

# **Re-Modulating the Growth Enterprise Market Segment to Drive the Growth of SMEs in Kenya through Securities Market Financing**

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## **Abstract**

Small and Medium Sized Enterprises (SMEs) are important in driving economic growth in emerging economies, vital in creating dynamic market-oriented growth, and spurring innovations and employment opportunities for a growing population. To do this, they need access to growth finance as well as knowledge and expertise. Access to finance is the main barrier to their growth and competitiveness. However, Kenyan SMEs face limited access to financing from banks due to relatively higher risks associated with them. Securities markets have an imperative role in bridging this financing gap through the provision of alternative funding sources for SMEs as their needs evolve over different phases of their life cycle. In a bid to aid SMEs in their financial growth, the Growth Enterprise Market Segment (GEMS) was created at the Nairobi Securities Market to provide a funding platform, diversification of ownership structure and unlocking value through more favourable listing requirements, while benefiting from increased profile and liquidity within a regulated environment. It targets SMEs with limited track record but with positive growth prospects. Nine years following its introduction, however, the number of SMEs seeking listing has been relatively low. Only six firms have listed on GEMS with five trading with poor stock liquidity and one already delisted. Guided by the Stages Model as well as Efficient Markets theory, and using a multi-scenario document analysis methodology, this paper analyses the literature and examines the reasons behind GEMS' struggle with attraction of SMEs. It argues that besides regulatory burdens, a range of other business environmental factors conspire and limit SMEs attraction to GEMS. The lack of competent SMEs financing experts, internal organization characteristics, lack of awareness of securities market and understanding of GEMS listing requirements among entrepreneurs in a more sophisticated securities markets financing options, and the urge to raise business profile over and above raising growth capital could have conspired to slow the growth in the number of SMEs listing on GEMS. The paper provides important recommendations on how to re-modulate the GEMS platform to attract more SMEs listing in Kenya.

**Keywords:** Business incubation and acceleration; growth enterprise market segment; Nairobi Securities Exchange; Ibuka platform; small and medium sized enterprises

**JEL Codes:** D53, G32, M13, O16.

## **Introduction**

Small and Medium Enterprises (SMEs) contribute greatly to economic growth of developing countries like Kenya. Their share in employment and wealth creation tends to be higher than from large firms. As such, policy provisions remain fundamental in propelling these enterprises towards self-sustenance and realization of their full potential in contributing to economic growth. Kenya aspires to achieve 10 percent average annual economic growth by 2030 as part of a wider economic plan to achieve sustainable growth. The development of a vibrant and

globally competitive productive and effective financial services sector aimed at promoting high savings levels to fund the country's overall investment needs, including the Big 4 Agenda, is critical to this high-level growth.

The Kenyan government introduced a 10-year Capital Markets Master Plan in 2014, recognizing the importance of the financial sector in achieving this vision. Kenya's securities market was to be upgraded from a Frontier Market to a Morgan Stanley Capital Index Emerging Market status by 2023. The Plan lays out a road map for implementing cross-cutting financial sector reform strategies. ITC (2019) argues that increasing the competitiveness of Kenya's SMEs underpins achieving the goals of Kenya's Vision 2030; the country's long-term development blueprint. This is based on data from the SME Competitiveness Survey. One area of concern for resolving SMEs' competitiveness and needed growth remains the aspect of financing.

It has also been recognized that SMEs have difficulties in obtaining finance through the formal debt markets such as commercial banks. This is due lack of collated assets, audited accounts and credit track record. As such, SMEs face limited access to financing from banks due to relatively higher risks associated with them. Capital markets, however, have an imperative role in bridging this financing gap through the provision of alternative funding sources for SMEs as their needs evolve over different phases of their life cycle. It is against this background, and in a bid to aid SMEs in their financial growth that the Capital Markets Authority (CMA) and the Nairobi Securities Exchange (NSE) created the Growth Enterprise Market Segment (GEMS) in 2013 to assist SMEs to raise growth capital from the securities market.

The GEMS was to provide a funding platform, assist SMEs diversify their ownership structure and unlock value through more favourable listing requirements, while benefiting from increased profile and liquidity within a regulated environment. The GEMS aims at accommodating SMEs mostly with limited track record but with positive growth prospects to scale up their operations. It was expected that through this listing platform, SMEs will be able to raise substantial initial and ongoing capital for expansion. Further, GEMS was to augment various initiatives undertaken by both the government and the private sector to deal with the challenges facing SMEs. However, listing on this market segment by SMEs has been lower than anticipated. Nine years following the introduction of GEMS, and despite the minimal listing requirements under this segment, the number of SMEs seeking listing has been relatively low despite eighteen nominated advisors (NOMADS) having been licensed by the CMA. Only six firms have listed on GEMS with five trading with poor stock liquidity, while one has already been delisted. The expectation by the CMA and NSE was that 24 GEMS listings would be achieved within ten years. The reasons as to why there exist a slow listing on GEMS at the NSE is unclear and thus an issue of concern, which therefore, needs to be understood and addressed.

