in disclosure management
November 1993	All restrictions on remittance of profits dividends and expatriates earning removed
February 1994	Capital controls for offshore borrowing relaxed subject to quantitative limits and finalized in May 1994
	Residents allowed to borrow up to maximum US$ 1 million
July 1994	Seven new stockbrokers licensed to make the market more competitive
	Gazettement of CMA (Amendement) regulations 1994 and capital market (Amendment) rule 1994 as legal notice No. 232 and 233 in Kenya Gazette supplement No. 4 of 22 July 1994. These amendments require an exchange to be approved by the CMA to be a company limited by guarantee
January 1995	Entry of foreign investors limited to 20%
	The Capital Market Authority Amendment Act, 1994 is passed
	The CMA (foreign investors) regulation 1995 are Gazetted in legal notice No. 3 in the Kenya Supplement No. 1 of 6 January, providing for foreign investors participation in the domestic capital market subject to a 2.5% limit for individual investors and 20% in aggregate for each stock
	Bob Mathews stockbroker suspended from the exchange trading floor due to irregularities in its operations
February 1995	Regional training course aimed at human capital development for technical staff of CMA
March 1995	Education trip to South East Asia of capital market staff
May 1995	CMA declines to renew the license of Bob Mathews stockbrokers for misconduct and gross violation of CMA Act and the CMA rules and regulations. CMA installs modern computer network to enhance its operations and facilitate information collation, analysis and dissemination.
June 1995	Withholding tax reduces to 7.5% for local investors in quoted securities
	Issue of commercial paper allowed for listed companies
	Government announces its support of the CDS and rating agency
	Eight more stockbrokers are licensed
	Board of directors of NSE is reconstituted
	15 June: CMA (Amendments) regulations 1995 are issued allowing CMA to collect fees from the market to finance its operations in Legal Notice No. 212 of Kenya Gazette Supplement No. 39

