

**EVALUATION OF FACTORS AFFECTING THE PERFORMANCE OF
STOCKBROKERS IN KENYA**



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**A Research Project Submitted To the Graduate School in Partial Fulfillment for the
Requirements of the Award of the Degree of Master of Business Administration of Egerton
University**



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DECLARATION AND APPROVAL

Declaration

This is my original work and has not been submitted to any other institution of higher learning.



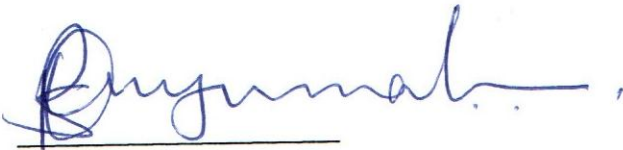
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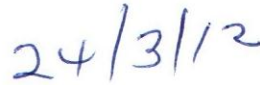
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DEDICATION

To my parents, Rachel and the Late Benson Dominic Okeri for all the sacrifices they made while raising me. To my loving brother, Maotsetung Maobe for schooling me. To my much loved sons Levi Machogu and Mao Maobe, my source of fortitude. To you all, I lovingly dedicate this project.

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The project relied on the support of a long list of friends and colleagues. My debts reach back to two extra-ordinary supervisors: Dr. Owuor and Dr. Onyuma. Many of the theoretical perspectives in this proposal are derived from their classes; writings and personal communications. Their deep respect for good writing and disciplined thinking set the standards to which I have aspired. To my loving husband Obed Oroko who provided insight, perspective, meaning and faith. Most of all to the Almighty God who makes me lie in green pastures.

ABSTRACT

The study aimed at empirically evaluating the factors that affect the performance of stock brokers in Kenya. The specific objectives included: to characterize the stockbrokers in Kenya, to establish the performance of stockbrokers in Kenya, to establish the factors affecting the performance of stockbrokers and determine how the identified factors influence the performance of stockbrokers in Kenya. The study carried out a survey of nineteen stockbrokers, targeting the operations supervisors of the selected stockbrokers. It employed the use of a structured questionnaire to collect primary data which was analysed using descriptive statistics (means and percentage frequencies), chi square, factor analysis, as well as inferential statistics (correlation and regression analysis) were used. This was to determine the influence of the factors affecting performance of stockbrokers in Kenya. The results from data that was analysed were presented in frequency tables, graphs and pie charts. On the basis of the study objectives, the results supported the following summary results: firstly, the effectiveness of the Boards of Directors of the majority of stockbrokers was very low especially in critical areas such as integrity, and decision-making. The study further established that stockbrokers take three working days to execute orders placed by their clients whereas the ideal durations should be T+1; once an order has been executed, the client gets the report within a day. The study also established that stockbrokers took T+7 days to register investors with the Registrar of Companies. The results from the study also showed that stockbrokers achieved higher performance in terms of client base, growth and expansion. However the stockbrokers achieved low performance in sales revenues and efficiency of operations. In addition to that, regulatory compliance, governance, financial management and risk management were the factors that significantly affected performance of the stockbrokers.

The study recommended: the establishment of paying interest on clients. The study also made recommendations that, there should be improvement of the physical infrastructure and particularly the telecommunication infrastructure, improvement in reliability, accurate and timely executions of trading orders, advice on undue risks by stockbrokers and on-line trading by stockbrokers. Finally concerning governance, there was the need to restructure stockbrokers from family ownership to limited companies and the market also required restructuring to enhance stockbrokers operational performance.

TABLE OF CONTENTS

DECLARATION AND APPROVAL.....i

COPYRIGHT.....iii

DEDICATIONiv

ACKNOWLEDGEMENT.....v

ABSTRACT.....vi

TABLE OF CONTENTSvii

LIST OF TABLESx

LIST OF FIGURESxi

CHAPTER ONE:.....1

1.0 Introduction2

1.1 Background of the study2

1.2 Statement of the Problem4

1.3 Objectives of the Study4

1.4 Research Questions4

1.5 Significance and Justification of the study.....5

1.6 Scope of the Study5

1.7 Limitations of the Study.....5

1.8 Definition of Terms.....6

CHAPTER TWO:.....7

LITERATURE REVIEW7

2.0 Introduction:.....7

2.1 Stock Broking in Kenya.....7

2.2 Trends in Stock Broking8

2.3 Factors Influencing Operations and performance of Stockbrokers12

2.3.1 Management Quality.....13

2.3.2 Corporate Governance13

2.3.3 Accounting Quality14

2.3.4 Regulatory Compliance14

2.3.5 Business Infrastructure.....	15
2.3.5.1 Robustness of the IT systems.....	15
2.3.6 Risk Management	16
2.3.7 Financial Management.....	17
2.4 Empirical Studies.....	20
2.4 Conceptual Framework.....	28
CHAPTER THREE:	31
RESEARCH METHODOLOGY	31
3.0 Introduction.....	31
3.1 Research Design.....	31
3.2 Population of the Study.....	31
3.3 Sampling Procedure and Sample Size.....	32
3.4 Data Collection.....	32
3.5 Reliability and Validity of Research Instruments	32
3.6 Data Analysis	33
CHAPTER FOUR:	35
RESULTS AND DISCUSSIONS.....	35
4.0 Introduction.....	35
4.1 Description of the Stockbrokers.....	35
4.1.1 Classification of the Stockbrokers	35
4.1.2 Stockbrokers' Number of Years in Operation.....	36
4.1.3 Types of Services Offered by the stockbrokers.....	36
4.2 Characterization of Stockbrokers.....	37
4.2.1 Number of Board of Directors	37
4.2.2 Mode of Appointment of Directors.....	38
4.2.3 Criteria for Appointment of Directors.....	39
4.2.4 Composition of the Board Members by Professional Training	40
4.2.5 Level of Effectiveness of the Board of Directors.....	41
4.3 Operations and Performance of the Stockbrokers	42
4.3.1 Average Waiting Periods to Execute Sale/Purchase Orders	42

4.3.2 Duration for Receiving Sale/Purchase Reports by Clients	44
4.3.3 System of Payment by Clients	44
4.3.4 Whether Money Deposited Earn Interest during the Waiting Period	45
4.3.5 Duration for Registration of Investors	46
4.3.6 Modes of Receiving Market Information by Clients	46
4.3.7 Level of performance among Stockbrokers	47
4.4 Factors Affecting the Performance of Stockbrokers.....	50
4.4.1 Effect of Identified Factors on Performance of Stockbrokers	50
4.4.2 Influence of Identified Factors on Performance of Stockbrokers.....	50
CHAPTER FIVE:	64
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	64
5.1 Summary of the Results	64
5.2 Conclusion	66
5.3 Recommendations	68
5.4 Follow-up Research	69
REFERENCES.....	70
APPENDIX A: LETTER OF PERMISSION TO COLLECT DATA.....	73
APPENDIX B QUESTIONNAIRE	74
APPENDIX C.STOCKBROKERS' DURATION IN OPERATION.....	79
APPENDIX D:LICENCED KENYAN STOCKBROKERS.....	80

LIST OF TABLES

Table 1. Classification of Stockbrokers	36
Table 2. Services Offered by Stockbrokers	37
Table 3. Composition of Board of stockbroker by professional training	41
Table 4. Level of Effectiveness of the Board of Directors of stockbrokers	42
Table 5. Average Waiting Period to Execute Orders.....	43
Table 6. Duration for receiving sale/purchase reports	44
Table 7. overall Performance Scores of the Stockbrokers.....	49
Table 8. Level of Performance of Stockbrokers	48
Table 9. Chisquare on differences in performance of Stockbrokers	50
Table 10. Factors Affecting Performance of Stockbrokers	51
Table 11. Factor Analysis of the Factors Influencing Performance of Stockbrokers.....	56
Table 12. Influence of Factors on the Performance of Stockbrokers	57
Table 13. Correlation Matrix of Factors affecting Performance of Stockbrokers	58
Table 14. Regression Analysis on the factors affecting the performance of stockbrokers... ..	62

LIST OF FIGURES

Figure 1: Factors Affecting Performance of Stockbrokerage firms.....	31
Figure 2. Classification of Stockbrokers.....	37
Figure 3. Number of members on Board of Directors.....	39
Figure 4. Mode of Appointment of the Board of Directors.....	40
Figure 5. Criteria for Appointment of Directors.....	41
Figure 6. System of Payment by Clients.....	47
Figure 7. Duration for registration of investors.....	48
Figure 8. Sources of Market Information for Clients.....	49

CHAPTER ONE:

1.0 Introduction

This chapter presents the background of the study, statement of the problem, the specific objectives, research questions, justifications and the limitations of the study.

1.1 Background of the study

A capital Market is any market in which securities are traded. Capital markets include the stock and bond markets. Companies and governments use capital markets to raise funds for their operations; for example, a company may issue an IPO while a government may issue a bond in order to conduct new or expand on-going activities. Investors buy securities in the capital markets in order to extract a return and earn profit on the securities. Capital markets include primary markets, such as IPOs that are placed with investors through underwriters, and secondary markets, in which all subsequent trading takes place.

At the centre of capital markets in Kenya is the existence of NSE. The NSE is an example of an emerging stock market that has been characterised by humble beginnings yet has grown considerably over time. In December 2009 the NSE was ranked 5th in Africa in terms of market capitalization behind South Africa, Egypt, Nigeria and Morocco. The NSE facilitates the mobilization of capital for development and provides savers in Kenya with an alternative saving tool for funds that would otherwise have been consumed. It also provides enterprises with non-bank source of financing through sale of shares to the public. It provides not only substitution but also diversification of risk to entrepreneurs as they raise capital through equity.

Besides the NSE there is the existence of CMA which was established in 1989 by an Act of Parliament. The authority is charged with overseeing orderly development of Kenya's capital markets. It also protects investors from financial loss from failure of a stockbroker to meet its contractual obligations. Besides that, CMA develops new financial products to

attract investors and other market participants. CMA also as the oversight body gives licences and regulations to the members of NSE who are the stockbrokers.

The first professional stockbroker in Kenya was established by Francis Drummond an estate agent in 1951. He impressed upon Sir Ernest Vasey, the then finance minister of Kenya the need for a stock exchange in East Africa. In 1953 after making a proposal to London stock exchange officials, they accepted and recognised the establishment of NSE. During this research Kenya had nineteen licensed stockbrokers and investment banks that are family owned and run businesses, with the exception of a few that have over the years hired professional management teams. There are also those that have been bought out by financially sound institutions. The latter include Renaissance Capital that have bought a seat previously held by Francis Thuo and Partners, NIC Capital that bought out Solid Investments Securities. Other professionally run stock brokers are: CFC Financial Services and National Industrial Capital both of which are members of banks that are publicly listed.

Stock broking firms link the investing public to the Nairobi Stock Exchange. This is because individuals currently cannot directly place an order on the NSE to buy or sell shares. The NSE is composed of these stockbrokers who provide the environment or market where shares can be traded. Generally, the stock market plays an important role in mobilizing savings thus improving economic development. Besides this, it also helps enhance the inflow of international capital and therefore facilitates government's privatization programs.

Investing at the NSE involves the identification of a stockbroker with whom an investor opens a central depository system (CDS) account. This CDS account is to facilitate the easy and electronic transfer of shares when an investor makes purchases or sales order.

The CDS Company usually will send by ordinary mail a statement giving a summary of transactions made through an investor's account every month. On their part, the stockbrokers give investors advice on where to invest in the stock market for a commission.

Stockbrokers draw closer together under the Kenya Association of Stockbrokers and Investment Banks (KASBI), an umbrella body which serves their interests and also addresses issues affecting them. The stockbrokers have lately experienced numerous challenges although there have been financial reforms and the adoption of innovations that are meant to improve efficiency and provide healthy operations of stockbrokers. The reforms put in place have not been successful following the collapse of three stock broking firms. This trend has dominated the period running from 2007 to 2009 during which investors' confidence of the stockbrokers remained low.

One of the fundamental pillars of a well built securities exchange is the existence of strong and efficient stock broking firms. This helps build investor confidence, and security of investments. The capital markets regulator can easily be equated to central bank in terms of its mandate and duty. While Central Bank of Kenya (CBK) endeavours to ensure activities of commercial banks and monetary policies are under check, Capital Markets Authority (CMA) helps stockbrokers adopt regulations that will spur confidence both in the local and foreign investors.

The NSE has had a low number of stock broking agencies since its formation in 1954. This has in effect created a cartel of a few players in the industry and left investors with a limited choice of the stockbrokers to choose from. The end result of this is that investors have been charged exorbitant fees by these cartels when they are managing their accounts on a discretionary basis (private fund management). However for the normal transactions, CMA determines the rates stockbrokers should charge their clients as commission.

There are examples from across the world on stockbroking houses that have collapsed thereby exposing its investor to financial losses. As an example, in Australia, the Securities Association of Australia (2001) noted that a Melbourne –based broking house Opes Prime Fund was put under receivership in 2008 owing more than \$ 1 billion to secured creditors including ANZ Bank and Merrill Lynch and leaving about 1200 investor clients facing potential losses totalling to hundreds of million dollars. There are

also examples from Kenya where Francis Thuo, Nyaga Stockbrokers, Ngenye Kariuki and Discount Securities Ltd have also been declared bankrupt. Therefore if Kenya hopes to achieve its vision 2030 then stockbrokers need to adopt better codes of practice.

1.2 Statement of the Problem

The stockbrokers in Kenya perform an important role in the capital market by facilitating trades for all categories of investors. Their role as intermediaries between the stock market and investors is critical in developing a capital market structure that is fair and stable. While much attention in research has been on the history of the Nairobi Stock Exchange and its efficiency, there has not been much research about the factors that affect the performance of its members (stockbrokers). Again, given the recent collapse of four stockbrokers and the reforms issued by CMA to the stockbrokers regarding capital requirements, management and disclosure, it was necessary to assess their performance. The study aimed at empirically evaluating the factors that affect the performance of stockbrokers in Kenya.

1.3 Objectives of the Study

The main objective of the study was to evaluate factors affecting the performance of stockbrokers in Kenya. The specific objectives were:

- (i) To classify and characterize the stock brokers in Kenya.
- (ii) To establish the performance indicators of stockbrokers in Kenya
- (iii) To evaluate the factors affecting the performance of stockbrokers in Kenya.
- (iv) To evaluate how the identified factors are influencing the performance of stockbrokers in Kenya.

1.4 Research Questions

- (i) What are the characteristics of the stockbrokers in Kenya?
- (ii) What are the performance indicators of stockbrokers in Kenya?
- (iii) What factors affect the performance of stockbrokers in Kenya?
- (iv) How do the identified factors influence the performance of stockbrokers in Kenya?

1.5 Significance and Justification of the study

The study was significant because of the following reasons. Firstly its findings would be used by the management of stock broking firms to improve on their performance and be able to prevent them from imminent collapse. Secondly, the government will also benefit since it would formulate policies that will guide stockbrokers in their operations. On the other hand information from this research will also be used by the government in setting standards that will forestall the collapse of stockbrokers. Finally, researchers and scholars will benefit from the study as a source of lead information to other areas of study.

1.6 Scope of the Study

In order to obtain a focused and comprehensive analysis, the study involved those stockbrokers registered and operating in the Nairobi stock exchange. If reference was made to the other stockbrokers that are not in Kenya, it was purely with the sole intention of corroborating evidence in the other studies elsewhere.