The paper was guided by firstly, the Stages Model of SMEs growth developed by Churchill and Lewis in 1982, which argues that a firm progresses through different stages, including existence, growth, take off and resource maturity, and thus a firm's characteristics, challenges, practices and attributes are mapped into separate successive stages (Farouk & Saleh, 2011); and secondly, the Efficient Markets Theory, which postulates that securities market listings value and stock price behaviour is not influenced by investors use of past or public information (Fama, 1970). Using a multi-scenario document analysis methodology, a type of qualitative research in which documents are reviewed and dissected by an analyst (Frey, 2018), this paper analyses the literature and examines the reasons behind GEMS' struggle with attraction of SMEs. This is achieved through coding securities market listing and SMEs growth documents' content into subjects by identifying, interpreting, and synthesizing the information

contained in such documents in order to assess an appraisal theme and gain deeper empirical knowledge about a subject matter.

The objective of this article was to discuss the reasons behind the low number of new SMEs listing on GEMS with a view to prescribing important recommendations on how to re-modulate the GEMS in order to end the NSE's IPO listing drought. The study had the following research questions: why has GEMS not attracted many SMEs to list on it? What has been the market price performance of the GEMS-listed SMEs? What can be done to re-modulate the GEMS listing platform to excite the SMEs to join the securities exchange to raise growth and development capital?

### **Small and Medium Sized Enterprises Sector in Kenya**

The SMEs sector in Kenya accounts for the lion's share of the total employment. Evidence shows that SMEs account for about 86 percent of the country's total employment outside small-scale agriculture and contribute to about 40 percent of the value of the economy. Kenya has about 2.1 mn registered SMEs constituting about 96 percent of all business enterprises in the country. The SMEs therefore represent the largest sector in the economy employing a larger percent of Kenya's workforce and contributing up to 18.4 percent of the country's Gross Domestic Product (Economic Survey, 2021).

According to a survey conducted by the Kenya National Bureau of Statistics in 2021, approximately 400,000 SMEs do not celebrate their second birthday thus raising questions about the sector's long-term viability. While the World Bank praised Kenya in its 2017 report on Doing Business in Kenya for making strides in making it easier to start a business, there is still a major issue in smoothing out the process. Finance continues to be the most pressing issue facing Kenyan SMEs. According to Quartey et al. (2017), the key problem affecting SMEs in Africa is access to finance, which is heavily influenced by factors such as firm scale, ownership, legal rights, credit information depth, firm's export orientation and top manager's experience. Few banks are eager to fund SMEs, especially at the start-up level. The Kenyan government and other partners, have developed the Financial Sector Deepening (FSD) programme aimed at increasing access to financial services for low-income households and small firms. The FSD, the World Bank, and the Kenyan Central Bank undertook a study to better understand the supply and demand sides of the SME market (African Review, 2021). It was reported that access to finance continues to be the most serious threat to the survival of SMEs and that they cannot achieve maximum growth unless they have sufficient long-term financial resources. This is where capital market financing plays a crucial role.

In recognition of the economic role played by SMEs and their challenges in financing, the government and private organizations have come up with strategies to increase access to financing for SMEs. Among them is the introduction of special securities market segment called GEMS that is aimed at reaching the SMEs for equity financing. The GEMS, according to Onyuma (2021) is a securities market segment set up by a securities exchange for growth firms that do not fulfil the usual requirements of profitability or track record.

### **Status of the Kenyan Securities Market**

The Nairobi Securities Exchange (NSE), founded in 1954, is the principal securities exchange in Kenya. Besides equity securities, cash and derivatives, the NSE also offers a platform for the issuance and trading of debt securities. The NSE which has 62 listed firms (with 5 under suspension awaiting delisting) has been undertaking reforms to bring it at par with other emerging markets. Nevertheless, market performance has been poor compared to other peer exchanges in Africa. The recent heated political events caused by the three botched presidential elections, collapse of some stockbrokers and the 2020 commercial disruption of business operations caused by Covid-19 pandemic have also provided a lot of challenges to the

performance, growth and development of the NSE as many retail investors shy away from the market. It is such challenges coupled with sluggish macroeconomic performance that have called for more reforms to improve its firm listings.

According to the PricewaterhouseCoopers (PWC) (2020), over the past ten years, there have been 215 IPOs by African companies in Africa and on international exchanges, raising \$16.9bn. Out of these, Kenya only managed to attract 3 IPOs, the NSE self-listing IPO in 2014 (Ksh.627mn), the Income-Real Estate Investment Trust (IREIT) IPO in 2015 by Stanlib Investments (Ksh.3.6bn), and the 2020 Homeboyz IPO (Ksh.252.8mn). This listing record is lower compared to listing in top 5 countries with the highest number of IPOs in Africa in which South Africa had 44 IPOs (\$4,774mn); Tunisia, 23 IPOs (\$391mn); Egypt with 13 IPOs (\$1,254mn); Tanzania with 8 IPOs (\$243mn); and BRVM regional market (Benin Burkina Faso Guinea Bissau Côte d'Ivoire Mali Niger Senegal Togo) also had 8 IPOs (\$301mn). Kenya seems to be lagging behind in the number and value of equity IPOs.