Period	Action taken
July 1995	Compensation fund introduced to protect the investors against loses arising from equity trading
	Foreign investors participation is raised to 40%
August 1995	The CMA (Foreign Investor No. 2) regulations 1995 are issued in Legal Notice No. 291, Kenya Gazette Supplement No. 55 of 24 August 1995.
January 1996	CMA allowed levying charges on public issues, bonuses, rights and private placements by public companies and gazetted in July 1997
March 1996	Submitted a CDS proposal to the Attorney General for review
April 1996	Barring Asset Management set up a regional investment fund for Africa, Simba Fund, with a resource pool of US$ 120 million (Ksh 6.9 billion) invested in seven sub-Saharan African economies including Kenya
May 1996	Kenya National Oil Company Ltd (Kenol), following a resolution at the company AGM, applies to de-listed from the NSI As a result, trading in Kenol at the NSE is suspended.
June 1996	Withholding tax reduced to 5% for local investors and 7.5% for the non-residents and it remains final. This reducing double taxation on equity investment incomes of individuals was raised from 10% to 15% while withholding tax on bearer instruments and certificates of deposit was raised from 10% to 20%
July 1996	Establishment of the Central Depository System progresses with the drafting of the CDS Bill almost being finalized by a consultant Brian Taylor Associate of UK.
	Kenya Finance Bank is put under the statutory management of the Central Bank of Kenya after persistent liquidity crises and suspended from the NSE.
August 1996	CMA forms 11 member disclosure standard committee to review the existing disclosure requirements and make recommendations
	CMA approves amendments governing takeovers
	Establishment of compensation fund
	Uganda Stock Exchange has the first ever public floatation of shares in the privatization of Uganda Grain Milling Corporation where the Government offered for sale 49% to public and 51% to core investors
September 1996	CMA (Amendment) rules 1996 Gazetted providing additional requirements on takeovers and de-listings to protect minority shareholders, in Legal Notice No. 286 of Kenya Gazette supplement No. 52 of 13 September 1996
October 1996	Disclosure committee formed by CMA
	Central Bank liquidates Kenya Finance Bank and appoints the Depository Protection Fund liquidator
	The NSE records the biggest deal in its 42-year history with NIC bank selling 4.9 million shares valued at Ksh 217 million
	The gradual privatization of Kenya Commercial Bank continues with the successful public offer for sale of 11.88 million shares at Ksh 50 each representing 10% of the company's issued capital, which subsequently reduced Government shareholding to 60% and is targeted for 40%
	Kenya's first venture capital fund, the Acacia Fund Ltd is launched
	An offshore investment fund incorporated in the Cayman Islands, Regent Undervalued Assets Africa Fund applies for a simultaneous listing at the NSE, Gaborone (Botswana) and Dublin (Ireland)
November 1996	Kenol suspension is lifted
November 1996	The first corporate bond is listed (the EABD bond)
January 1997	A new CMA Board is inaugurated
February 1997	Government lists the first Treasury bond
March 1997	An association of stockbrokers is formed to develop code of conduct and promote professionalism of stockbrokers
	East Africa member state securities regulatory authorities is formed under the memorandum of understanding between the securities regulators of Kenya, Uganda and Tanzania
April 1997	Education program first seminar held
	Treasury bond trading commences
	The first issue of Government three one-year floating rate bonds
	TPS Serena issues 12 million new ordinary shares to the public at a price of Ksh 13 each
May 1997	The second public education seminar held
	CMA issues guidelines on issuance of corporate bonds, commercial paper and other debt instruments
June 1997	Tax exempt of gains by insurance companies from trading at the stock exchange aiming to release for trading large stockholding which were in the custody of insurance companies and therefore boost the supply of securities in the market
August 1997	IMF freezes EASF aid facility to Kenya, weakening the shilling, reducing the foreign reserves, and increasing inflation
September 1997	African Tours and Hotels limited shares are suspended from trading on the NSE
October 1997	The first issue of two year floating rate bond
	Kingfisher Company Ltd (formerly Phillips International Ltd) application for lifting of the suspension is declined and the company advised to meet all the listing requirements.
December 1997	The Association of Financial Analysts is launched
	The second multi-party elections are held in Kenya
April 1998	CMA publishes the guidelines on disclosure standard by listed companies to form audit committees of non-executive directors with knowledge of business and accountancy
	Government issues the second two year floating rate bond
	KCB floats the fourth privatization offer
June 1998	Tax amnesty bonds floated aimed at encouraging compliance with Income Tax Act
	Insurance companies required to invest minimum 20% of their gross premium in Government securities
	Government plan to promulgate legislation to hasten establishment of collective investment schemes like mutual funds and unit trust