1.7 Limitations of the Study

The results of the study were based on factor analysis of perceptions-ratings of factors identified by Information and Credit Rating Agency (ICRA 2004). The factors, though not exhaustive were broad enough to cover all areas of operations of stockbrokers. Moreover, it is quite possible that the findings will tend to be biased as respondents who participated in the study came from stockbrokers of various sizes. If we keep this limitation in mind, the findings are still very useful as they can serve as research leads and thus help researchers understand various factors affecting operations and performance aspects of the stock markets. In addition, it was not possible to collect quantitative information especially on profitability of the stockbrokers except for two stockbrokers and the study relied mainly on the qualitative data provided by the respondents. This is because during this research stockbrokers were not required by law to publish their financial statements.

1.8 Definition of Terms

Performance:

The word performance has been used in the study to mean operational performance of stockbrokers.

Stock broker:

This term refers to firms that sell and buy stock on behalf of a client; the broker works as an agent matching up stocks for buyers and sellers. This word in the study was be to refer to both licensed stockbrokers and investment banks that are members of the Nairobi Stock Exchange.

Stock market:

This is a market for trading of publicly held company stocks and associated financial instruments.

Liquidity Risk:

The financial institutions face liquidity risk when they fail to meet their financial obligations as they fall due.

Market Risk:

Generally, financial institutions face market risk due to adverse movements in interest rates and exchange rates, changing tax policies, changing prices of investments and trading activities in the securities market.

Operational Risk:

This means the possibility for the stockbrokers to face risks due to lack of experienced staff, system failures, wrong management techniques and procedures.

T+1, T+2:

This refers to settlement date of a security transaction and denotes that settlement on a transaction occurs on a transaction date plus one day, plus two days or plus 3 days.

CHAPTER TWO:

LITERATURE REVIEW

2.0 Introduction:

The chapter presents a review of various related literatures under the following subjects/themes;

2.1 Stock Broking in Kenya

The Stockbroking industry in Kenya has grown over time, the industry is regulated by Capital Markets Authority (CMA). The authority was established in 1990 through CMA Act (Cap 485A). It is the oversight body that is needed to keep stock brokers in check; its creation was promoted by NSE to bring an orderly and transparent market which could also take care of investors' interests. CMA cushions investors by operating a comprehensive fund to compensate them from financial loss, as a result of failure of a licensed stockbroker, to meet its contractual obligations.

CMA Annual Report of (1997/98) noted that the compensation fund for investors is financed by every licensed stockbroker who maintains with NSE an irrevocable bank guarantee by a commercial bank for Kshs.1.5million. The funds could be used to settle inter-broker claims in day to day unsettled trades. NSE too is required to maintain another level of compensation paid by buyers and sellers of securities at a rate of 0.01% of the consideration; this fund is used when the bank guarantee amount is not adequate. CMA also requires buyers and sellers to pay 0.01% of the consideration towards the compensation fund. This fund is accessed if the first two are depleted and the licensed broker is bankrupt legally. The research will evaluate how regulations are affecting operations and performance of stockbrokers in Kenya.

Besides that in the NSE Annual Report of (1997), it was noted that self regulation in stock broking industries is of great importance; these rules are efficient as they are enforced by the people close to the centre of the activity. Self regulations are also widely accepted as being necessary and are quickly adjusted from time to time to suit needs of

stockbrokers. They are mostly preferred because they are cost effective. The study however will depart from the afore-mentioned to evaluate whether compliance to set regulations affects stockbrokers' performance in Kenya.

Furthermore, NSE conducts induction courses to stock brokers with the objective of introducing the concepts and issues pertinent to the market including: trading rules, delivery and settlements, transfer registration process, back-room operations, client rights and complaints and automation. The study will however, evaluate if stockbrokers are implementing the training and how it affects their operations.

2.2 Trends in Stock Broking

The securities market of both the advanced industrial and developing market economies have undergone dramatic changes lately. This change has taken the form of both globalization and integration of these markets thereby creating internationalised markets out of purely national ones. While this has been heralded as a boon to the investment community, it has created fundamental challenges to the industry as competition and global economic meltdown.

In the stockbroking industry, the relationship of principal-agent is one of the oldest and most common modes of social interaction. Agency relationship arises when the agent acts for, on behalf of, or as a representative for the other, designated as the principal. Stockbrokers act as the agents to the investing public which is their principal in execution of trades at the NSE.

According to Liaw (1999), the business of investment banking is undergoing radical reshaping. It is trending towards globalization and a one-stop shopping and consolidation is the wave of the future. One of the ways stock broking firms are using to stay afloat is by going through a consolidation phase. The banks that were independently undertaking their own operations have now integrated investment firms. For example, Citigroup became an investment bank player when it merged with Travellers and its Salomon Barney subsidiary back in 2000. This is also an emerging trend in Kenya, for example in 2007 NIC Bank integrated with Solid Investments Limited and formed NIC Capital

Limited. On its part CFC Bank has a stock broking division called CFC Financial Services.

Stockbroking firms have retail operations to allocate security issues all over the country. The industry also has institutional asset managers, pension and fund managers investing on behalf of their clients. They are moving away from commission -based ways of making money to fees- based ways. They are doing this by having private operations that cater for the wealthy investors. This practice is meant to help them improve their liquidity profiles amidst the global financial crisis.

In relation to the afore-mentioned, the number of security firms in China is coming down because of the tight controls on its securities industry and the poor performance of china's stock market after the global financial crisis in the year 2000. In relation to the reforms in the securities' industry, the Chinese government injected capital to revitalize the industry ailing from liquidity problems. Many local security firms suffered heavy financial losses because they offered guarantee for higher returns to investors which proved impossible to honour. As a result, the government of China realised that low investor confidence would affect performance of the stock market. In its first stage of a broad package support for the industry, it provided loans to Shenyin & Wanguo Securities and Huaan Securities in mid- 2005 (Chan et.al,2007).

The sentiments as illustrated above regarding China's securities market are fundamental to this study. The study takes note of the fact that China's stock broking firms are facing constraints in their operations due to liquidity problems, the research will go further to establish many more factors that play a part in affecting performance of stock broking firms in Kenya.

An example here in Kenya was where KASIB previously called upon the Central Bank of Kenya to consider lending to investment banks. These sentiments have been practiced in the U.S.A where recently, there was a bail-out of Bear Stearns Investment Bank by the

Federal Reserve Bank. Bear Stearns was faced with imminent collapse owing to the sub-prime mortgage crisis that hit investment banks last year, prompting the crafting of a bail-out plan by the bank and the Morgan Chase Investment bank in May 2007 (Alex, 2008).

According to Chan *et al* (2007), the writer's sentiments as illustrated earlier regarding China's securities market are fundamental to this study. The study appreciates the fact that China's stock broking firms are facing constraints in their operations due to liquidity problems, the research will go further to establish many more factors that play a part in affecting performance of stock broking firms in Kenya.

According to Scarlet (1999), the stock broking industry in Australia can be characterised in terms of change drivers currently affecting the business environment. A number of changes were occurring in the industry as global competition, redesigning of business processes, new financial products and services were being introduced rapidly. Consequently, all these changes were creating a dynamic situation in the industry because it is facing increasing competition both from home and abroad. The industry was tending towards globalization and a one-stop shopping, and consolidation was the wave of the future. Investors too were looking across for international securities so that they can diversify their investment risk. Scarlet also noted that, the US market was also mature, and to some extent over-banked, therefore all major investment banks have expanded abroad. This research benefited from this findings but it concerned itself with stockbrokers and explored the factors affecting their performance.

The collapse of Bear Stearns, one of Wall Street's oldest and among the most respected brokerage houses, triggered fear and turmoil on world financial markets. For many investors, it reinforced a negative circle of failing US interest rates, a shrinking dollar and rising risk. The trend was replicating in the Kenyan stock market where the stockbrokers such as Discount Securities, Nyaga Stockbrokers, Francis Thuo and Ngenye Kariuki had been suspended from trading in the market.

In Kenya, the stock broking industry with the NSE has had an incredible performance from 2002 to 2007. The main NSE index rose 817% in dollar terms. The stock market in its competitiveness became one of the best performing in the world. In the investment research firms' report, there were several stock market billionaires. This quick wealth formation created excitement among people who had never invested in the stock market to start buying shares. When Kengen listed its shares in 2006, there were long queues at the stock broking firms. Equally, when Eveready, the battery maker, and Scangroup, an advertising company listed the supply of shares would not equal the demand. This led to oversubscriptions, and by the end of the year 2006, 15billion Kenya shillings got into the market from the listings, thereby leading to the rise of the index by 60%. This trend however changed after 2007 and the share index dropped. (Alex, 2008). In (2006), KASIB reported that close to a million Kenyans now owned shares thereby economically boosting the stock broking industry. A sound economy kept the trend rising, and the government was urged to sell more of its holdings in mature companies so as to boost the secondary share market.

When Safaricom shares were floated in 2008, thousands of Kenyans lined up at the stockbrokers to get a share of the mobile phone company. It was the biggest initial public offer in East Africa. There were calls for its delay over issues raised in relation to a Guernsey-registered entity called Mobitelea, which was investigated in 2007 by a parliamentary regulator over reports that it owned a part of Safaricom alongside Vodafone. It was established that despite the adverse publicity Kenya had received from the post-election violence, both local and international investors had expressed interest in buying the shares (Alex, 2008).

The sentiments expressed about the booming stock broking industry flooded with investors has not been the case lately. NSE has experienced investor numbers drop. The NSE growth has consequently slowed with new issues being under- subscribed. The trend has significantly affected the operations and performance of the Kenyan stock brokers as they have had to retrench some of their staff and cut operation costs. This was because firms depend on the clients' commission to sustain their operations.

2.3 Factors Influencing Operations and performance of Stockbrokers

The factors affecting the operations and performance of stockbrokers have been identified by the Information and Credit Rating Agency (ICRA) of 2004. ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional Investment Information and Credit Rating Agency.

ICRA's rating for stockbrokers provided an analytical framework that focused on the key operational, financial and qualitative factors that are most critical in assessing the overall performance, competitive positioning and its ability to withstand challenging operating environment and service its debt obligations. ICRA's rating methodology is not based on any mathematical formula; instead it involves an in-depth analysis of several qualitative and quantitative factors. In ICRA's view, the analysis of financial ratios alone (based on annual reports) would not be able to capture the entire business risks associated with stockbrokers, unlike commercial banks and non banking financial companies.

The ICRA's rating methodology is not an exhaustive list of the factors reflected in ICRA's rating, as the factors are continuously modified to capture the structural changes in the industry, but it should enable a broking company to benchmark itself on these key considerations used by ICRA while assigning a credit rating. For the rating of a stockbrokerage house, ICRA also considers all other group companies engaged in various capital market related business activities as in ICRA's view, their revenues and business operations would be highly inter-linked. While ICRA would evaluate a broker's performance against all these critical factors before assigning an overall rating, special emphasis may be placed on some of them, depending on the operating profile of the broker being rated and the nature of instrument. ICRA's methodology comprised an analysis of the following factors:

2.3.1 Management Quality

With the dynamic nature of domestic capital market, management quality for the equity brokerage sector is of utmost importance in ICRA's framework for assessing a broker's quality rating. While it's easy for the brokerage houses to scale up their business operations during the booming capital market, in ICRA's view, only strong management would help the company sail through stressful times. ICRA assesses the management quality on the following aspects: -

2.3.1.1 Stability and Experience of Top Management

ICRA's framework evaluated the stability of the top management, their experience in capital market business operations and their track record to successfully respond to changes in industry dynamics. ICRA also analyses a company's ability to attract and retain talent, frequency and quality of the training imparted to the employees and a well laid out succession plan for the top management. A brokerage house with a proven track record of managing the business efficiently through various business cycles, professional management structure, good market reputation and history of fair practices would be viewed favourably by ICRA.

2.3.2.2 Independence of Board of Director

While the independent representation at board level provided a third party perspective and valuable inputs to the company's financial and business strategies and corporate actions, it also helped in protecting a company's stakeholder's interests by assessing the associated critical risks and managing the company's integrity. ICRA's framework analyses the depth of the board of directors, their participation in the Board's meetings, and their independence from the daily operations.

2.3.2 Corporate Governance

ICRA's analysis of corporate governance practices prevalent in a company reflect the distribution of rights and responsibilities among different participants in the organisation such as the board, management, shareholders and other financial stakeholders, and the rules and procedures laid down and followed for making decisions on corporate affairs. The emphasis of ICRA's analysis is on the corporate business practices and quality of

disclosure standards that address the requirements of the regulators and which are fair and transparent for its financial stakeholders.

2.3.2.1 Accounting Quality

Adherence to proper accounting practices and transparency in disclosures are critical attributes, and the extent of the same are assessed while taking a view on the current financial health and potential risk factors of a stockbroker. Specifically, ICRA would examine the factors like quality of audit, quality of disclosures, transparency of accounting policies, accounting policy followed for derivative instruments and proprietary trading, and existence of reporting lines of an internal audit department for evaluating the adequacy of a stockbroker's accounting quality standards.

2.3.3 Regulatory Compliance

The rules and regulations applicable to stockbrokers, besides being statutory, play an important role in curbing aggressive risk taking and in enforcing discipline. The regulatory infrastructure relates not only to the government body that has the power and responsibility to supervise the market, but also includes self-regulatory organizations such as stock exchanges, accounting standards boards, and accounting and auditing professional associations and similar organizations. It also includes their rules and regulations, procedures, and facilities such as stock exchange listing and trading rules or accounting and auditing standards, plus the monitoring and enforcement of these rules.

The ICRA rating methodology not only examines the compliance record of the stockbroker being rated, but also its record of litigation. Specifically, the following aspects, among others, are analysed: compliance with various acts, rules, guidelines and by-laws including the Companies Act. In addition, ICRA examined the stockbroker's history of non-compliance and severity of regulatory sanctions, history of penal action by regulator for violation of norms and promptness in restoration of services. The history of litigation by retail or institutional clients and management attitude towards client-related statutory requirements was also examined by ICRA.

2.3.4 Business Infrastructure

Being a dynamic industry where timely dissemination of information is very critical, the quality of service provided by a stockbroker would depend on its infrastructure. Stockbrokers with poor back-office infrastructure are likely to compromise both on risk management as well as client servicing. Thus, the ICRA rating methodology provided for a close examination of the following aspects: -

2.3.4.1 Robustness of the IT systems

ICRA analyses the adequacy of infrastructure as required to comply with the requirements of regulators/stock exchanges. The adequacy of connectivity with the exchange houses, communication network and their redundancy levels with branches and sub-brokers, system's un-utilised capacity and its scalability, time taken to restore the connection failure, database maintained, policy on disaster house for maintaining clients transaction history and efficient real time margin monitoring system. While stockbroker's existing IT systems may be adequate for current scale of business, ICRA also evaluated the stockbroker's focus on continuous improvement and ability to scale up its IT systems in line with the business growth. Stockbrokers with proven track record of scaling up their business operations without any major disruption due to technical snags would perform better in ICRA's overall assessment.

2.3.4.2 Adequacy of Management Information System

In ICRA's view; robust Management Information System (MIS) plays a crucial role for a stockbroker in monitoring branch efficiency, utilisation of the capital placed with the exchange houses, monitoring dealer limits, client limits besides ensuring smooth running of the normal business operations. Accordingly, ICRA's framework would evaluate the quality and timeliness of the reports generated through the MIS system and its relevance for the stockbroker in improving upon its business performance.