The trading activity and liquidity at the NSE has also been seriously subdued. For instance, the NSE 20 Share Index, according to CMA (2021) has since dropped to 1,882 points in January 2021 with the total number of shares traded decreased to 294mn shares. Also, the total value of shares traded at the NSE decreased from Ksh 10.24bn in December 2020 to Ksh 8.85bn in January 2021. In April 2021, NSE 20 Share Index was at 1,873.46 and equity turnover was Ksh356.4 mn, while market capitalization stood at Ksh.2.524tn (NSE, 2021).

The NSE has not had major listings since the Safaricom IPO, a trend which has seen investors concentrate most of their wealth in a few large-cap stocks like Safaricom, East African Breweries, Equity Bank, KCB Bank and Co-operative Bank account for 79.4 percent of the market value of the companies listed at the Exchange. The Kenyan securities market currently has a market capitalization of Ksh 2.524tn, with Safaricom alone controlling 44 percent of the market value. The CMA is concerned that the NSE will not be able to meet its expected listing goals as outlined in Kenya's Capital Markets Master Plan, which calls for at least four new listings on the NSE per year. Just a few large-cap stocks account for nearly 79 percent of overall market capitalization, rendering the securities market volatile due to the reliance on a few securities, which poses a risk of a market crash if anything happens to these firms.

The securities market therefore needs a fresh listing of high-value firms and several SMEs listings to increase diversity within the Kenyan market and correct the market imbalance. This will reduce the dominance of the five companies and fill the gap occasioned by de-listings and erosion in the value of blue-chip stocks like Kenya Airways and Kenya Power. Access to the securities markets is influenced by a variety of factors, especially in emerging markets like Kenya (Gravdina & Sahovsca, 2013) include; the level of awareness of securities market listing benefits, cost of listing, level of a firm's riskiness and profitability, corporate governance issues, listing and trading rules for entering the securities market, and the capital structure preference of a firm, in particular for SMEs.

The CMA has been engaging stakeholders such as the National Treasury, NSE, Central Depository and Settlement Corporation (CDSC), Fund Managers Association (FMA), and MSEA, among others, on how to come up with value propositions for listing on the NSE and proposals to loosen entry regulations into the market in order to alleviate the listing bottlenecks. Consequently, the NSE developed an Incubator and Acceleration Board called Ibuka to help entrepreneurs grow and succeed by providing a variety of business support tools and consultancy services to firms that are not yet ready to list but have promising prospects. This is aimed at assisting in the creation of a pipeline of active SMEs for future exchange listing. There is also the launch of the GEMS at the NSE in 2013 aimed at addressing the lack of listing, with the goal of providing more options for SMEs finance, especially long-term funding, through the use of favourable listing criteria tailored for SMEs. After its inception, the segment

has attracted a total of six SMEs, five of which have listed by introduction (one of which has been delisted), and one by cross-listing.

The NSE is therefore banking on the Ibuka programme to help raise the number of firms listed, as well as lobbying the government to sell additional shares in successful blue chips such as Safaricom, KCB Bank, Kengen, and KenyaRe, in addition to other non-listed parastatals like Kenya Pipeline Corporation, Kenya Airport Authority, and Kenya Ports Authority to the public. This is a departure from the past where the NSE has been waiting on firms to put their house in order then approach them for listing; a process that has proved slow and sometimes exposed new shareholders and creditors to losses. The NSE is therefore experiencing a serious dearth of IPO listings, which are key in introducing new investors into the securities market. It has instead seen a raft of listings by introduction, largely limited to SMEs under its GEMS, which have failed to excite stock investors. The question which arises then is why has GEMS not attracted many SMEs to list on it, and what can be done to re-modulate the GEMS listing platform to excite the SMEs to join the securities exchange to raise growth and development capital?

### **The Need for the Growth Enterprise Market Segment**

Before the creation of GEMS in Kenya, firms listed on NSE's under the main investments market segment (MIMS) needed to have a minimum of 1,000 shareholders, and the alternative investments market segment (AIMS) required a minimum of 100 (CMA, 2020). Even if the owners did not want to have direct control over the firm, acquiring a large number of shareholders before listing could be extremely expensive. Other firms were immediately excluded from the NSE's listing criteria due to lack of a profitable track record. To list on the MIMS, a firm needed to have five years of audited financial statements and to have made a profit in at least three of those years. On AIMS, firms were required to have three years of audited financial statements, two of which had to demonstrate profitability. This was a significant roadblock for firms in industries like mining and oil, which may have strong prospects but lack the track record needed by the MIMS and AIMS listing boards, while still in the exploration phase. Firms that changed their primary operation or created from the reorganization of older firms were also affected (CMA, 2014). In fact, SMEs were completely excluded from the listing equation, given their scale of operations. Such restrictions on listing in the MIMS or AIMS seemed to be at odds with growing foreign interest in the Kenyan economy. These are therefore the issues which GEMS was to address so that SMEs could also find a window for them to raise growth and development capital through the securities market.