Period	Action taken
November 1998	New stock index AMMI 27 launched by Alico Asset Management
December 1998	ICDC offer rights issue raising Ksh 350 million
January 1999	CMA issues guidelines to promote corporate governance
January 2000	Rights issue by Pan African Insurance
March 2000	On the 21st African Lakes opens trading to public becoming the first tech stock and first dual listed share
April 2000	CDS Bill passes the second reading in Parliament
May 2000	8 May: CMA launches the reform strategy for fundamental reorganization of Kenya's capital market
July 2000	1 July: Reorganization program for the stock market is launched to cater for specific needs of different issuers
	14 July: Kenya, Uganda and Tanzania come a step closer to the regionalization of stock exchange with the signing of the report of the joint stock exchange task force on cross-border listing
	17 July: Bids from prospective suppliers of CDS and ATS are opened
	28 July: Kenya gets readmitted to the community of bankable economies when IMF agreed to advance support for the budget
August 2000	1 August: new trading cycle T+5 is launched, that is a process of registration in an ambitious preparation exercise for the implementation of the CDS environment, together with the implementation of the reforms on the NSE Board
	11 August: Ministers for Finance from Kenya, Uganda and Tanzania propose the establishment of the Capital Markets Development Committee (CMDC) as a separate committee under EAC framework; this is endorsed during the 31 meeting by the Council of Ministers. This was aimed at harmonizing policies and proposals of importance to the capital markets from the three EAC countries
	18 August: NSE and CDSC announce the short list of CDS and ATS system vendors. CDS Act and CMA act are passed by parliament and receive presidential assent paving way for the full implementation of the CDS.
September 2000	CFC financial services is licensed as the first dealer
	25 September: Final CDS bid proposals opened
	Long awaited institutional framework for the regulation of the retirement benefits sector is gazetted
October 2000	NSE becomes a member of the association of national numbering agencies, the global securities numbering agency
	NSE and CDSC completes the selection of a vendor to supply ATS and CDS; that is efaSEMS and Consortia
	ASEA (African stock exchanges associations hold its first conference of the new millennium
December 2000	20 December: Shelter Afrique launches a floating rate Ksh 350 M
February 2001	5 February: The three NSE boards become operational
	Workshop to create awareness on debt instruments targeting the stockbrokers
March 2001	27 March: EABL shares commence trading at the Uganda Stock exchange
May 2001	EADB launches a Ksh 2 billion medium term note
January 2001	Review of the listing rules
June 2001	Safaricom bond launched Ksh 4 billion medium term note
	With the budget, all companies seeking listing on NSE to pay 27% corporate tax instead of 30% for the first three years of listing and also to have amnesty from previously undeclared profits on condition that full disclosure is maintained in the first one year after listing
October 2001	ICDC launches its public share issue
November 2001	14 November: MSC begins official trading
	20 November: SNG first right issue
	30 November: EA community legislative assembly is launched by EA heads of state
December 2001	20 November: ICDC floats additional new shares
January 2002	2 January: CMA under section 11(3) (L) of CMA 200, cancelled listing of Theta group, Regent undervalued Asset Africa Fund, Pearl Dry cleaners, and Lonrho Motors. Also fixed securities for KPCU, Marshalls, Kenya Orchards, SNG, Chancery Investment, Lonrho Motors, hutching Biemer, and Pearl Dry cleaners
	Total launches its right issue
March 2002	Kenya Airways shares introduced on the official list of Uganda Stock Exchange
April 2002	CMA announces the approval of new NSE trading and settlement rules with amendments where block trades were revised upwards from Ksh 3 million to 50-200 million
May 2002	12 May: Consultative meeting in Nairobi hosted by NSE and CMA to discuss proposals of the committee for presentation to the finance ministers
	CFC Financial Services Limited allowed to operate as an Investment bank without taking deposits to provide investment advisory services
July 2002	Any new listed company with an initial listing of at least 30% of its share capital allowed enjoying a corporation tax rate of 25% for a period of five years
	New foreign investors' regulations where the locals have 25% minimum reserve of the issued share capital with the balance 75% becoming a free float for all classes of investors. This applies to IPOs and GOK privatizations
August 2002	Shareholder agreement for NSE, CMA, AKS, CMA Investor compensation fund and nine institutional investors through the Capital markets Challenge Fund came together as investors in Central Depository and Settlement Corporation (CDSC)
October 2002	Hak Securities allowed operating as an investment bank after fulfilling the requirements

Appendix: Summary of institutional and policy changes

	Initiation stage (1920s-1953)	**Formalization stage**		**Revitalization stage (1989-1999)**
		(1954-1963) pre-independence period	(1964-1988) Indigenization policy	
Regulatory system	Informal regulatory system	Self-regulatory system		Statutory regulatory system
Trading system	Call auction coffee-house forum trading system			Call auction trading floor forum trading system
Stockbrokers	Non-specialized	Specialized stockbrokers (6)		Specialized stockbrokers (20)
Foreign investors	Dominating foreign investors trading	Restricted foreign investors trading		Relaxation of the restrictions on foreign investors trading
Control of listed firms	Dominating foreign controlled listed firms	Listing of local controlled firms, decreasing proportion of foreign controlled listed firms		Locally controlled firms dominating
Taxation policy	Non-controlled policy regime	Discriminative taxation policy regime		Incentive based taxation policy
Securities traded	Non-diversified			Introduction of bonds and commercial paper
Market scope	East African Community (EAC)		No EAC market	Proposals for EAC and beyond
Political regimes	Pre-independence	Post-independence		
Macroeconomic policy regimes	Un-controlled regime		Controlled policy regime	Decontrolled Policy regime

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