2.3.4.3 Strength of Back Office Operations

Back office operations serves as a back bone of a stockbroker for ensuring efficient servicing of the client while mitigating the risk by assigning dealer-wise, sub-broker-wise and client-wise exposure limits. Stockbrokers with poor back-office infrastructure are

likely to compromise both on risk management as well as client servicing. The systems deployed have to be strong enough to be able to capture and report all the transactions of clients without any error. A stockbroker's back office operation also helps in capturing the client's transaction history on the basis of which a client can be categorized into various segments and accordingly a more customized service can be provided to the client. ICRA's evaluation of a stockbroker's back office operations comprises of assessment of the processes, quality of the data captured, storage facility, and the extent of automation.

2.3.5 Risk Management

Stockbrokers are inherently considered to be risky with extreme volatility possibility in the capital market. From the rating perspective, it is of prime importance for a stockbroker to maintain a separate risk management team independent of the business sourcing and to follow a standardized and policy based risk management procedures. ICRA evaluates the adequacy of stockbroker's risk management systems on the following parameters: -

2.3.5.1 Risk Governance

ICRA's framework evaluated the participation of directors (including external and non-executive) in reviewing policies and control effectiveness. It also evaluated clearly laid out individual responsibility for monitoring and reporting risk. ICRA also evaluated documented policies and standard procedures, integration of risk provisions in budgeting, capital allocation for various lines of business and independency of the risk management team. In addition to the above factors, companies doing regular stress testing and upgrading their systems accordingly are also viewed favourably by ICRA.

2.3.5.2 Management of Market Risk

The analysis of stockbroker's exposure to market risk encompasses the mix of proprietary trading versus customer-oriented trading. It further involves the variability of the trading returns, quantification and reporting of the market risk. Besides analysing the market risk associated with the proprietary trading, ICRA also evaluates the market risk of the stockbroker in terms of setting up and monitoring the client-wise exposure limits. ICRA

also evaluated the quality of the collateral placed by client as margin, allowable time to take the delivery of the stocks in cash segment and margin cover maintained on funding clients. A stockbroker with small proprietary book as a proportion of overall asset size, risk based trading policy, policy based on conservative exposure limits and margin cover would be viewed favourably by ICRA.

2.3.5.3 Management of Credit Risk

According to ICRA (2004), credit risk analysis evaluated the credit appraisal procedures for approving new clients and new franchisee. It also evaluated the initial deposit requirement, setting up of country-party limits, margin call policy, and efficiency of the follow ups in case of margin shortfall. ICRA further evaluated stockbrokers on procedures for approving under-writing deals or merchant banking investments, and concentration of business with any particular client.

2.3.5.4 Management of Operational Risk

As a routine business operation, stockbrokers are engaged in processing large number of transactions and transferring huge amounts of cash and securities every day. For executing such large data based transactions, it is necessary to have efficient and smooth running internal control system. ICRA's analysis on stockbroker's exposure to the operational risk would be based on the adequacy of the internal control and information systems, training level of the manpower, history of operational failure, ability to restore the operation system, availability of the back-up system, and adequate systems to implement market and credit risk policies.

2.3.6 Financial Management

With the booming capital market over the last few years, stockbrokers have significantly improved upon their financial performance. Riding on the buoyant capital market, many stockbrokers have also raised capital either through IPO route or through private equity placement over the past years. However with the significant market correction in January 2008, the environment has become very challenging for the stockbrokers and subsequently their profitability has come under pressure. The ICRA's framework of assessing the stock broker's business and financial strength evaluates the stockbroker's

ability to scale up its business operations in the booming market while ascertaining the sustainability of its business operations in stressful times. ICRA analyses a stockbroker's business and financial strength on the following parameters: -

2.3.6.1 Earning Strength, Profitability and Stability

ICRA's framework examines the company's ability to maintain its profitability through economic swings and ability to generate adequate return on net worth. In order to capture a company's scale of operations, franchisee strength and competitive positions ICRA analyses pre-tax earnings which in ICRA's view also provided cushion to absorb losses in stock broking business which is exposed to the variations of the capital market. For reducing the effect of cyclical fluctuations as well as any one time losses or gains, ICRA's standard approach for computing pre-tax earnings is to use weighted average of pre-tax earnings from last three years, with the most recent year receiving higher weightage. In order to analyse the company's ability to generate revenues while keeping the expenses under check, ICRA analyses pre-tax margins.

A stockbroker having a large owned retail network, expensive manpower, high lease rentals, inefficient processes is expected to have lower pre-tax margins as compared with any other player having franchisee operated retail network or having presence in only institutional equity broking, diversified earning profile utilising the resources and less expensive man-power. Stockbrokers with large proportion of variable cost would be more comfortable in protecting their pre-tax margins in stressful times. According to ICRA (2010), the several indicators of financial management of stockbrokers include: asset quality, capitalisation profile and liquidity management.

2.3.6.2 Asset Quality

It is of prime importance for the stockbrokers to maintain stringent risk management framework and monitoring systems in order to limit any losses associated with a capital market related business operations. In order to capture a long track record of maintaining good asset quality, ICRA's framework evaluated the quantum of provisions on bad debts, write offs of bad debts and error trades on stock broking business as a percentage of company's net worth and also as a percentage of operating income for past several years.

However, in the absence of any stringent regulatory credit provisioning policy, it is difficult to assess the company's asset quality on the basis of the financial indicators alone. For the same, ICRA also analyses the track record of the stockbroker in maintaining sufficient margin cover of accepted collateral on their top clients during the highly volatile period.

2.3.6.3 Capitalisation Profile

Given the volatile nature of the equity broking industry, a stockbroker needs to have an adequate level of capital to be placed with the exchange houses for margin requirement. Since sudden liquidity requirement is a possibility (for instance, through higher margin requirement by the Exchange Houses during volatile market and also during the expiry week for every month), the ability to raise funds quickly is a distinct positive for a stockbroker.

In analysing a stockbroker's adequacy of funds, ICRA evaluated the parameters like financial flexibility in the form of availability of various sources of funding, quality of capital, committed bank lines for alternative liquidity, average utilisation of the capital placed with the exchange houses, collection period from the clients and capital needs of off-balance sheet transactions.

Stockbrokers with a proven track record of maintaining sufficient capital with the Exchange House and with no history of shutdown of broking terminals or of being put in square-up mode on account of margin shortfall would be viewed favourably by ICRA. The rating framework also evaluated stockbroker's capital adequacy for the current business operations and its ability to raise further funds for business expansion. In ICRA's view, strong capital levels provided necessary cushion in terms of absorbing any delay in collections from clients and losses during bad capital market. However, ICRA evaluated the stockbrokers on the basis of free net worth available for the business after adjusting it for risky or ill-liquid investments.

Stockbrokers are expected to have low external borrowings, at-least on the balance sheet, as they normally place bank guarantees with Exchange Houses for margin requirement.

Therefore in the analysis of stockbrokers' actual gearing, ICRA also considered the bank guarantees as a part of external debt programme.

2.4 Empirical Studies

A study by Serri (2004), points out that over the last decade, stock markets have received a great deal of attention, both as a source of financial development and ultimate economic growth. The depth of a stock market is captured by its capitalization and this is an important measure of one aspect of financial development. Financial development from the stock market is enhanced by institutions, as legal systems characterised by existence of transparency, contractual enforcement and protection of property rights. These are crucial to the development of capital markets.

Pagano *et.al* (1993), also argues that existence of transparency and regulations increases investor confidence and has a large impact on the financial markets. La Porta *et al.* (1997) also shows that legal traditions influence the degree of protection of creditors, shareholders and efficiency of contract enforcement. These ultimately affect financial systems. They highlight that not only the quality of legal framework but also effectiveness of legal institutions are crucial for financial development. Better institutions tend to reduce return volatility in emerging markets. Similarly, the importance of institutional quality shows that total stock market returns are positively correlated with respect for law, the lack of government corruption, the efficiency of the judicial system and the quality of accounting standards. Whereas their studies are on the stock market as a source of financial development in emerging markets, this study will evaluate how regulations affect the performance of stockbrokers in Kenya.

A study by (Munga, 1974), established that 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 investment 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

According to Munga (1974), Stock broking firms require extensive regulations to help them in their operations. In Kenya the Capital Markets Authority is the body charged with regulating the financial market so as to protect investors' rights. These rights include: receiving account statements that are easy to understand from brokers, getting their cheques after sale in good time, discussing account problems with compliance department of the firm, receiving complete information about commission fees and to fully understand terms of transactions.

According to Oditah (1996), regulating investment firms helps in preventing systemic risks. However, a more typical reason is to stop criminals from theft because the financial services industry offers special attractions for theft. While most people would say that such thefts from the financial services are left to the normal criminal and civil law, laws against theft cannot be relied on; lockers need to be fitted in the same way to prevent them. It makes sense for preventive action so as to ensure that people who cannot meet certain basic standards of propriety are kept out of the financial services market. In line with oditah (1996), the study will evaluate many other factors affecting stockbrokers operations.

According to Khoury (1990), the regulation of financial institutions is an integral part of every national financial market. The most recent disclosure in the financial market literature has centred on regulatory reforms. Issues that were raised are: there should be optimal level of regulation, regulation's effect on the firms' competitiveness, their efficiency, macro-economic variables and the firms' innovation. These arguments borders on the study's position to determine whether issues of regulations are affecting

operations and performance of stockbrokers. The findings have not extensively dealt with the effect of regulations on the sustainability of stockbrokers in Kenya. Therefore this study would address the gap.

According to Muyundo and Kibua (2004), the factors that are responsible for the downward trend in the NSE include: unstable macroeconomic environment, inadequate product innovation, insufficient and weak regulatory framework, poor governance and lack of integration with other stock exchanges within the region. Generally, poor formulation and inadequate implementation of policies are the key causes of the decline in the performance of the NSE. However the study will evaluate those factors affecting the performance of stockbrokers who are members of NSE.

In addition to that, the removal of restrictions on foreign participation in any of major securities market has contributed to globalization trend. This has been part of a process of liberalization and deregulation of advanced markets and economies generally. Liberalization has facilitated market access and attracted new investors. Beginning with the deregulation of commissions by the New York Stock Exchange in 1975, the process of liberalization spread globally to the British Securities market, fixed commissions ended, and hence encouraging international investments.

Liaw *et al* (1999), similarly noted that, the main objective of securities regulation were the facilitating capital formation and the protection of the interests of the investing public. When investment firms are well regulated investors are protected, furthermore, integrity and professionalism in the stockbrokers are basic to the success of the stock exchanges.

According to Prentice (2002), the regulations of any sort maybe unnecessary for the rational investor with good information on the risks and returns offered through particular issuers. The market can sort itself out without governmental intervention from acts as: churning, front- running, insider trading, manipulation, concealing information, outright lying and other forms of securities fraud. While the major concern in his study is

deregulation of the market, this research will proceed beyond this, to evaluate if the acts he has mentioned above are a causative factors in the Kenyan stock broking ailments.

In exploring the events of 1929 following the US market crash, (Prentice, 2002), noted that those events eroded much of the faith that had been shown in markets, institutions, and politicians would quickly give way to scepticism. The bankers quickly moved from the pinnacle of public esteem to the bottom. Wall Street legends became symbols of greed, despised in all quarters after a public inquiry into them revealed corruption and lack of proper regulation and accountability.

According to Kofi (1998), in the analysis of the effects of institutional factors on the development of the Ghana Stock Exchange observed that in order to ensure orderly and equitable dealings in securities, there should be good regulations. In addition to that, there should be protection and security of investors and all security markets should operate within the laws and regulations of the country. He noted that the extent of laws enforcement had a direct bearing on the development of the stock market. Moreover, the study found evidence of enforcement of regulations. There was suspension of stock broking firms and imposition of fines. In early December 1995 Databank Brokerage Limited, EBG Stock Brokers and SDC Brokerage were suspended for contravening the rules governing their operations.

The study further analysed information disclosure requirements in the market. It was noted that public disclosure is very important for both pricing and market confidence. The study found out that disclosure policies governing the Ghana Stock Exchange, as enshrined in Legislative Instrument (LI) 1509 were quite comprehensive. The Various regulations under this legislative instrument touched on information to be disclosed to the general public. Subsequently for those firms wanting to list on the exchange, the information disclosure must provide details on, history of the business, capitalization, and distribution of shares; dividend records, fiscal year end and all pending legal matters. Through interviews of the Ghana Stock Exchange officials and stockbrokers, the study

found out that to a large extent all the information disclosure requirements were being enforced by Ghana Stock Exchange.

The Stockbroking industry in general experiences challenges both ethical and financial regarding their operations. Some of these challenges subsequently affect their operations. Reputation is an important issue among investment bankers. Hayes (1997), observed that the stock broking industry is subject to a rigid hierarchy that ties a stockbroker's reputation to its influence in the industry. According to Hayes (1997), those investment firms in the upper brackets in the hierarchy as Morgan Stanley, Merrill Lynch, Salomon Brothers and Goldman enjoy a more prestigious and lucrative position than their counterparts as Wall Street West Inc. The study further suggested that the prestigious investment firms would aggressively defend their place in the hierarchy, even to the point of pulling out of profitable deals if there are ethical issues involved.

According to Keown and Pinkerton (1981), insider trading was widespread and pointed out that about 50 percent of the price gain experienced by a target firm's stock prices occurs before an actual takeover announcement. The literature has ample evidence suggesting insiders can successfully circumvent regulations designed to prevent the exploitation of private information. John and Narayan (1997), further show that disclosure of regulations regarding security exchanges create incentives for informed insiders to manipulate the market. In sum, the above mentioned studies suggest that even the ex-post reporting requirements by SEC do not eliminate the possibility that insiders trade on privileged information to the detriment of investors.

According to Sims (2003), some of the major ethical issues within organisations includes: mistrust, misinformation and disclosure. A number of scandals afflicting Wall Street over the years had created what is referred to as a 'triple-tier who is who' scandals that involve, banks and stockbrokers. Stockbrokers also face a challenge regarding their organisation culture. An organisation culture socializes people, and ethics is an integral part of an organisation's culture. Therefore an organisation's culture conveys to members that certain actions are acceptable even though they are illegal. For instance, when

executives at General Electric, Westinghouse conspired to fix prices for their electrical, the defendant testified that, when they reported to their new jobs, that they found price fixing to be an established way of life and simply fitted in. It had become so common and gone on for so many years until they lost sight of the fact that it was illegal. Unethical behaviours lead to organisations to straying from doing the right things and thereby being unable to recover.

Leadership is a major component of a company's success, most of the organisations that are prone to go under experience poor leadership. Leadership has proved to be a big challenge in the securities market. According to Deturk (1996), leadership is all about understanding an organisational culture, maintaining values, team work and vision. Whether we call it leadership or management, administration or maintenance of the desired goal should be, doing the right things right. In this study we shall evaluate if leadership plays a role in stock broking in a bid to understand how it affects their operations.

According to Okamura (2001), most banks in Japan go bankrupt because they accumulate huge bad debts and this is because bodies charged with the responsibility of monitoring the banks failed. These findings have not specifically addressed bankruptcy in brokerage houses. It is worth noticing that bankruptcy is a big challenge for organisations across the board, and bankruptcy stems from financial distress.

According to Young (2009), investors were incurring huge losses, market indexes cut in half, gains realised from stocks over years are getting lost, and everywhere investors are looking for investments that are worthwhile and with stable returns. Lauren Young (2009), similarly in the Business Weekly noted that investors were failing to know which investment firm to trust. This was attributed to big investment banks that had collapsed due to unethical practices and mismanagement. If clients cannot trust Bear Stearns or Lehman Brothers then it could be hard to trust smaller investment brokers. Investment banks had noted the investors' hesitance as a result of betrayal from Wall Street and had therefore pledged fiduciary. Investors' biggest risk is not the losses they may incur from

the stock market; their biggest risk is bad or unethical practices by stockbrokers. This study will however establish factors that affect operations of stockbrokers.