The GEMS platform was to enable SMEs to raise capital to drive their growth plans while benefiting from increased profile and liquidity within a regulatory environment designed to meet their needs (CMA, 2014). The objectives were to make it affordable for SMEs to gain access to financial resources that were previously the preserve of larger firms, and also to raise their public profile as well as for SMEs owners/investors to realize the cash value of their investments with ease (ACCA, 2013).

In Kenya, a number of reasons could be responsible for the slow pace of SMEs listing at the NSE. For example, despite the securities market's introduction of the GEMS, it has been reported that SMEs are not participating due to a lack of knowledge and information about the benefits of a securities market listing (Nyakweba, 2014). One of the basic ingredients of a well-functioning securities market is public awareness. The government has attempted to launch a concerted campaign through the CMA in order to educate the public about the benefits of investing in the securities market (Awino, 2019). Tailor made information on GEMS required to help instil trust in the public and encourages investors to participate in the market. Public awareness campaigns can raise public interest and propagate market growth.

Another barrier to listing on the NSE's GEMS is the segment's strict guidelines. For example, the Unaitas Sacco Society Ltd, a savings and credit co-operative society, tried but failed to meet the listing requirements (ACCA, 2013). Listing requirements and corporate governance requirements have been found to have the greatest impact on SME listing on the NSE (Mwarari, 2013). Despite these limitations, the establishment of GEMS is an essential strategy for SMEs to gain deeper access to the securities market, especially for SMEs that want to grow their businesses and take advantage of Kenya's expanding capital markets, especially in recognition of the importance of SMEs in driving economic growth and transformation under the Vision 2030 economic blueprint.

### ***Firms Listed on the GEMS on the Nairobi Securities Exchange***

The GEMS listing requirements have been relaxed to accommodate smaller growth firms. The relaxed requirements included not having minimum firm asset value or profitability record; submission of audited accounts for only the year preceding the year of listing, with no profitability requirement; and a minimum of Ksh.10 million in paid up share capital. This listing segment demands only that listed companies have 25 independent shareholders and a 15 percent free float within three months of listing (having 15 percent of their shares in the hands of public investors). Securities issuers here only need a single year of experience and have never had to be profitable, but they must be able to show that they have enough working capital to run the business for at least 24 months after listing. As of 12<sup>th</sup> September 2021, the GEMS segment had a combined market capitalization of Ksh.1.1bn, which amounts to 0.11 percent of the total NSE market capitalization.

It is worth noting that the segment has not attracted as many SMEs as was predicted. Following its launch of GEMS, Home Afrika Limited became the first firm to be listed on 15<sup>th</sup> July 2013 (Anyanzwa, 2014) listing 405mn shares. In November 2014, Flame Tree Group also became listed but was later delisted having violated the listing rules. Kirwitu Ventures Limited joined the GEMS in November 2014 by listing at Ksh1,250 a share; however, its stock price has never changed since its listing. Furthermore, Atlas Development and Support Services was cross-listed at the NSE on 17<sup>th</sup> December, 2014 but was later delisted from the NSE on 25<sup>th</sup> April 2019 following resignation of its Kenyan NOMAD.

In addition, Nairobi Business Ventures Limited obtained listing on the GEMS board on 12<sup>th</sup> June 2016 selling 23.6 mn shares. On November 30<sup>th</sup> 2020, the NSE approved Nairobi Business Ventures Ksh83 mn buyout deal by Dubai-based Delta International FZE to automatically acquire a listing status; a process technically known as a reverse takeover, to take control of Nairobi Business Ventures (NBV) whose shoe retailing business had collapsed. Lastly, Homeboyz Entertainment Limited listed its shares by introduction on GEMS listing board of the NSE on 20<sup>th</sup> December 2020 by listing 63.2 mn shares, becoming the first entertainment company in Kenya to do so (NSE, 2020).

### ***Performance of GEMS Listed Firms at the NSE***

While the Capital Markets Master Plan, 2014-2023 aims to have 40 firm listings on GEMS by the end of 2023, thus raising the market momentum, this goal is yet to be met. Even as the NSE strives to attract SMEs to the securities market, the output of the companies that are already listed is lacklustre. The NSE and financial advisors are aware of the financial difficulties that investors who invest in listed SMEs are already experiencing.