Abolafia (2001), in exploring the scandal of Salomon Brothers, the leading bond dealer on Wall Street, admitted that traders had systematically rigged the Treasury bond market, the largest securities market in the world. The broker had repeatedly submitted bids in the names of customers who had not authorised them but in truth they were buying on their own account. The scheme was used to buy 46% of the securities in 1990 and 57% in 1991 allowing them to control 94% of the securities offered by the US Government. This could not allow other dealers to get any trades for their clients. During the investigations of this scandal it was further discovered that a majority of the investment firms in the US had engaged in forged deals at the trading floor. The investigations uncovered a practice that was nearly universal in nature; the firms had created crib sheets so that when they lied, they lied consistently. This behaviour while taking place at the USA, of interest to our research is to know if the same manipulations replicate in our stock market amongst the brokers.

In August 2009, a speech by the Chairman of the NSE disclosed that investor confidence with the stock market had dropped. During that time a launch of the Complaints Handling Unit (CHU) was done. Through partnership with stakeholders, the Capital Markets Authority (CMA), Central Depository and Settlement Corporation (CDSC) and Kenya Association of Stock Brokers and Investment Banks (KASIB). The formed CHU would resolve investors' complaints in a quick and efficient way. For the investor, this unit would provide a hassle free way of getting their concerns processed and resolved. The ease of access of CHU via email, fax and mobile phones for those who can't access the internet may play a role in boosting investor confidence. Investor confidence is a two Way Street that requires the stock market players to not only talk to the investors but also get feedback from them. This two way communication enables understanding of challenges that investors face and products they wish to see in the market.

Versluysen (1998), indicated that in markets for publicly offered securities, investor access to information pertaining to their prospective investments was more limited than that of professional intermediaries. Investors can therefore be protected by the compulsory disclosure of financial data and other relevant information relating to the issue of securities.

Pardy (1992), also contended that a company that raises funds from public must be required to disclose information to allow educated investors to make reasoned investment decisions. Such information should be made available at stock broking firms for investors to easily access them. Financial market professionals have access to information that is not widely available. In unregulated markets, the possibility exists that unsuspecting investors will be harmed by those with information not available to the public at large. This is important for the economy because lack of public confidence in securities market would cause the supply of funds to the market to go down. This would deprive the economy of the benefits of a well functioning market.

Kofi (1998), noted that the transparency of trading procedure allows efficiency of the market. Procedures that were not transparent brought suspicion and reduced the rate of investment. On the Ghana Stock Exchange, buying and selling of shares are done through stockbrokers who are licensed to trade on behalf of their clients. The study found that trading on the GSE was quite transparent. There is transparency since stockbrokers fill in a bargain slip in triplicate. One copy is for the stock exchange and another slip goes to the stockbroker making the transaction. This slip has information on price, quantity and the security involved. All brokers interviewed confirmed that there is transparency. Despite these measures, however, one cannot rule out collusion between brokers in price establishment, although there is no evidence of such practice. At the Ghana Stock Exchange, a surveillance unit is set up to monitor operations of all market players.

Further in the study, transaction costs were analysed. Unreasonably high costs affected market development since investors aimed at minimizing cost to increase their returns. Those companies going public through share issue they incur the following costs as;

underwriting fee, legal fee, brokerage commissions, costs of printing prospectus and fees for the Stock Exchange. For the individual investors, the costs they incurred were brokerage commissions.

2.5 Conceptual Framework

The conceptual framework of the study was based on ICRA's rating methodology for stockbrokers. ICRA provided an analytical framework that focused on the key operational, financial and qualitative factors that are be most critical in assessing its overall performance. ICRA also focused on the competitive positioning and its ability to withstand challenging operating environment and to service its debt obligations. ICRA's rating methodology was not based on any mathematical formula; but instead involved an in-depth analysis of several qualitative and quantitative factors.

In ICRA's view, the analysis of financial ratios alone (based on annual reports) would not be able to capture the entire business risks associated with stockbrokers, unlike commercial banks and non banking financial companies. The current rating methodology was not an exhaustive list of the factors reflected in ICRA's rating, as the factors were continuously modified to capture the structural changes in the industry, but it should enable a stockbroker company to benchmark itself on these key considerations used by ICRA while assigning a credit rating. For the rating of stockbrokers, ICRA also considered all other group companies engaged in various capital market related business activities. In ICRA's view, their revenues and business operations would be highly inter-linked. While ICRA would evaluate a stockbroker's performance against all these critical factors before assigning an overall rating, special emphasis was placed on some of them, depending on the operating profile of the stockbroker being rated and the nature of the instrument.

ICRA's methodology comprised of the following factors: management quality (promoters quality, stability and experience of top management, liquidity management, independence of the Board of Director), corporate governance, accounting quality, regulatory compliance, business infrastructure (robustness of IT system, adequacy of management information system, strength of back office operations), risk management

(risk governance, management of market risk, management of credit risk and management of operational risk), financial strength (earning strength and stability, asset quality, capitalisation and liquidity profile).

The stockbroking business is affected by various factors as; management of the firm, its directors' composition and profile of the directors. All these factors highlighted are suggested to affect performance (profitability, client base, efficiency in operations, sales revenue, and growth expansion) of stock broking firms in Kenya. The dependent variables were also subject to extraneous economic factors as interest rates, income and inflation. The relationships between the independent and dependent variables are illustrated in Figure 1.

Independent Variables

Dependent variables

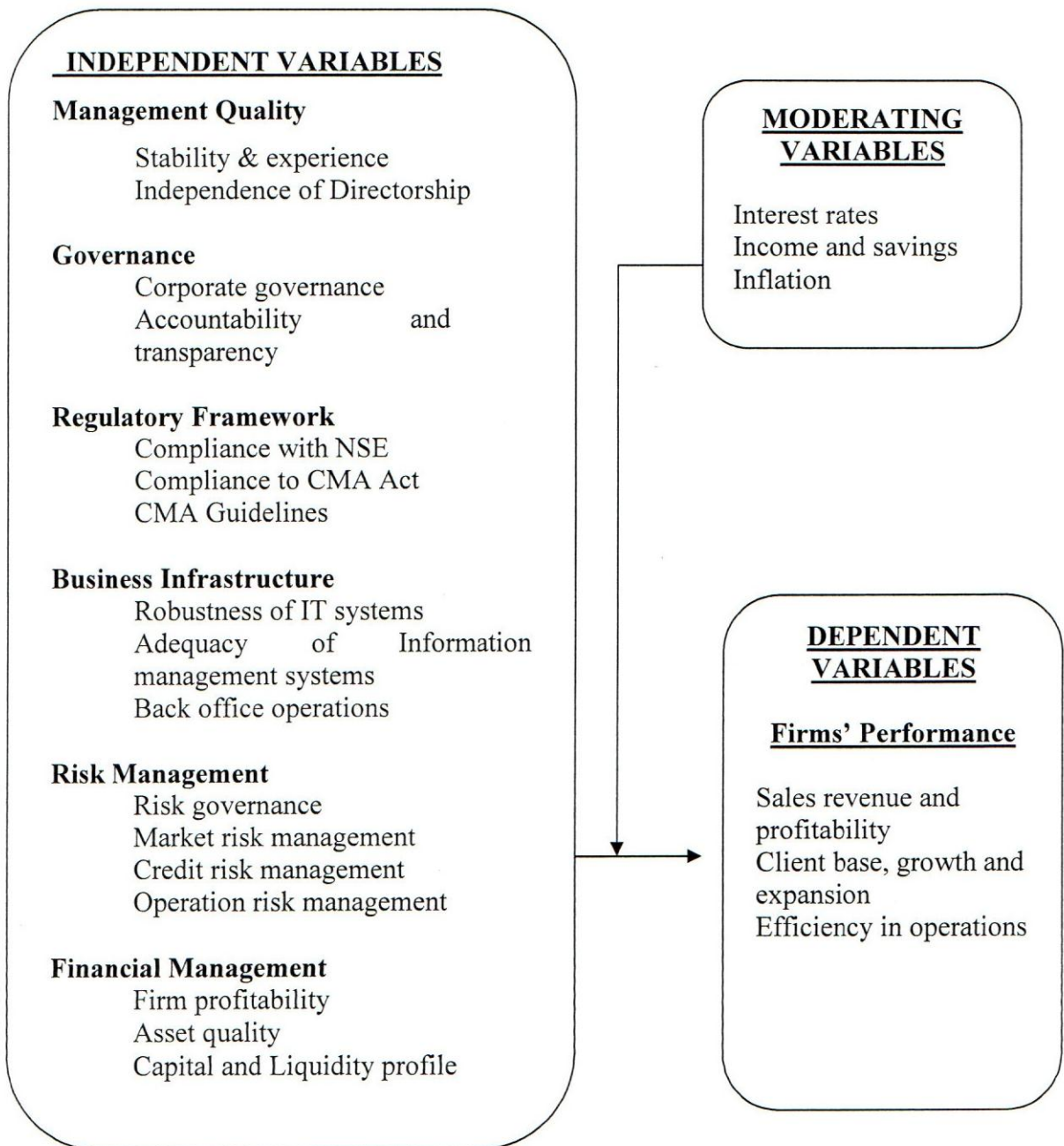


Figure 1: Factors Affecting Performance of Stockbrokerage firms

Source: Modified from ICRA, 2010

CHAPTER THREE:

RESEARCH METHODOLOGY

3.0 Introduction

The chapter presents the overall research methodology used in the study. It covered research design, population and sample size, data collection methods and research procedures as well as data analysis and presentation methods.

3.1 Research Design

The research used survey research design and descriptive and correlation methods of research. The methods estimated the extent of relationship between independent variables with the performance of stockbrokers. The survey made allowance for standardization and uniformity both in questions asked and methods of approaching the subject, making it easier to compare and contrast the answers by the respondents.

The study was mainly based upon the primary data which was collected with the help of pre structured questionnaire targeting various stockbrokers in Kenya. ICRA's rating methodology for stockbrokers provided an analytical framework that focused on the key operational, financial and qualitative factors, found to be most critical in assessing their overall performance. ICRA's rating methodology was not based on any mathematical formula; instead it involved an in-depth analysis of several qualitative and quantitative factors. In ICRA's view, the analysis of financial ratios alone (based on annual reports) would not be able to capture the entire business risks associated with stockbrokers, unlike commercial banks and non banking financial companies.

3.2 Population of the Study

The population of interest in the study comprised nineteen stockbrokers in Kenya. It looked at all the stockbrokers that are in existence and which are all licensed members of the Nairobi Stock Exchange (NSE).

3.3 Sampling Procedure and Sample Size

The study undertook a survey of all the 19 stockbrokers that are in operation in Kenya. In order to achieve this, the study employed purposive sampling technique to select study respondents. The entire population was studied because it was small and manageable. Census method was employed to make conclusions for the entire population.

3.4 Data Collection

The researcher reviewed several literatures on the performance of stockbrokers to draft the questionnaire. The questionnaire was presented to the research supervisors for further improvement. The study was facilitated by use of a questionnaire with structured and open ended questions. There was one respondent from each firm; the operation manager or the line supervisor whenever the operation manager was not available. The operations managers were targeted because the study intended to focus on respondents who will be able to give an overall understanding of the factors affecting the firms' performance. The collection of data took a period of one month. The researcher made personal visits to all the target population. The questionnaire was administered and it took considerations of the research questions of the study. There were nineteen questionnaires and the response rate was 100%.

3.5 Reliability and Validity of Research Instruments

Reliability measures the degree to which a research instrument yields consistent results or data after repeated trials. To ensure reliability, the questionnaire was pre-tested on a few selected respondents from related institutions. The purpose of the pre-test was to refine the instrument so that respondents had no problems in answering the questions, and in reporting and recording data (Saunders et al., 2000; Babbie, 1990). In addition, it helped in obtaining an overall assessment to the questions of reliability of the data that had been collected. In this study, a reliability co-efficient (alpha value) of more than 0.7 was assumed to reflect the acceptable reliability. The Alpha value ranges from zero to one and indicates the reliability of an instrument. The more the Alpha value is closer to one, the more reliable the instrument

Validity refers to the extent to which the instrument collects data that is meant to collect. It is the degree to which results obtained from the analysis of data actually represent the phenomenon under study (Locke, K 2001). In this study, ensuring validity of the data collected involved going through the questionnaires in relation to the set objectives and making sure that they contain all information that enabled it to answer these objectives.

3.6 Data Analysis

The primary data that was collected was analysed with the help of the Statistical Package for Social Sciences (SPSS) computer program (Version 12.0). The level of significance applied was 0.05 to determine the effect of the identified factors on the performance of stockbrokers, Pearson product Moment Correlation Coefficient (PMCC) was used. PMCC is a measure of the tendency of two variables X and Y measured on the object. It's applied to determine relationship among a pair of independent and dependent variables. Its aim was to determine whether the variables affecting the performance of stockbrokers were significant or not. In order to answer other research questions, the study analysed the primary data using descriptive statistics such as frequencies, means, and percentages. Correlation and regression analysis was also applied to determine the best indicators of the stockbrokers' performance. The study used descriptive statistics to describe the characteristics of the stockbrokers. In order to determine the extent to which the identified factors affect performance of stockbrokers, the responses to each performance indicator were scored on a scale of 1, indicating least level, to 5 indicating highest level of application.

To determine the effect of the factors on performance of stockbrokers, factor analysis was used. Factor Analysis is a general name denoting a class of procedures primarily used for data reduction and summarization. The techniques of percentage and weighted average and factor analysis were used to identify the factors that significantly affect performance of stockbrokers. In research, there may be large number of variables, most of which are correlated and which must be reduced to manageable level. The relationship among a set of many interrelated variables are examined and represented with the help of factor analysis.

Correlation and analysis was be used to establish the relationship between the dependent and independent variables while regression analysis was used to establish the influence of the identified factors on the stockbrokers' performance.

The following model was used to evaluate the influence of the identified factors on the stockbrokers' performance.

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + b_6X_6 + e$$

Where; $Y =$ Stockbrokers performance

$X_1, X_2, X_3, X_4, X_5, X_6 =$ Identified factors

$b_0, b_1, b_2, b_3, b_4, b_5, b_6, =$ are their regression coefficients

$e =$ Error term

CHAPTER FOUR:

RESULTS AND DISCUSSIONS

4.0 Introduction

The chapter presents the research findings and discussion of the results with reference to the specific research objectives. The main objective of the study was to evaluate the factors affecting the performance of stockbrokers in Kenya.

4.1 Description of the Stockbrokers

In this section, the analysis focused upon the background information of the selected stockbrokers in Kenya. Such a profile was important since it helped to unravel the factors, which influenced operations and performance of the stockbrokers. The description included: classification of firms, duration in operation and types of services offered by the stockbrokers.

4.1.1 Classification of the Stockbrokers

During the period of the study the results showed that 53% of the total stockbrokers evaluated were classified as stockbrokers. Those classified as stockbrokers dealt only with buying and selling of shares, whereas 47% of the firms were considered investment banks dealing with the buying and selling of shares and also offered; fund management, mergers and acquisition services at the Nairobi Stock Exchange market. This implied that a greater number of stockbrokers were dealing with buying and selling of shares. This was attributed to the capital requirements for the stockbrokers as set out by CMA. Those market intermediaries applying for investment banking licenses were required to increase their capital to Sh250 million from a previous minimum requirement of Sh30 million, while those applying for stock broking licenses were expected to raise their capital to at least Sh50 million from the previous minimum of Sh5 million. In a gazette Notice No 4937, for May 2011, CMA reduced Africa Investment Bank, Drummond Investment Bank, Kestrel Capital (EA), Apex Africa Investment Bank, and Sterling investment banks to stockbrokers.

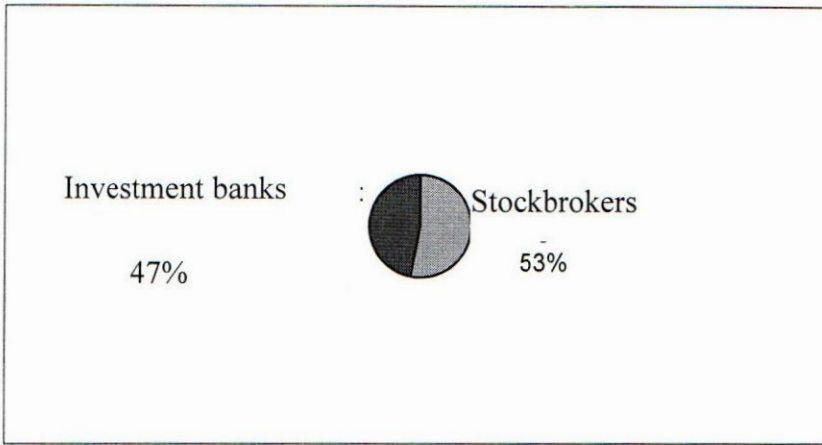


Figure 2. Classification of Stockbrokers

4.1.2 Stockbrokers' Number of Years in Operation

According to the results (Table 1), the stockbrokers have been in operation for an average period of 14 years. The shortest serving stockbroker was found to have been in operation for only 3 years (Kingdom Security), whereas the longest serving company was 60 years old (Drummond). During the period the study was being conducted Drummond Ltd was an investment bank. This implied that stock broking business is not new in Kenya. In reference to appendix 2, stockbrokers in operation for a period of between 10-16 years were 11. Those in operation for 17-60 years were 3 stockbrokers, while those in operation for less than 8 years were four.

During the study however, most of the stockbrokers that had bought seats of fallen brokers from NSE were reluctant to be associated with the parent companies. They indicated to be in operation from the period they started under new management. This implied that since the earlier stockbrokers had liquidity problems and lacked operational efficiency, the new firms wanted to start afresh in the stock market.

4.1.2 Types of Services Offered by the stockbrokers

The results (Table 2) indicated that all the 19 stockbrokers were involved in buying and selling of shares. In addition, 8 of the stockbrokers offered fund management while 5 stockbrokers were involved in advisory and research.

Table 2. Services Offered by Stockbrokers

Service offered	Frequency	Percentage
Buying and Selling of shares	19	100.0
Fund management	8	47.1
Advisory & Research	5	29.4

Source: Data analysis (2011)

4.2 Characterization of Stockbrokers

The first objective of the study sought to characterize the stockbrokers. In this regard, the study examined the various management aspects of stockbrokers such as number of board of directors, mode of appointment of directors, criteria for appointment of directors and composition of board of directors. Characterization of stockbrokers was necessary to enable easier understanding of stockbrokers operations.

4.2.1 Number of Board of Directors

On the basis of the results (Figure 3), the composition of the board of directors of the stockbrokers had an average of six (6) members. A closer look indicated that the number of members ranged from four (4) to eight (8) directors. This implied that most of the stockbrokers preferred a smaller number of directors. Small focused boards were generally preferred because management of the board is easier. Those boards which are very large attract high remunerations and take time in decision making.

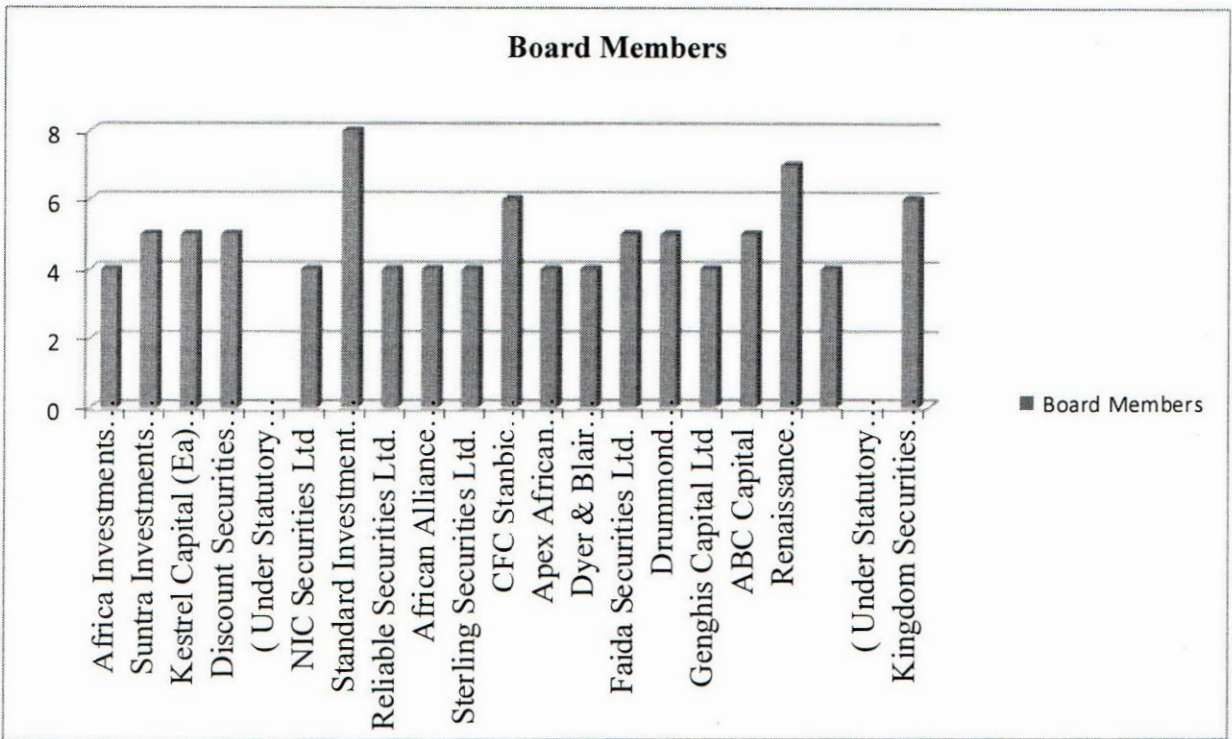


Figure 3. Number of members on Board of Directors

Source: Data analysis (2011)

4.2.2 Mode of Appointment of Directors

According to the study results (Figure 4), 59% of the stockbrokers appointed their board members by shareholding. Furthermore, 29% of the stockbrokers reported that appointment of directors was by application and interview whereas, 11.7% of the firms did not have any particular mode of appointment. It was apparent from the results that shareholding was the most preferred mode of appointment of the board of directors. In addition, in some cases a mixture of shareholding and professional qualification was used as the criteria. The mode of appointment of directors was integrated in the Articles of Association of the stockbrokers. However, the appointment and removal of directors is controlled by Companies Act 1985 and by the company's articles but in some respects the Companies Act cannot be varied by company's articles. In other respects it is indicative only and its provisions maybe amended or overridden by the articles. Every company is required to adopt articles of association to influence the appointment and removal of directors

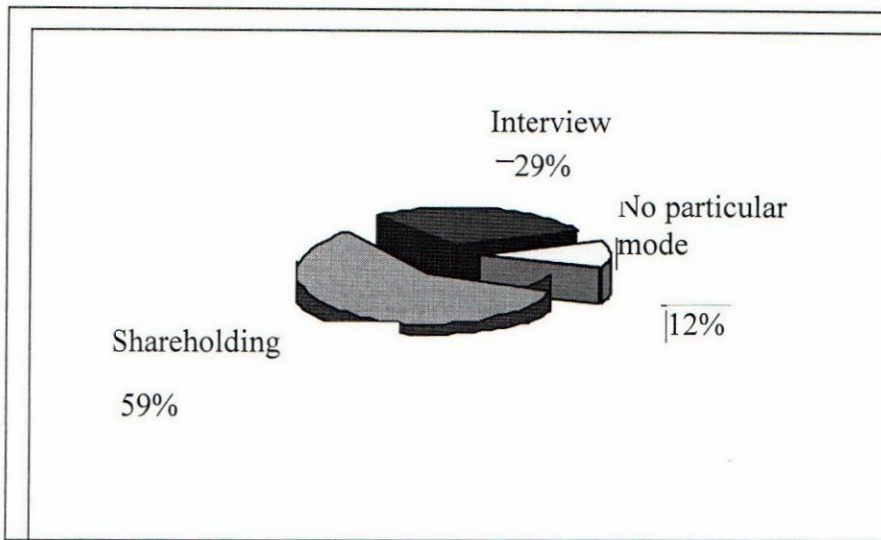


Figure 4 Mode of Appointment of the Board of Directors

Source: Data analysis (2011)

4.2.3 Criteria for Appointment of Directors

The results (Figure 5) show that in 50% of the stockbrokerage firms, the main criterion for appointment on the board of directors was the level of shareholding among the members. In addition, 20% of the firms had professional qualification as the main criterion for appointment while 30% had a mixture of shareholding and professional qualification as criteria for appointment to the board of directors.

In other situations like the Securities Exchange Commission (SEC), in an instance, the commission gave a circular regarding the criteria for appointment of stockbrokers to boards of public companies. It had come to the notice of SEC that some directors of stockbrokers were also directors of public listed companies in the exchange. This was considered not to be in the interest of the investing public as it could give rise to conflict of interest, insider trading and other types of market manipulations. A directive was given that; no director of a stockbroker should concurrently serve on the board of listed or unlisted public company. It further directed that no public company shall accept appointment of any person who is a director of a licensed stockbroker. The commission

also directed immediate resignation of those already in the offices and indicated sanctioning of those who will violate the directives.

However, for stockbrokers in Kenya they were no clear cut rules on the appointment of directors. This implied that as long as a person had majority shareholding they qualified as directors regardless of the fact that they were members of publicly listed companies. This kind of trend was affecting the performance of stockbrokers because their directors lacked independence. Other issues as insider trading and conflict of interest could easily come on board and result to operational inefficiency among the stockbrokers.

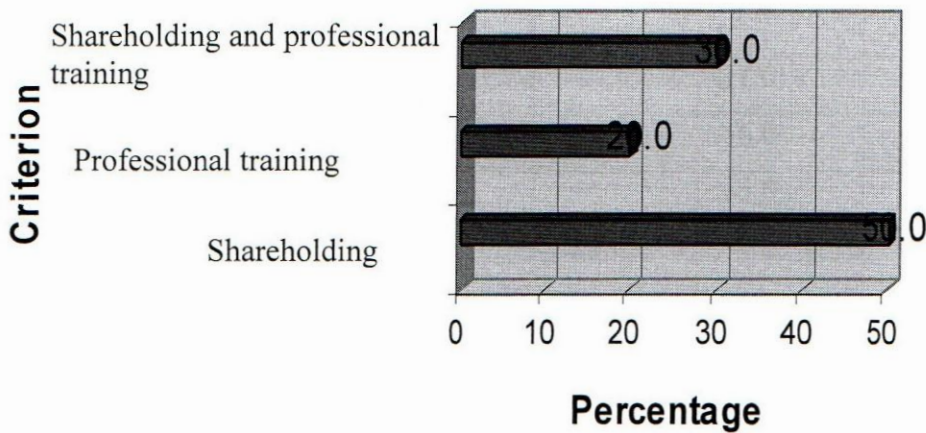


Figure 5. Criteria for Appointment of Directors

Source: Data analysis (2011)

4.2.4 Composition of the Board Members by Professional Training

The study assessed the composition of the board of by professional training. According to study findings (Table 3), lawyers constituted 26%, financial analysts formed 8%, economists were 11%, and businessmen/women accounted for 56% while other professions (teachers, doctors, engineers and others) constituted about 15% on the board of directors. It may be noted that a significant proportion of the members of the board of directors were business people or entrepreneurs with a small number of other professionals such as

lawyers, financial specialists and economists. This implied that critical professional training among members of the board (lawyers, financial specialists and economists) had not been incorporated in majority of the stockbrokers. Also being a good stockbroker demands the ability to convince people to invest and as a result stockbrokers require professionals who possess razor sharp memories, analytical mind, logical thinking and a foresight to make wise projections. However, while many of the stockbrokers had a lot of useful data, they were poor in the necessary market information and knowledge which ordinarily should be the collateral. The reason is because they lacked the skills required to obtain this intelligence.

Table 3. Composition of Board of stockbroker by professional training

Professional Training	Percentage Frequency
Lawyers	26.0
Financial specialist	8.0
Economists	11.0
Entrepreneurs/Business	56.0
Other professions	15.0

Source: Data analysis (2011)

4.2.5 Level of Effectiveness of the Board of Directors

The study set out to establish the effectiveness of the Board of Directors. In this regard, the study sought to collect the respondents' views on the aspects of management such as leadership, integrity, decision making and investor confidence. According to the study results (Table 4), 82.4% of the respondents reported that boards were not effective in leadership, 88.2% reported they were not effective in integrity, and 88.2% said they were not effective in decision-making and 70.6% reported the board to not being effective in inspiring investor confidence. These results suggested that the effectiveness of the Boards of Directors of the majority of the stockbrokers was still very low especially in critical areas such as integrity, and decision-making. These further affected the performance of stockbrokers because decisions took long before being made. In the researcher's view, the board members should ideally balance their roles by focusing on leadership rather than supervision; they should also focus on making decisions rather than completing

tasks. A proper functioning board can be a force in a stockbroker's success. When a board is working effectively, its members will offer unbiased advice on financings, acquisitions and strategic partnerships.

In the researcher's view, nearly all companies benefit from the involvement of qualified independent directors. Although the advice from insiders can be valuable, it often reflects a narrow perspective. Most of the stockbrokers were family run and your family and employees are more apt to tell you what you want to hear, while outside board members can broaden the range of experience and skills.

Table 4. Level of Effectiveness of the Board of Directors of stockbrokers.

Aspect	Percentage Response		Total
	Not effective	Effective	
Leadership	82.4	17.6	100.0
Integrity	88.2	11.8	100.0
Decision making	88.2	11.8	100.0
Investor confidence	70.6	29.4	100.0

Source: Data analysis (2011)

4.3 Operations and Performance of the Stockbrokers

The second objective of the study sought to establish the level of operations and performance of the stockbrokers. In this regard, the respondents were asked to indicate the level of operations and performance in terms of: average waiting periods to execute orders, duration to receive sale/purchase reports, system of payment by clients, whether money deposited yielded any interest during the waiting period, duration for registration of investors, modes of receiving market information by clients and the level of performance. The results of data analysis and discussions are as follows:

4.3.1 Average Waiting Periods to Execute Sale/Purchase Orders

The results on (Table 5) about waiting periods before clients' orders are executed in the market indicated that 11.7% of the stockbrokers executed clients' orders by one day. A

23.5% take two days, 47.1% take 3 working days, and 11.7% take 4 working days while only 6.0% of the stockbrokers take 5 working days to execute the orders. On average all firms were taking 3 days to execute clients' orders. It was apparent from these results that a significant number of the stockbrokers take 3 working days to execute orders placed by their clients. However, the period was longer compared to the one working day as expected by the clients. These implied that clients were losing out on share value because of the long wait before execution of their orders.