The NSE monitors listing advisors to ensure that they are following rules and regulations, and the weak performance of the companies listed on the GEMS cannot be attributed only to a general market downturn brought by the difficult economic conditions. This is because it is the duty of the board of directors of the listed companies to ensure that rules are followed. A company's success is influenced by a variety of factors, including the financial and economic

environment in which it operates. Is it possible that the valuation of SMEs that are candidates for GEMS listing does not take all factors into account? Some of the listed SMEs were brought to the market at valuations that did not represent their risks. Firms that approach the GEMS board are high-risk because they are still rising, have not grown, and have a history of poor governance.

With the market downturn, the share prices of some SMEs have plummeted to new lows, leaving investors counting paper losses and raising concerns on whether the listing prices of these firms took into account all of the risks that come with smaller firms. Shareholders in Home Afrika Ltd and Atlas Development Ltd have lost money in these firms. It is worth asking why there is such a sudden flurry of interest on the GEMS by SMEs. Could it be the pursuit of owners' prestige and fortune? Are the firms' early investors hoping to benefit from the selling of their shares after listing and the price rises before the market corrects? Home Afrika's shares, for example, reached an all-time high of Ksh.25 only a few months after going public, up from the Ksh.12 initial listing price. The stock, however, closed on November 17<sup>th</sup> 2014 at Ksh.4.15, dropping further to Ksh.0.40 in September 10<sup>th</sup> 2021, mirroring the company's poor performance following its initial public offering. Similarly, the shares of Flame Tree Group, listed at Ksh.8, rose to Ksh.14 on the first day of trading, but have since fallen to Ksh.1.35 by September 10<sup>th</sup> 2021.

There is also a disconnect between what listed SMEs inform the market (investors) and the truth of trading. Atlas Development's decision to sell its core business of providing logistics to the oil and gas industry in order to invest heavily in a Nigerian gaming company, for example, sent the wrong message to local investors (Mwanyasi, 2019). Atlas Development's share price had fallen by more than 90 percent to Ksh.1.05 per share at the time of being suspended from trading in 2017, compared to Ksh.11.50 per share during listing. On the other hand, even those GEMS which have shown some good performance are not any better. Kurwitu Ventures, for example, listed at Ksh.1, 250 per share, which seemed a little high considering the firm's lack of a track record of profitability. The firm's shares closed at Ksh.1, 500 in mid-November 2014, which is a 20 percent increase over its introductory listing price but on very small stock trading volumes-same price as at September 10<sup>th</sup> 2021.

It is worth noting that only two GEMS-listed firms, Kurwitu Ventures and Nairobi Business Ventures, have seen their share prices rise since their listing. Despite the price rise, investors were concerned by Kurwitu Ventures' lack of consistent investment plans and Nairobi Business Ventures' increased borrowing, which stood at Ksh 66.46 mn in March 2019. Kurwitu Ventures informed investors at the time of listing in November 2014 that it will invest Ksh100 mn in 2015, Ksh150 mn in 2016, and Ksh200 mn in 2017, but the company has not made any investment transactions public and its shares have not traded on the exchange since then.

Homeboyz Entertainment, an entertainment and public relations outfit, listed on the GEMS on 20<sup>th</sup> December 2020 selling 63.2 mn shares at Ksh.4.60. While the firm is a strong brand in media and entertainment, there are concerns over its family ownership and management structure and political risk exposure. The firm, for instance, is not adequately corporatized because it is family-owned and managed. The three siblings are the major shareholders, board directors, and also lead the management. In a board where three out of five directors are the original family owners, they have the majority voting power, giving them tight control over its decisions (Business Daily, 2020). The NSE should have advised them to diversify their board with individuals who bring in corporate governance experience. That would give investing public confidence that the board will make independent decisions, pursue shareholders' and not family interest. In sum, majority of the listed SMEs have exhibited poor financial performance and erosion on firm value, while one has even been delisted from the exchange.

## **Re-Modulating the Gems Listing Board to Attract More SMES**

Despite the introduction of GEMS, only a handful of SMEs have listed at the NSE. By September 2021, almost nine years after the introduction of GEMS segment, only six SMEs have been listed, of which one has been delisted over non-compliance with listing rules. Compared to the other market segments, the NSE has lower entry requirement for companies listing under GEMS yet few firm are seeking listing on its GEMS listing board. The low level of SMEs listing in this segment is a pointer to some existing challenges hindering them from listing in the securities market in Kenya.

It can be recalled that this SMEs listing platform was created to provide a forum for young businesses looking to expand, raise capital, diversify their ownership structure, and unlock value through more favourable listing criteria. How then, can the slow pace of listing at the GEMS be addressed? It is worth noting that the government has issued an amnesty on tax penalties and interest on any unpaid tax for SMEs that list under the GEMS for a period of two years prior to the listing in the 2019/2020 Budget Statement; a step aimed at addressing this long-standing issue. The 10-Year Capital Markets Master Plan (2014-2023) set a target of four new SMES listings each year, as this represents the future supply of potential MIMS/AIMS board listed firms. Despite the numerous incentives, especially tax-related incentives, offered under GEMS, the counter has been underutilized.