The stockbrokers also lost out on revenue as it implied some clients withdrew their funds due to the long delays. For other stockbrokers the long period was attributed to the fact that postponing the execution of the order was for the interest of the client. Other orders were delayed on special conditions such as price limits or limited liquidity. The type of orders also contributed to the duration of execution. Those orders placed at best: meant execute immediately at the best available price, at limit meant that, execute at or better than a specified minimum price for sales or maximum price for purchase.

However, with the introduction of automated order entry, investors were able to execute their orders faster than before. By law, stockbrokers are obligated to give each of the investors the best possible order execution. Most of the stockbrokers were taking T+3 to execute orders while the ideal period should be T+1.

Table 5. Average Waiting Period to Execute Orders

Duration	Frequency	Percentage
1 Day	2	11.7
2 Days	4	23.5
3 Days	8	47.1
4 days	2	11.7
5 Days	1	6.0

Source: Data analysis (2011)

4.3.2 Duration for Receiving Sale/Purchase Reports by Clients

The study results (Table 6) show that in 64.8% of the stockbrokers, the duration for clients receiving sale/purchase reports was one day. In 23.5% of the stockbrokers, the duration was 2 working days whereas in 11.7% of the stockbrokers the duration was 3 working days. It was apparent that in majority of the firms, once an order had been executed, the client got their report within a day. These findings were also positive because investors' confidence was boosted by these acts of efficiency from the stockbrokers.

Table 6. Duration for receiving sale/purchase reports

Duration	Frequency	Percentage
1 Day	11	64.8
2 Days	4	23.5
3 Days	2	11.7

Source: Data analysis (2011)

4.3.3 System of Payment by Clients

The results established that in 67% of stockbrokers the money was deposited into a security account before purchase of shares, whereas in 33% of the firms, the payments were made after purchase of shares (Figure 6). These findings implied that majority of the stockbrokers required their clients/investors to deposit money into a security account before the purchase of shares. In other stockbrokers, paying cash upfront into an account with them enabled them to charge lower commission rates. This was because the risk of a customer not paying up for the shares purchased is zero. Elsewhere according to the SEC it states that in a cash account you must pay for the purchase of a stock before you can sell it. If you buy and sell before paying for it, you are free riding which violates the credit extension provisions of the Federal Reserve Board. In such cases your stockbroker is required to freeze your shares account for 90 days.

From the results, stockbrokers required most investors to pay upfront for the shares before buying for them. This implied that stockbrokers were keen not to make orders for clients who might not pay for the stocks. Other stockbrokers reported to buy stocks for investor before payment, the percentage of these were 33%, they further revealed that some of the customers failed to pay up for the shares once they dipped. This could require the stockbrokers sometimes to dispose off the shares at a loss to recover the money used thereby affecting their performance.

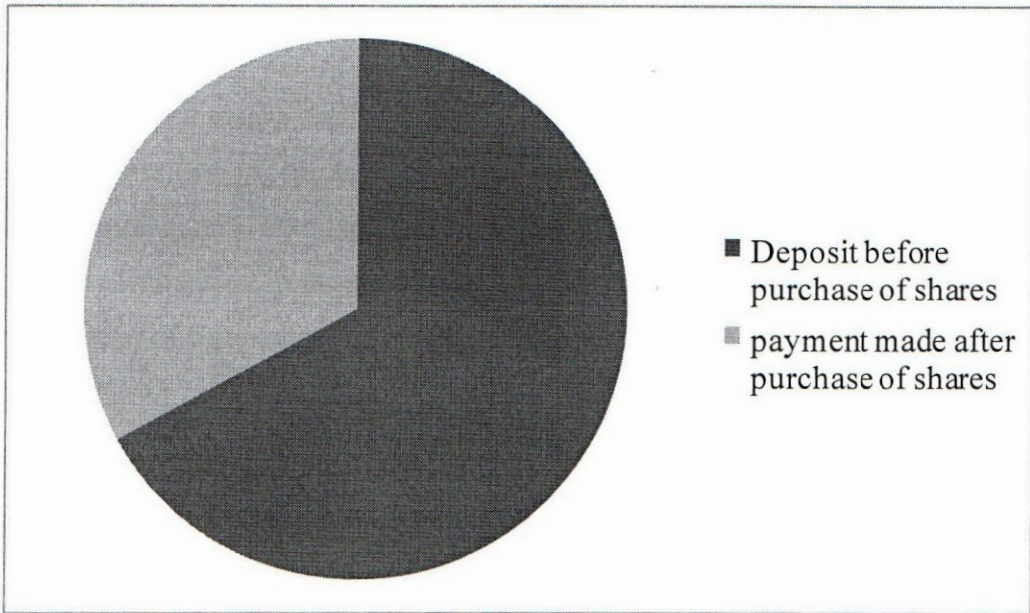


Figure 6. System of Payment by Clients

Source: Data analysis (2011)

4.3.4 Whether Money Deposited Earn Interest during the Waiting Period

The study's respondents were asked whether the money deposited earned interest during the waiting period. The findings showed that in all the stockbrokers, the money did not earn any interest. This suggested that the money deposited did not earn interest and therefore clients were losing out on it, because cash held as cash itself does not appreciate if there is no interest rate on it, or return on investment. These implied the investors were not willing to hold their funds with stockbrokers without buying shares for a while. In

other stock exchanges for example JSE, cash in your account is paid interest per month. The rate is market related and varies from month to month.

4.3.5 Duration for Registration of Investors

The study sought to find out the duration of registration of the investors by the registrar of companies and the responses are as summarized in Figure 7. According to the findings, 52% of the stockbrokers took 7 days in addition to the transaction day (T+7 days) to effect registration of investors with the registrar' of companies office. The results further showed that 28% of stockbrokers took T+6 days, 12% of stockbrokers took T+5 days whereas no stockbroker reported to take T+4 days to effect registration of the investors. It was clear from these results that, majority of the stockbrokers took T+7 days to register investors. This implies that the registration process was slow; clients were not able to sell their shares immediately because of these delays. The stockbrokers also felt they were losing out on commission from sale of shares due to the delay in registration of the clients with the registrar of companies and therefore their performance was affected.

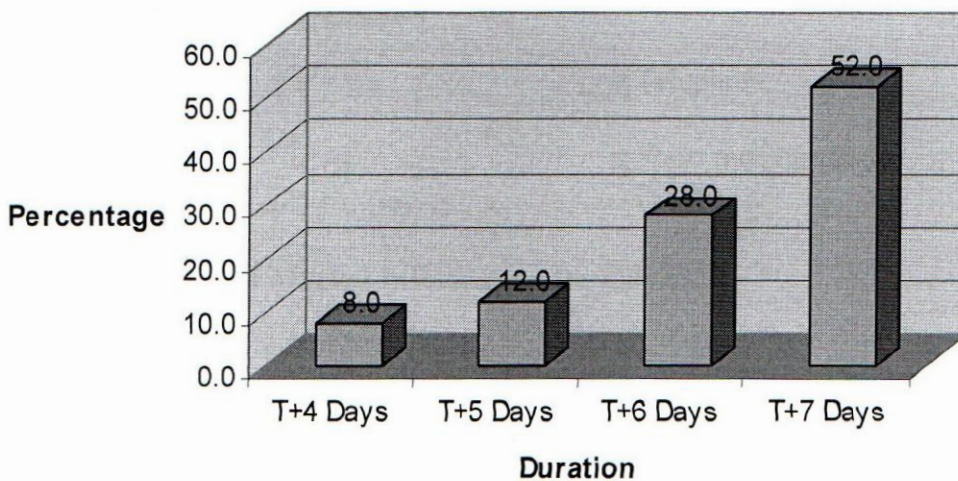


Figure 7. Duration for registration of investors

Source: Data analysis (2011)

4.3.6 Modes of Receiving Market Information by Clients

The study also assessed the various modes through which clients/investors received market information from their stockbrokers. According to findings (Figure 8), 54% of

stockbrokers used email, 12% of stockbrokers used short message services (SMS), 10% used telephone, 8% used their website and 4% provided price lists at their offices. It was evident from the results that a significant proportion of the stockbrokers used email to disseminate market information to their clients. However it was further revealed that most investors did not access their emails in good time even though it was the most preferred mode of communication. As a result of this lapse in communication, between the investor and the stockbroker, there were delays in execution of orders and lost investment opportunities. This affected the performance of stockbrokers since investors were not maximizing the investment opportunities and stockbrokers lost out on commissions.

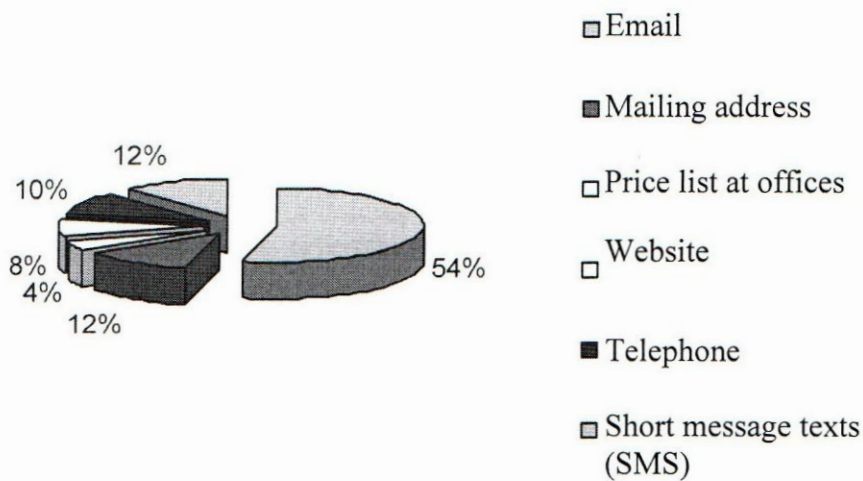


Figure 8. Sources of Market Information for Clients

Source: Data analysis (2011)

4.3.7 Level of performance among Stockbrokers

The second objective of the study sought to establish the level of performance achieved by stockbrokers. In this regard, the study respondents were asked to qualitatively indicate the level of performance of stockbrokers in terms of: sales revenue, profitability, efficiency of operations, growth and expansion and client base. Responses to these performance indicators were measured on a five-point Likert scale ranging from 1 to 5 (with 1 indicating very low level of performance and 5 indicating very high level of

performance). The higher the score, the higher was the level of performance, and vice versa. Table 7 summarizes the performance of stockbrokers.

Table 7. Level of Performance of Stockbrokers

Performance Indicator	Percentage Responses (%)				Mean
	Low (1)	Moderate (2)	High (3)	Very High (4)	
Sales Revenue	2.9	18.6	50.0	27.1	3.03
Profitability	1.4	15.7	51.4	31.4	3.12
Efficiency of operations	2.9	17.1	52.9	24.3	3.01
Growth & Expansion	0.0	15.7	44.3	37.1	3.22
Client base	4.3	11.4	34.3	50.0	3.30

Source: Data analysis (2011)

The study results on sales revenue (Table 7), indicated that 27.1% of respondents reported that sales revenue was very high, 50.0% reported high, 18.6% reported that they were moderate whereas only 2.9% of respondents reported that sales revenue were low. On the basis of profitability, 31.4% of the respondents reported that profitability was generally high, 51.4% reported that profitability was high, 15.7% reported moderate whereas only 1.4% of respondents reported that profitability was low.

With regard to efficiency of operations, the study results indicated that only 24.3% of respondents reported efficiency of operations was very high, 52.9% reported that efficiency of operations was high, 17.1% reported moderate whereas 2.9% of respondents reported that efficiency of operations was low. The results also revealed that 37.1% of respondents reported that growth and expansion was very high, 44.3% reported that growth and expansion was high, 15.7% reported it was moderate whereas none of respondents reported that growth and expansion was low. Finally, the findings also showed that 50.0% of respondents reported that client base was very high, 34.3% reported that client base was high, 11.4% reported moderate whereas only 4.3% of respondents reported that client base was low.

Table 8. Overall Performance scores of the Stockbrokers

Level	Percentage Responses (%)			Total
	Low	Moderate	High	
Client base	17.0	31.0	52.0	100.0
Growth & Expansion	22.0	32.0	46.0	100.0
Profitability	40.0	45.0	15.0	100.0
Sales and Revenue	43.0	38.0	29.0	100.0
Efficiency of operations	54.0	34.0	12.0	100.0

Source: Data analysis (2011)

On the basis of performance scores regarding client base (Table 8), 52% of stockbrokers achieved high performance, 31% achieved moderate performance while only 17% attained low performance. With regard to growth and expansion, 46% of stockbrokers achieved high performance, 32% achieved moderate performance while only 22% attained low performance. Performance index on profitability indicated that only 15% of stockbrokers achieved high performance, 45% achieved moderate performance while only 40% attained low performance. On the basis of sales revenue, 29% of stockbrokers achieved high performance, 38% achieved moderate performance while 43% attained low performance. Finally, performance score of efficiency of operation show that only 12% of stockbrokers achieved high performance, 34% achieved moderate performance while 54% attained low performance. These findings suggest that the stockbrokers reported relatively higher performance in client base, growth & expansion and profitability whereas performance was low especially in sales revenues and efficiency of operations. This means that for stockbrokers to achieve operational efficiency it should improve on sales revenues and profitability.

Table 9. Chi-square on Differences in Performance among Stockbrokers

Stockbrokers' Performance	Level of performance			Total
	Low	Moderate	High	
Profitability	8(40.0%)	9(45.0%)	2 (15.0%)	19(100.0%)
Client Base	3(17.0%)	6(31.0%)	10(52.0%)	19(100.0%)
Growth and Expansion	4(22.0%)	6(32.0%)	9(46.0%)	19(100.0%)
Sales Revenue	8(43.0%)	7(38.0%)	4(19.0%)	19(100.0%)
Efficiency	10(54.0%)	6(34.0%)	3(12.0%)	19(100.0%)

Pearson Chi-Square value (χ^2) = 53.803(a); df = 30; P = 0.005, P < 0.005; N = 19

In order to determine whether there was significant variances in performance among the stockbrokers, Chi-square test was done and findings presented in Table 9. On the basis of the Chi-square value and significance values, the findings indicated that there was a significant difference in performance among the stockbrokers as illustrated on the table above.

4.4 Factors Affecting the Performance of Stockbrokers

The study sought to establish the factors affecting the performance of stockbrokers in Kenya. To achieve the objective the study sought information on the extent to which various factors affect performance as well as determine the effect of the factors on performance of stockbrokers.

4.4.1 Influence of the Identified Factors on Performance of Stockbrokers

To achieve the objective, the respondents were asked to indicate the extent to which the various factors affected performance among the stockbrokers. The identified factors broadly included: management quality, accounting quality, corporate governance, regulatory compliance, business infrastructure, risk management and financial management. Responses to these factors were measured on a five-point Likert scale ranging from 1 to 5 (with 1 indicating very less extent and 5 indicating the very great) Table 10 summarizes the results of analysis and are discussed as below:

Table 10. Factors Affecting Performance of Stockbrokers

Factor(s)	Percentage Responses (%)					Mean
	Very Less extent (1)	Less extent (2)	Neutral (3)	Great extent (4)	Very Great extent (5)	
<u>Management Quality</u>						
1. Stability and experience in top management	7.5	45.0	5.0	22.5	20.0	4.65
2. Independence of directorship as depth of board	0.0	37.5	12.0	12.5	35.0	4.66
<u>Governance</u>						
1. Corporate governance as rights, responsibility among the participants	5.0	12.5	15.0	40.0	27.5	4.72
2. Accounting quality as audit, disclosures.	2.5	15.0	7.5	40.0	35.0	4.76
<u>Regulatory Compliance</u>						
1. Compliance with Acts, Rules & Guidelines.	2.5	20.0	2.5	32.5	42.5	4.78
<u>Business Infrastructure</u>						
1. Robustness of IT	2.5	5.0	50.0	40.0	2.5	4.65
2. Adequacy of MIS, as quality and timeliness of reports	2.5	17.5	7.5	20.0	47.5	4.72
3. Back-office operations as processes and quality of data	0.0	10.0	50.0	17.5	22.5	4.60
<u>Risk Management</u>						
1. Risk governance as capital allocation and independence of risk management teams	5.0	30.0	12.5	47.5	5.0	4.67
2. Market risk management as trading returns.	0.0	12.5	22.5	12.5	52.5	4.71
3. Credit risk management as	0.0	2.5	7.5	35.0	55.0	4.80
4. Operation risk management	5.0	10.0	20.0	40.0	25.0	4.68
<u>Financial Management</u>						
1. Company profitability as pre-tax profit and margins	17.5	10.0	10.0	47.5	25.0	4.74
2. Asset Quality	7.5	20.0	5.0	22.5	45.0	4.70
3. Capital and liquidity profile	0.0	12.5	12.0	37.5	35.0	4.75

Source: Data analysis (2011)

With regard to management quality, the results revealed that 42.5% of the respondents reported that stability and experience in management affected the performance of stockbrokers generally to a great extent, whereas 52.5% (45+7.5) reported generally to a lesser extent. Similarly, 47.5% of respondents reported that independence of directorship generally affected performance to a great extent with 37.5% reported only to a lesser extent. It was apparent from the study results that management quality is of greater significance in the smooth operations of stockbrokers. However, most of the stockbrokers reported that they did not have an independent board. This is because their boards were selected mainly on shareholding.

On the basis of governance of stockbrokers, 67.5% (40+27.5) of the respondents reported that corporate governance affected the performance of stockbrokers generally to a great extent whereas 17.5% reported that corporate governance affected their performance generally to a lesser extent. In addition, 75% of respondents reported that accounting quality (such as audit, disclosures, and propriety trading and reporting lines) generally affected performance to a great extent while 17.5% reported only to a lesser extent. This implied that stockbrokers were not giving full disclosures and there was also lack of independence, therefore all these were greatly affecting the performance of stockbrokers.

The study results on regulatory compliance indicated that, 75% of the respondents reported that compliance with acts, rules and guidelines, by-laws, history of non-compliance and management attitude affected the performance of stockbrokers generally to a greater extent whereas 25% of respondents reported generally to a lesser extent. This implied that majority of the stockbrokers did not comply with guidelines and Acts as directed by CMA and due to non-compliance the stockbrokers' performance was affected. Investors did not feel confident investing with stockbrokers who were not complying with regulations and therefore the brokers lost on commissions.

With respect to business infrastructure, the study findings showed that 42.5% of the respondents reported that robustness of IT systems (i.e. connectivity, failure restoration, and database and transaction maintenance, up-scaling of IT systems) affected

performance of stockbrokers generally to a great extent whereas 7.5% reported generally to a lesser extent. Furthermore, 67.5% of respondents reported that adequacy of information management systems (quality and timeliness of reports) generally affected performance to a great extent with 20% reported only to a lesser extent. The study results further showed that only 40% of the respondents reported that back-office operations processes, quality of data storage and automation, affected the performance of stockbrokers generally to a great extent whereas 10 % reported generally to a lesser extent. This implied that many of the stockbrokers had infrastructures that were not effective and these affected the stockbrokers' performance. Other stockbrokers had systems controls that allowed employees to trade on client shares without their knowledge. This was attributed to the poor IT systems in place; the investors were sceptical about the security of their investments and this was affecting the stockbrokers' performance due to low investor confidence.

On the basis of risk management, 52.5% of the respondents reported that risk governance (risk reviews, policies, capital allocation, and independence of risk management teams) affected performance of stockbrokers generally to a great extent. A 35% reported generally to a lesser extent. In addition, 67% of the respondents reported that market risk management (trading returns, quantification, reporting and monitoring) generally affected performance to a great extent with 12.5% reporting only to a lesser extent. The study results further revealed that 90% of the respondents reported credit risk management (franchise approval, initial deposit requirement, counter limits) affected performance of stockbrokers generally to a great extent whereas 2.5% reported generally to a lesser extent. Finally, the findings on risk management indicated that 65% of respondents reported that operation risk management i.e. training level of manpower, operational failure and backup system generally affected performance of stockbrokers to a great extent with 15% reporting only to a lesser extent. This implied that risk management in the stockbrokers was not being handled properly. Stockbroking industry is associated with two types of risk viz internal risk and external risks in terms of volatility of stock prices and daily collection of payments from the clients. In view of the above, to avoid such risks and to survive in the industry, stockbrokers need to maintain risk management

systems to protect their capital interests, a feature that was lacking in the stockbroking firms under study.

With regard to financial management quality, study findings revealed that 72% of the respondents reported that company profitability (pre-tax profit and margins, return on net-worth and revenues) affected performance of stockbrokers generally to a great extent whereas 27.5% reported generally to a lesser extent. Similarly, 67% of respondents reported that asset quality as bad debts, write-offs generally affected performance to a great extent with 27.5% respondents reporting only performance was affected to a lesser extent. Furthermore, the results showed that 72% of the respondents reported that capital and liquidity profile as: quality capital level, fund-raising mechanisms and financial flexibility generally affected performance to a great extent with 12.5% reporting only to a lesser extent. This generally implied that proper financial management skills were not being practiced by the stockbrokers; there were reports of low sales revenue, bad debts and liquidity problems.

Factor analysis was done to identify the most important factors that influence performance among stockbrokers (Table 11). On the basis of the extraction values and factor loadings obtained, the following factors were found to be influential to varying extents: Credit risk management (46.512%), corporate governance (18.946%), regulatory compliance (14.062%), financial management (10.044%), Business infrastructure (6.435%) and management quality (4.000%).

The results indicated that, credit risk management influenced the operational performance of stockbrokers to a greater extent (46.5%). This means that due to lack of proper credit risk management the performance of stockbrokers decreased. In the researcher's view the stockbrokers should develop written standards regarding the amount of credit extended to vendors and customers or borrowed from lenders. Using risk management software may help managers automate their credit risk management process, allowing for real-time management policies. The benefits from a proper credit risk management enhance a company's operational cash flow, resulting in quicker expansion of business operations.

Strong financial credit history also allows companies a higher potential for outside investments.

The results also showed that regulatory compliance had a strong relationship with the performance of stockbrokers (14%). Regulatory Compliance is the term generally used to describe the policies and processes which financial firms have in place to ensure that they follow the very many laws, rules and regulations put in place by the bodies which control financial activity in a given jurisdiction. Those rules and regulations are designed to ensure that such financial activity in the markets is fair, transparent and robust.

According to the results, accounting quality also had a significant effect on performance of stockbrokers and therefore they needed to have better accounting quality to improve on their performance. The stockbrokers' performance was also affected by lack of adequate information systems and also experienced challenges in operation risk, asset quality and risk governance. This implied that stockbrokers needed to overcome those challenges so as to achieve better operational performance.

Table 11. Factor Analysis of the Factors Influencing Performance of Stockbrokers

Factor(s)	Initial	Extraction	Factor Loadings (%)
<u>Management Quality</u>			
1. Stability & Experience in management	1.00	0.540	1.600
2. Independence of directorship	1.00	0.519	2.400
Total			4.000
<u>Corporate Governance</u>			
1 Corporate governance	1.00	0.712	9.43
2. Accounting quality	1.00	0.701	9.50
Total			18.946
<u>Regulatory Compliance</u>			
1. Compliance with Acts, Rules & Guidelines, by-laws,	1.00	0.695	14.062
Total			14.062
<u>Business Infrastructure</u>			
1. Robustness of IT systems	1.00	0.589	2.141
2. Adequacy of Information management systems	1.00	0.578	2.174
3. Back-Office operations	1.00	0.565	2.118
Total			6.435
<u>Risk Management</u>			
Risk governance	1.00	0.836	11.517
Market risk management	1.00	0.804	11.615
Credit risk management	1.00	0.796	11.537
Operation risk management	1.00	0.772	11.541
Total			46.512
<u>Financial Management</u>			
Company profitability	1.00	0.638	3.341
Asset Quality.	1.00	0.621	3.325
Capital and liquidity profile	1.00	0.608	3.362
Total			10.044

Source: Data analysis (2011)

On the basis of the extraction values and percentage of variance obtained (Table 11), the effect of various factors were in order of magnitude: risk management (46.512%), corporate governance (18.946%), regulatory compliance (14.062%), financial management (10.044%), business Infrastructure (6.435%) and management quality (4.000%). These results indicated that the factors that significantly affect the performance of the stockbrokers included: risk management, corporate governance, regulatory compliance, financial management, and business infrastructure and management quality. This implied that, for stockbrokers to perform well they should improve on its corporate governance by adopting proper accounting techniques. The stockbrokers should also adopt better financial management skills by empowering employees through training and adopting board members who are independent in decision making.

Table 12. Influence of the Factors on the Performance of Stockbrokers

Factors	Initial	Extraction	Factor loadings
Regulatory compliance	1.000	0.889	14.062
Governance	1.000	0.862	18.946
Financial Management	1.000	0.835	10.044
Risk Management	1.000	0.721	46.512
Business Infrastructure	1.000	0.638	6.435
Management quality	1.000	0.532	4.000
Total			100.0

Extraction Method: Principal Component Analysis.

Source: Data analysis (2011)

4.4.2 Influence of Identified Factors on Performance of Stockbrokers

To determine the extent to which the various identified factors influenced performance, the various factors were correlated with various indicators of performance (sales and profitability, client base, growth and expansion, and operational efficiency) as shown in Table 13.

Table 13. Correlation Matrix of Factors affecting Performance of Stockbrokers

Independent Variables	Statistics	Dependent Variables		
		Sales and profitability	Client base growth and expansion	Operational efficiency
Risk Governance	Pearson Correlation	.475**	.309	.600
	Sig. (2-tailed)	.004	.593	.799
	N	19	19	19
Corporate	Pearson Correlation	.488**	.130*	.393*
	Sig. (2-tailed)	.000	.003	.004
	N	19	19	19
Regulatory compliance	Pearson Correlation	.463**	.392*	.466
	Sig. (2-tailed)	.000	.005	.000
	N	19	19	19
Asset Quality	Pearson Correlation	.109**	.234*	.340
	Sig. (2-tailed)	.001	.004	.901
	N	19	19	19
Adequacy of Information Management Systems	Pearson Correlation	.538	.367*	.504**
	Sig. (2-tailed)	.167	.004	.005
	N	19	19	19
Accounting Quality	Pearson Correlation	.536**	.368*	.551
	Sig. (2-tailed)	.000	.001	.234
	N	19	19	19
Credit risk Management	Pearson Correlation	.538**	.367*	.504
	Sig. (2-tailed)	.002	.001	.432

	N	19	19	19
Operation Risk Management	Pearson Correlation	.438**	.267*	.351
	Sig. (2-tailed)	.013	.024	.246
	N	19	19	19
Capital & Liquidity Profile	Pearson Correlation	.701**	.383*	.211
	Sig. (2-tailed)	.014	.024	.117
	N	19	19	19

* Significant at $p < 0.05$ level,

** Significant at $p < 0.00$ level,

On the basis of the Pearsons correlation coefficient values (r) (Table 13), risk governance significantly influenced sales and profitability ($r = 0.475$) but not operational efficiency ($r = 0.600$) and client base growth and expansion ($r = 0.309$). This implied that only risk governance was both positively related, and significantly influenced sales and profitability, operational efficiency, client base, growth and expansion. This further implied that an increase in adoption of risk governance significantly led to improved performance in sales and profitability, operational efficiency, client base, growth and expansion among the stockbrokers.

The study results indicated that corporate governance significantly influenced sales and profitability ($r = 0.488$), client base growth and expansion ($r = 0.130$) and operational efficiency ($r = 0.393$). This means that an increase in corporate governance by stockbrokers significantly led to an increase in sales and profitability, client base growth and expansion and operational efficiency.

Also, correlation analysis (Table 13) indicates that regulatory compliance significantly influenced sales and profitability ($r = 0.463$) and client base, growth and expansion ($r = 0.392$). This implied that an increase in regulatory compliance by stockbrokers significantly led an increase in sales and profitability as well as client base growth and expansion. This meant that stockbrokers can greatly improve their performance by adopting better regulations.

Further, results (Table 13) indicate that asset quality was found to significantly influence sales and profitability ($r = 0.109$) as well as client base growth and expansion ($r = 0.234$). This means that an increase in asset quality by stockbrokers significantly led an increase in sales and profitability as well as client base growth and expansion.

According to the study results (Table 13), adequacy of information management systems was significantly correlated to client base, growth and expansion ($r = 0.367$) and operational efficiency ($r = 0.504$). This implied that an increase in adequacy of information management systems by stockbrokers significantly led an increase in client base growth and expansion as well as efficiency of operations.

A look at results also revealed that that accounting quality significantly influenced sales and profitability ($r = 0.536$) and client base, growth and expansion ($r = 0.368$). This means that an increase in accounting quality by stockbrokers significantly led to an increase in sales and profitability as well as client base, growth and expansion. This meant that stockbrokers can greatly improve their performance by adopting better accounting quality.

Further, results of correlation analysis of credit risk management and performance index showed a positive significant relationship on sales and profitability ($r = 0.538$) and client base, growth and expansion ($r = 0.367$). This implied that an increase in credit risk management by stockbrokers significantly led an increase in client base growth and expansion as well as sales and profitability.

The results also indicated that operations risk management significantly influenced on sales and profitability ($r = 0.438$) and client base growth and expansion ($r = 0.267$) and not operational efficiency ($r = 0.351$). This means that an increase in operations risk management by stockbrokers significantly led an increase in sales and profitability as well as client base, growth and expansion.

Finally, capital and liquidity profile showed a positive significant relationship on sales and profitability ($r = 0.701$), client base, growth and expansion ($r = 0.383$) and not operational efficiency ($r = 0.211$). This implies that an increase in capital and liquidity profile by stockbrokers significantly led an increase in client base growth and expansion as well as sales and profitability.

Regression analysis

Regression analysis was done to confirm the significant relationships and determine the influence accounted for by the factors on the dependent variable (stockbrokers' performance). On the basis of the standardized coefficient (Beta values) and the level of significance of the identified significant factors, (Table 14) confirmed that the factors had a significant effect on the performance of stockbrokers. These were: credit risk management, regulatory compliance, adequacy of information management systems, operation risk management, capital and liquidity profile and corporate governance. It was clear that the above-identified factors significantly determined the performance of the stockbrokers.

Table 14. Regression Analysis on the factors affecting the performance of stockbrokers

Factors	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.712	.233		15.960	.000
Risk governance	.113	.049	.093	2.308	.026
Corporate governance	-.116	.037	-.403	-3.130	.000
Regulatory compliance,	-.218	.049	-.343	-4.478	.000
Accounting quality	-.258	.047	-.082	-5.427	.054
Adequacy of information management systems	-.223	.037	-.262	-5.227	.000
Credit risk management	-.238	.017	-.245	-5.327	.002
Operation risk management	.123	.029	.302	2.303	.000
Capital and liquidity profile	-.126	.017	-.352	-2.130	.000
Asset quality	-.318	.069	-.133	-4.548	.007
R	R Square	Adjusted R	Std. Error of the Estimate		
.815	.6642	.6574	.522		

Dependent Variable: Performance of stockbrokers

Predictors: (Constant), Operation risk management, Corporate governance, Regulatory compliance, capital & Liquidity profile, Adequacy of information management systems and Accounting quality

Source: Data analysis (2011)

Further, on the basis of the regression coefficient (R^2), the results indicated that about 66.42% ($R^2=0.815$) of the performance among the stockbrokers is influenced (accounted for) by the combined effect of the identified factors namely; credit risk, operation risk management, corporate governance, regulatory compliance, capital and liquidity profile, adequacy of information management systems and accounting quality.