To address the issue of underutilisation, the CMA has made some concerted effort to raise public awareness of the opportunities. Although the GEMS eligibility requirements are less stringent than those of the AIMS and MIMS, a greater focus on corporate governance is placed on investor security and trust. As a result, SMEs must have a high degree of corporate governance to ensure that internal controls and risk management are proportional to their size. The CMA has identified 70 potential SMES that can list during the Business Incubator and Accelerator on the Listing Experience (BIALE) forum held in March 2017 as part of its push to increase listings on the NSE. Its Master Plan objective of increasing GEMS listings by 4 SMEs per year by 2023 could result in a stable supply of future AIMS/MIMS listed firm.

The level of interest in the securities markets as a source of long-term financing to finance growth and expansion plans for SMEs in Kenya is evident in the response from SMEs' listing candidates. The business incubator and accelerator (Ibuka) programme is designed to offer interested firms a concrete and hands-on experience with the listing process. Under this programme, interested SMEs participate in a stage-by-stage, one-on-one, organized engagement with the CMA, NSE, NOMADS, Transaction advisors, Lawyers, Auditors, Stockbrokers, and Investment banks among other service providers, to provide confidential business-to-business discussions about their preparation for listing (Onyuma, 2021). Identifying business needs/strategic issues, preparing business strategies, considerations for appointment advisors and other agents, mandating negotiation, necessary paperwork, regulatory and other approvals, the process of issue placement and allotment, listing fees and deadlines are all areas of engagement during this process (Onyuma & Ndung'u, 2021). This is geared to develop a pipeline of successful businesses to be listed in the future.

The NSE and CMA have to further reorganize the presentation of the GEMS listed firms in the NSE price lists by classifying the firms based on sectors rather than as separate segment at the bottom of the price list. But even having been placed within these sectors, SMEs are still labelled as GEMS. More elaborate strategies, including proper valuations and pricing, should be put in place and activities within the GEMS market should be successfully implemented. When achieved, these can be expected to foster growth of the GEMS-listed SMEs and translate to high trading volumes, ultimately pushing the securities market activity to the next level.

Proper valuations at the point of entry to the securities market will not only benefit the SMEs post-listing but also provide attractive exit arrangements to private equity firms. Despite

a reduction in the eligibility requirements in terms of capitalization, free float shares and the number of minimum shareholders, there are other costs, both monetary and non-monetary, which the regulator should still consider cutting.

In addition, considering the possible general downsides of business incubators elsewhere, as reported by Lukosiute, Jensen and Tanev (2019), and looking at the incubation and accelerator requirements as designed by CMA/NSE, the following needs to be re-modulated: Firstly, in terms of the admission criteria, the Ibuka incubation programme seems not to have performed proper due diligence and assessment to ensure SMEs quality and business viability. This may be the reason why some of the listed SMEs are being delisted. Secondly, considering the services and offerings, the incubated SMEs seem to have received low commitment from incubation programme stakeholders such as business mentors, advisors, and external partners. External service providers are usually not interested in a firm's incubation success.

Moreover, equity dilution upon listing can lead an SME to bankruptcy and those which have diluted too much equity during public listing could struggle in future to convince other strategic private equity investors to invest in it. Therefore, every time an SME issues new shares, the existing shareholder's equity decreases. Probably, the NSE incubation programme does not meet the SME's initial expectations. In addition, participation in such an incubation programme also puts intellectual property at risk. SMEs who join an incubation programme are risking exposing their product/idea to third parties that have similar access to the incubation programme; thus, the need for legal advice on intellectual property consultancy (Onyuma, 2021). In the post-incubation and post-listing, SMEs seem to seek for funding from other sources such as strategic partners, business angels and lenders. The incubation programme seems therefore unattractive to potential SMEs, yet it is expected to entice SMEs to list on GEMS, and other SMEs who are potential candidates for the Ibuka programme seem to be unaware of the NSE incubation programme's ecosystem.

Kenya's bid to have SMEs raise fresh capital through the NSE also faces new hurdles over diminishing investor interest, declining stock prices, poor performance of existing SMEs listed firms and the economic effect of Covid-19 pandemic. The NSE seems to be struggling to attract SMEs to both its incubation programme, which is designed to prepare potential issuers to raise capital through the Exchange, and listing on its GEMS counter. The Ibuka programme creates a good pipeline of SMEs that have the potential of listing in future. In its nature, it is an incubation and acceleration programme designed for SMEs seeking high growth prospects. However, out of the 26 companies that have joined the programme, only Homeboyz Entertainment had graduated from Ibuka into tangible listing on GEMS in December 2020. The NSE's Ibuka programme needs to be re-modulated so that it becomes mandatory for SMEs that enter the programme to graduate into listing.

In order to address the issue of low number of listings as well as slow uptake of the securities market's products in Kenya, the government, through CMA, has been offering tax incentives to attract firms with the potential to list to the Exchange. The incentives have however, not boosted the number of listings. This is because the measures undertaken to address the low number of listings have not taken a bottoms-up approach to identify the real impediment to listings, focusing mainly on tax exemptions whilst there are a number of deep underlying issues that still need to be remedied, in order to make Kenya's securities market more robust.

The other key issues that need to be re-modulated in order to unlock capital for SMEs in the securities market via GEMS listing are herein presented. Firstly, the rise of private equity firms providing easily accessible capital is a challenge. Currently, Kenya's private equity space has been vibrant. Raising capital through private equity firms has been on the rise, filling much of the void left by the drought in IPOs on the NSE. The attractiveness of private equity funding as opposed to public listing is mainly because private equity funding gives firms the

opportunity to continue financing their growth while remaining privately held. This allows firms to preserve decision-making control which is usually lost when firms list is critical if they are to be convinced to seek listing. The GEMS IPO listing threshold of 25 percent ownership should be reduced, probably to even 10 percent, to reduce the fear in SMEs' owners of losing their ownership control.

Secondly, once an SME has decided to join GEMS, it needs to appoint a NOMAD whose role is to guide it through the NSE's listing requirements, ensuring that it is compliant. Despite the requirement for a NOMAD to advise SMEs on listing on the GEMS, the uptake of licensing among NOMADS has not been impressive because of the amount of cross-sector expertise required. Mpathia (2016; 2017) notes that a financial service firm is not able to properly advise the SME without the help of a law firm, human resource consultant to advise the SME on various issues in order to assess technical viability of the listing services, which cannot be offered by one firm. Although market regulations allow a licensed NOMAD to partner with other professional firms and form a consortium of advisors, this makes the listing cost to be prohibitive for SMEs as every member of the consortium will have to charge its fee.

Developed markets have different tier firms that provide services to different segments of the securities markets. Kenya does not have such advisory firms that specialize in large IPOs doing the listing for GEMS since their cost would be prohibitive. There is the need for partnerships by different professionals to serve as NOMAD for the SMEs market. For example, a mid-size financial company, human resource consultant and law firm can partner and apply for a NOMAD license to offer quality advisory service to SMEs aspiring to list on the GEMS; some sort of a one-stop advisory service outfit with affordable professional fees not too costly to SMEs. The view of some SMEs interviewed in a Financial Sector Deepening (FSD) project by Mela et al. (2015) is that NOMADS are somewhat of a grudge purchase particularly the requirement to maintain a long-term relationship after the listing process. This calls for review of the continuous role of NOMADS in SMEs listed on the GEMS through the assessment of both their cost, benefits and attendant risks to ensure SMEs are enabled to access capital in addition to enjoying the other benefits of listing at minimum cost, while the investing public remains protected from possible exploitation.

Moreover, there is also the fear of loss of firm control by SME owners. In fact, many SMEs especially family owned/closely held are reluctant to list due to fears of dilution of ownership and loss of control (Cytton, 2018). The SMEs tend to rely on bank finance and a proven network of family and friends to raise additional capital when required. Such firms could be avoiding getting listed due to constant pressure to increase earnings that come with it as a public firm who usually take a short-term view mainly interested in seeing constant rises in the stock's price so they can sell their shares for a profit and less emphasis on the values and core ideologies of the firm. To remedy this, the NSE, CMA and the government, through amendments to the Company Act, should come up with market regulations to address the concerns of loss of control by major investors. Such policies could allow firms to have a shareholder's structure that ensures the initial owners do not lose control; such as the Facebook (Meta) ownership model with a dual class stock structure consisting of Class A and Class B shares. Despite Mark Zuckerberg and a small group of insiders owning only hold 18 percent of the shares, these few insiders own the majority voting rights in the company. In such a shareholding structure, the class of shares they hold guarantees them 10 votes per share as compared to what is held by the public shareholders, which carry only one vote per share.

In addition, during December 2020, the United States Securities and Exchange Commission (SEC) approved the New York Stock Exchange's proposal to allow firms to raise capital in a direct listing (Kunthara, 2020), thus opening the door to a new alternative to the traditional IPO. In a direct listing, a firm floats its shares in the securities market, but without hiring investment banks to underwrite the transaction like in a traditional IPO. In this way, an

SME will be able to issue new shares and sell them to the investing public in a single, large transaction on the first day of trading, much like the first trading day in a traditional IPO. Compared with a traditional IPO, a SME doing a direct listing with a capital raise would save on underwriting fees typically paid to such consultants. A firm could also potentially benefit more from a first-day surge in its stock price. In a standard IPO, the main beneficiaries are the professional/institutional investors, often mutual or hedge funds that buy shares from the firm before they start trading publicly on the market.