CHAPTER FIVE:

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

The chapter presents the summary, conclusions and the recommendations of the study as highlighted below:

5.1 Summary of the Results

The study sought to empirically evaluate the factors that affected the performance of Kenyan stockbrokers. The specific objectives of the study included: to characterize the stockbrokers, to establish the performance of stockbrokers, to establish the factors affecting the performance of the stockbrokers and determine the influence of the identified factors on the performance of stockbrokers in Kenya. On the basis of the study's objectives and data analysis, the results supported the following summary results:

To begin with, the results showed that 53% of the total stockbrokerage firms evaluated were classified as stockbrokers, whereas 47% of the firms were considered as investment banks dealing with the buying and selling of shares at the Nairobi Stock Exchange market. These stockbrokers had been in operation for an average period of 14 years with the shortest serving three years and the longest serving company being sixty years. In addition to being involved in the buying and selling of shares by all stockbrokers, the stockbrokers also offered fund management as well as advisory and research services.

The other observation was that the composition of the board of directors of the stockbrokers had an average of six (6) members, with the number of members ranging from four to eight directors. It was clear from the results that most stockbrokers preferred a smaller number of board members due to its ability to make faster decisions and required lesser remunerations. Shareholding was also the most preferred mode of appointment of Board of Directors. This also compromised on independence of the board; this is because in some situations directors of stockbrokers were also directors of listed companies. This caused a conflict of interest. Besides that, the effectiveness of the

Boards of Directors of the majority of stockbrokers was observed to be very low especially in critical areas such as integrity, and decision-making. This was attributed to lack of independence of the Board of Directors.

In addition to that, it was also apparent from the results that a significant number of the stockbrokers took 3 working days to execute orders placed by their clients. This period is longer compared to the one working day as expected by the clients. In the majority of the firms, once an order had been executed, the client gets the report within a day. This was positive because investors' confidence was boosted by these acts of efficiency from the stockbrokers.

One other observation from the results was that majority of the stockbrokers took T+7 days to register investors with registrar of Companies. The duration was considered by stockbrokers and investors as too long and therefore missed out on investment opportunities due to the delays.

The results also showed that, majority of the stockbrokers required their clients/investors to deposit money into security account before the purchase of shares. The money deposited did not earn interest during the waiting period. It was also noted by SEC that stockbrokers elsewhere paid their clients interest on money in their accounts at the prevailing market rate.

It was also evident from the results that a significant proportion of the stockbrokers used email to disseminate market information to their clients. However some other accessible technologies as call or text messages were being used by the stockbrokers. It was also noted that a big number of investors took long to respond to market information and therefore they missed on immediate lucrative investment opportunities. This not only affected the stockbrokers' performance due to lost commissions but also resulted in lost returns for investors who could have earned from timely investments.

Finally, the results revealed that the stockbrokers generally achieved higher performance in terms of client base, growth and expansion and profitability, whereas the performance

was low especially in sales revenues and efficiency of operations of the stockbrokers. On the other hand the results from factor analysis further indicated that the factors that significantly affected the performance of the stockbrokers were: regulatory compliance, governance, financial management and risk management. The results from regression analysis also established that, credit risk management, regulatory compliance, adequacy of information management systems, operation risk management, capital and liquidity profile and corporate governance were the factors that significantly determined the performance of the stockbrokers.

5.2 Conclusion

The specific objectives of the study included: evaluating the performance of stockbrokers and establishing the factors affecting the performance of stockbrokers. The study also went out to characterize the stockbrokers in Kenya. In addition, the study endeavoured to empirically establish the factors that affect the performance of Kenyan stock brokers. In addition to this, the study attempted to determine the effect of the identified factors on the performance of stockbrokers in Kenya. Based on the survey findings, the study made the following conclusions:

To begin with, the study established that companies evaluated were classified as stockbrokers and investment banks dealing with, buying and selling of shares at the Nairobi Stock Exchange market. The stockbrokers had been in operation for an average period of 14 years with the shortest serving 3 years and the longest serving stockbroker being 60 years. In addition to being involved in the buying and selling of shares by all stockbrokers, the investment banks offered fund management as well as advisory and research services.

With regard to the management of the stockbrokers, the study concluded that stockbrokers were managed by Boards of Directors with an average of six (6) members. It was apparent from the findings that shareholding was the most preferred mode of appointment of the Board of Directors. The study also established that the effectiveness of the Boards of Directors of the majority of stockbrokers was very low especially in critical areas such as integrity and decision-making.

On the basis of the operations of the stockbrokers, the study concluded that a significant number of the stockbrokers took 3 working days to execute orders placed by their clients. However, the period was longer compared to the one working day as expected by the clients. It was also apparent that in majority of the firms, once an order had been executed, the client got their report within a day. Similarly, majority of the stockbrokers took T+7 days to register investors with registrar of companies and this was not positive because investors' confidence was not boosted by these acts of inefficiency from the stockbrokers. In addition, the majority of the stockbrokers required their clients/investors to deposit money into security account before purchase of shares. Nevertheless, the study noted that the money deposited with the stockbrokers by their clients did not earn interest during the waiting period. It was also evident from the study that a significant proportion of the stockbrokers used e-mail to disseminate market information to their clients although there were potentials for stockbrokers to adopt even more accessible technologies such as mobile phone and related services.

With regard to the performance of stockbrokers, the study concluded that the stockbrokers achieved varying levels of performance. The study results indicated that they achieved high levels of performance in terms of client base, growth and expansion and profitability; whereas performance was low especially in sales revenues and efficiency of operations. This pointed to the need for the stockbrokers to focus on the areas that achieved low performance while sustaining the growth in the performing areas of the stockbrokers.

The study identified a wide range of factors that affected the performance of the stockbrokers to varying extents. The study concluded that: credit risk management, regulatory compliance, accounting quality, capital liquidity, company profitability, and corporate governance, adequacy of information management systems, market risk management and asset quality affected the performance of stockbrokers to a very great extent. The study further revealed that factors such as operation risk management, governance, independence of directorship, stability and experience of management and

back-office operations affected the performance of stockbrokers to a lesser extent. Together with the results from factor analysis, it concluded that the factors that significantly affected the performance of the stockbrokers in order of magnitude included: regulatory compliance, governance, financial management and risk management.

5.3 Recommendations

In view of the key study results and conclusions, the study proposed the following specific recommendations to improve on the performance of stockbrokers in Kenya.

Firstly, the stockbrokers should pay interest on clients' deposits. Since the stockbrokers are financial institutions that actually invest such funds in short-term financial instruments, there is no reason why the owners of such funds should not benefit from the accrued interest on their own funds. Consequently the study strongly recommends that the investors should be paid a market interest rate on the cash held with the stockbrokers. This recommendation can be enforced by CMA because it is their regulatory body.

The study also recommended that secondary market activities, such as surveillance and supervision of dealers to maintain high standards, must be monitored to boost investor confidence. CMA should be more independent and utilize its mandate to put in place regulatory compliance for the stockbrokers. Better regulations would improve the performance of stockbrokers.

Thirdly, concerning issues of governance, the study recommended that Stockbrokers management change their ownership styles from family run businesses to limited liability companies. This restructuring coupled with market restructuring could facilitate better performance of the stockbrokers.

Another recommendation is the need to encourage the development of more investment products. The fact that most of the investors on the NSE are small investors and also unsophisticated, points to the need to encourage brokerage managers to develop exchanged traded funds and index funds. The inclusion of large and small investors would improve

on the profitability and sales revenues of stockbrokers which were found to be low from increased commissions. This could improve their operational efficiency.

Further recommendation was that there is need for the government to improve the physical infrastructure, particularly the telecommunication infrastructure, which is the pivot around which business on the stock market revolves. The stockbrokers should adopt an IT system that easily allows for online trading, this will enable Kenyans in the diaspora to invest in the stock market and it will also attract international investors. Instances of stockbrokers trading on the investors' funds will also be solved by good information systems. And Improved IT systems will greatly improve their operational performance.

The final recommendation was that the stockbrokers need to devote more efforts to improve in the areas that are highly important to the stock investors, such as reliability in order executions, responsiveness, accurate and timely executions of trading orders, advice on undue risks and reliable and efficient dissemination of market information to investors.

5.4 Follow-up Research

The study did not cover all investment banks in Kenya; it only covered stockbrokers and investment banks that are members of NSE. Further researchers can broaden their approach and study factors affecting operations of all the investment banks in Kenya. Future researchers will be able to analyse financial information of stockbrokers for a number of years since it is now a requirement for stockbrokers to publish their books of accounts.

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APPENDIX A:

ASENATH MAOBE
P.O. BOX 2500
ELDORET
MOBILE: 0721518973

TO THE OPERATION MANAGERS
STOCKBROKERS IN KENYA

Dear sir/Madam,

RE: REQUEST TO COLLECT DATA ON MY RESEARCH

With the permission of Egerton University, I hereby humbly request for your participation in answering the attached questionnaire.

This study is on: “evaluation of factors affecting the performance of stockbrokers in Kenya”. Your contribution on this study will greatly enable the evaluation of the factors that affect your performance and recommendations to improve on that.

Thank you.

Asenath Maobe
CMII/0347/07

APPENDIX B:

QUESTIONNAIRE

Date of interview: _____

SECTION A: BACKGROND INFORMATION OF THE FIRM

1. Name of the firm/Stockbroker:
2. Classification of the firm/stockbroker:
Stockbroker Investment bank
3. Number of years the firm has been in operation in the country?
4. Specify the range of services offered by this firm?
.....
.....

SECTION B: MANAGEMENT OF THE FIRM

1. How many Board of Directors does the firm have? _____
2. The mode of appointment/selection of this Board of Directors?
Application/Interview Elections Nomination
3. What are the criteria used for one to qualify as a Director?
 Ownership of shares Professional training Other
(specify)
4. What is the composition of the Board in terms of professional qualifications?
 Lawyers [give number.....]
 Finance specialists [.....]
 Economists [.....]
 Other professions [list and give numbers].....
5. Please rate the level of effectiveness of the Board of Directors in achieving the following aspects of the firm?

Aspect	Not effective	Average	Effective
Leadership			
Integrity			
Decision making			
Investor confidence			

SECTION C: OPERATIONS AND PERFORMANCE OF THE FIRMS

1. What is the average waiting period between order to buy/sell put by a client and purchase/sell by stockbroker? Give number of days.....
2. What is the system of payment by a client?
 - Money deposited with broker into security account before purchase of shares
 - Payment made after purchase of shares
3. Does the money deposited yield any interest during the waiting period?
 - Yes (indicate percent interest given)
 - No
4. How many days does it take a broker to send a purchase or sale report to a client?.....days
5. How many days does it take a client to receive the report of purchase?days.
6. How do you determine prices?
.....
.....
7. How long do investors wait before their names go into the registrar's books.....?
8. How do you describe trading on the Nairobi Stock Exchange?
 - Very transparent (every transaction is /are made known to the public)
 - Some trading is conducted privately outside the NSE (e.g. over the counter market.)
9. Do you provide any kind of market analysis for your clients?

Yes

No

10. How do your clients receive market information?

.....
.....

11. Indicate the level of performance of the firm. Tick appropriately in the table below.

Performance Indicator	Response			
	Very High	High	Moderate	Low
Client base				
Sales Revenue				
Profitability				
Operational Efficiency				
Growth & Expansion				

SECTION D: FACTORS AFFECTING PERFORMANCE OF STOCKBROKERS

1. In your own opinion, which of the following factors affect your firm’s performance?
Tick where applicable in the table below.

Factor/issues	Response		
	Yes	No	Do not Know
Management quality			
Governance			
Regulatory compliance			
Business Infrastructure			
Risk Management			
Financial Management			

1. Indicate the extent to which the following factors affect performance of your firm? Use the scale 1-4 where, **1-** Very less extent, **2-** less extent, **3-** great extent and **4-** very great extent.

Factor(s)	Response			
	1	2	3	4
<u>Management Quality</u>				
1. Stability & Experience in management as top management, experience in capital markets, ability to attract talent, training, succession plan				
2. Independence of directorship as depth of board, participation in board meetings, independence in operations				
<u>Governance</u>				
1. Corporate governance as rights, responsibility among participants (board, management, shareholders, partners), Standards, transparency, disclosures etc.				
2. Accounting quality as Audit, disclosures, propriety				

trading and reporting lines				
<u>Regulatory Compliance</u>				
1. Compliance with Acts, Rules & Guidelines, by-laws, history of non-compliance, management attitude				
<u>Business Infrastructure</u>				
1. Robustness of IT systems as connectivity, failure restoration, database and transaction maintenance, up-scaling of IT systems.				
2. Adequacy of Information management systems as quality and timeliness of reports				
3. Back-Office operations as processes, quality of data storage and automation				
<u>Risk Management</u>				
Risk governance as risk appetite reviews, policies, capital allocation, independence of risk management teams				
Market risk management as Trading returns, quantification & reporting and monitoring				
Credit risk management as Franchise approval, initial deposit requirement, counter limits				
Operation risk management i.e. training level of manpower, operational failure, backup system				
<u>Financial Management</u>				
Company profitability as Pre-tax profit and margins, return on net-worth and revenues				
Asset Quality as Bad debts, write-offs, margin cover of collateral accepted.				
Capital and liquidity profile as quality capital level, fund-raising mechanisms, financial flexibility				

APPENDIX C.

STOCKBROKERS' DURATION IN OPERATION

Name of Stockbrokers	Years in Operation
1. Drummond Invest. Bank	60
2. ABC Capital	20
3. Apex Ltd Invest. Bank	16
4. Faida Invest. Bank	15
5. Reliable Securities Ltd.	15
6. Sterling Securities Ltd	15
7. Kestrel Capital (EA) Ltd	14
8. Suntra Invest. Bank	14
9. Dyer and Blair Invest. Bank	12
10. Standard Investment Bank	
11. Genghis Capital Ltd.	11
12. African Alliance Securities Ltd	11
13. African Investment Bank	10
14. Renaissance Capital Ltd	8
15. CFC Stanbic Financial Services	8
16. NIC Securities Ltd.	4
17. Kingdom Security Ltd.	3
18. Discount Securities (under statutory management)	17
19. Ngenye Kariuki (under statutory management)	15

Source: Data analysis (2011)

APPENDIX D:

LICENCED KENYAN STOCKBROKERS

1. Afrikan Investments Ltd.
2. Suntra Investments Bank Ltd.
3. Kestrel Capital (Ea) Ltd.
4. Discount Securities Ltd.
5. NIC Securities Ltd
6. Standard Investment Bank.
7. Reliable Securities Ltd.
8. African Alliance Investment Bank
9. Sterling Securities Ltd.
10. CFC Stanbic Financial Services Ltd.
11. Apex African Investment Bank Ltd.
12. Dyer & Blair Investment Bank Ltd
13. Faida Securities Ltd.
14. Drummond Investment Bank Limited
15. Genghis Capital Ltd
16. ABC Capital
17. Renaissance Investment Bank
18. Ngenye Kariuki & Co. Ltd. (Under Statutory Management)
19. Kingdom Securities Ltd.

Source www.cma.org