Lastly, the primary goal of IPOs over time in Kenya has been to provide a platform through which firms can raise large capital in a transparent manner where price discovery mechanisms are determined by the forces of demand and supply. One regulatory provision of concern to firms has been the cost of listing that includes transaction advisory costs, marketing and listing costs (Mela et al. 2015) particularly for SMEs. Evidence show that East African countries still remain the most expensive markets for stock investors within the continent with a bulk of the trading costs related to brokerage fees. For instance, underwriting fees, charged by investment banks are the single largest direct cost associated with IPOs in Kenya (Onyuma, 2020). Although underwriting remains a significant process mainly for large IPOs targeting to raise substantial capital, and with expectation of more SMEs to list on GEMS and raise capital through IPOs, both the CMA and NSE should adopt the United States SEC model and consider regulatory review to fast-track direct listing by SMEs. This works particularly so where a firm has an internal financial expert able to map out the IPO requirements for targeted investors. The CMA should therefore undertake a review of the Public Offers and Listing Regulations to facilitate the direct listing especially for SMEs, as a means of making the GEMS listing board more attractive specifically on managing costs of listing.

### **Conclusion and Recommendations**

The Kenyan SMEs seems unaware of both the advantages and the criteria of listing on GEMS. Yet securities market listing offers access to vast sums of capital at a lower cost than other capital-raising strategies such as borrowing. It was difficult for SMEs in Kenya to obtain exchange listing before the creation of GEMS, but this is now possible for those who qualify, with just a little re-tweaking of GEMS. Several recommendations are hereby provided for re-modulating the GEMS listing board to remedy the low number of new SMEs listing on GEMS in Kenya.

The SMEs' ability to provide details is crucial to their listing on the GEMS. If the SMEs sector in Kenya is to achieve sustainable levels of growth and development, the government and business service providers must pay attention to access to business information services. Due to a lack of adequate business support services and inadequate information technical infrastructures, many businesses operate in an information-poor environment. Relaxed legal and regulatory requirement is equally important on access to securities markets by SMEs. The SMEs to be listed on GEMS are required to produce regulatory documents for approval by the Exchange. The many legal requirements could be rendering most SMEs unable to get listed on the Kenyan Exchange.

The CMA should make its information access to SMEs unfated. In that way, SMEs will be able to understand the requirements when applying for listing. The NSE together with CMA should consider further cutting down the costs of listing for SMEs as this will ensure that they are able to easily meet these costs together with other requirements. However, as an industry, the two must recognize that the potential of the GEMS counter will only be fully unlocked through re-modulation (continuous improvement and refinement) to expand its outreach and to attract even more SMEs to list. The two institutions should be committed to strengthening the GEMS and leverage the lessons learned so far in order to make it an even more attractive option for growing the SME sector in Kenya.

Moreover, the restrictive business rules and regulations must be reviewed. To address this, CMA should review the restrictive provisions in market regulations that are unattractive to capital raising and listing by SMEs in order to ensure that the rules encourage rather than discourage active participation in the securities market—restrictions on investor engagement. Investment in real estate investment trust, especially a Development- Real Estate Investment Trust (DREIT), for example, needs a minimum investment of Ksh. 5 million. This is a barrier to investors who want to invest in a Real Estate Investment Trust (REIT) listed by an SME.

Furthermore, the cost of listing also acts as a barrier to access securities market by SMEs. The cost of listing is a major factor that may be preventing these firms from listing on the GEMS. Consequently, CMA should make the process of listing appealing to SMEs while ensuring investor rights and not compromising minimum disclosure standards. The NSE should ensure that their legal requirements for SMEs are not that stringent. The underwriting of IPOs remains an important process particularly for large IPOs targeting to raise large amount of capital. However, with the expectation of more SMEs to list on GEMS and raise capital, CMA and NSE should consider the United States SEC model and undertake regulatory review to actualize direct listing by SMEs, especially, where a firm has an internal financial expert able to map out the IPO requirements for targeted investors.

In addition, the CMA and NSE should engage with private equity firms to explore the possibility of exiting through the securities market. The private equity market space in Kenya has grown significantly in recent years, with a focus on financing SMEs with high market potential. The CMA should work with private equity firms to consider exit mechanisms through the securities market, which will allow such markets to benefit from the private equity sector's dynamism. However, in order for this to happen, the problem of the NSE's shallow market must be resolved in order for SMEs' IPOs to be feasible. There is also need to review the continuous role of NOMADS in SMEs listed on the GEMS of the NSE. This should be done through the assessment of both their costs and attendant risks to ensure SMEs are enabled to access capital in addition to enjoying the other benefits of listing at minimum cost, while at the same time the investors remain protected from possible exploitation.

Lastly, the securities market regulator and the Nairobi Securities Exchange should develop public awareness campaigns aimed at improving securities market literacy. The level of awareness and knowledge of both SMEs and even large firms with listing potential, as well as local investors who are significant in driving IPOs, remains one of the major impediments to the number of listings and uptake in the securities listed at the NSE. To address this, the CMA along with other market participants, should launch a comprehensive awareness campaign aimed at improving literacy about the securities market and the various opportunities available to its participants.

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