RECOMMENDATIONS TO THE NAIROBI STOCK EXCHANGE

Bureau for Private Enterprise
U.S. Agency for International Development

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Recommendations to the Nairobi Stock Exchange Nairobi, Kenya

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A Report by Arth:.r Young for USAID

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To the Nairobi Stock Exchange:

The Nairobi Stock Exchange is now an association of six stockbrokers in the Capital of Kenya. In function they do not meet the definition of a stock exchange as all their orders are not exposed to competition with each other. Neither are they an over-the-counter market as no products are purchased, inventoried or sold by dealers. Functionally, they are Kenya's national society of stockbrokers, meeting daily to determine the best bid and the best offer then held by any broker on behalf of a customer and agreeing to limit any trades arranged that day to the range of these best bids and offers which on a typical day have spreads of from 7% to 70% above the bids. Trades are then negotiated by each broker between his customers, and occasionally with another broker by telephone.

Each Thursday, the members pool their trading volume figures for each security, but these figures are not published or accumulated. The best current bid, offer and prices of any sales during the week are also compiled on Thursday for publication.

Shares of about 55 companies are listed. Government securities are listed but never trade. One Member is appointed by the government to compute quotations on government securities by a formula based on theoretical interest rates for various maturities. True market values would probably be lower. The use of the quotations is probably to establish a theoretic value for the portfolios of banks, pension and insurance companies required to hold these securities.

Current trading volume is about $13 million shares annually (Exhibit 1 annualized), valued at about 270 million Kenya shillings (US$16 million)(Exhibit 5 annualized). The average price of traded shares is therefore about 20.76 KSh (US$1.22). Exchange member reports to me of their own average weekly trading volume multiplies to about 7,000 trades a year, up from the estimate of 4-5,000 trades a year for 1980-83 in a 1984 study, and at about the level reported for 1978.

The Exchange prescribes minimum commissions which when applied by me to trading records for the first 3 1/2 months of 1988 indicate annualized commission to the Members of about 10.3 million KSh (US$607,000)(Exhibit 3). However, the six brokers gave me in confidence their individual gross commission income which totalled about $5.5 million KSh (US$319,000). This is a troubling discrepancy which may be due to misunderstanding, or it may be that brokers are charging substantially less than the prescribed minimums, especially on large trades.

The income of the Exchange itself is about 150,000 Ksh (US$8,823) per year with about two-thirds coming from listed companies, a sixth from member fees, and a twelth from "agent" fees. The Exchange has no staff, ministerial functions are supplied below cost for about 70,000 KSh by an accounting firm which specializes in acting as a secretariat for companies. The Exchange neither owns nor rents real estate, but meets on Thursdays in the conference room of a member, and on other business days in a hotel restaurant.

Although there are 352 million shares listed with a market value of one billion Ksh (US$424 million)(Exhibit 2), the turnover ratio is only 3.6% a year, a small fraction of turnover in developed countries (Exhibit 5 annualized). There are no available figures on share distribution by size of holdings in listed companies.

Ten listed companies account for 63% of the listed shares (Exhibit 8), 65% of shares traded(Exhibit 6), and 78% of member commission income (Exhibit 10. But one company, Breweries, alone, with 10% of shares outstanding produces 45% of trading and 58% of commissions.

Kenya is said to have a very high savings rate. Its financial institutions are fairly well developed with a larger appetite for shares than the available supply. The Exchange is therefore a seller's market - most trades occur at or near to best offer prices. There are always multiple buyers in the wings waiting for offers judged reasonable on the basis of dividends with little attention to earnings and prospects.

There are numerous reasons for the shortage of shares in public hands which have been well documented, for example in an International Finance Corporation/Central Bank of Kenya report of 1984. Correction of many of these problems is a prerequisite to growth of ownership of Kenya business by a broader group of its citizens. There is progress. Partial ownership of one large bank was last year very successfully distributed, another is in progress with a third being planned. The Stock Exchange as an organization has an active role in advising on bringing to market new issues.

Altogether, the climate for growth of shareownership is promising.

Stock Exchanges are vital institutions in an enterprise system which best motivates and mobilizes the energies of a people to improve their standard of living and quality of life. They make attractive the bringing together of the savings of many persons through shares in and debt of job and product creating organizations. Centralization in one auction marketplace of the value opinions of all participants in financing such an enterprise creates fair pricing as a measure of efficiency, for liquidity of savings, and for increasing capital through pledging securities as collateral. The trading cost to customers is also less to customers in an auction market where most trading at commission directly for customer accounts has no dealer intervention as compared to an over-the counter market where all trades are subject to a dealer spread usually larger than broker commissions.

Throughout the world in the 1980s, public ownership through private and institutional investment and privatization of government enterprises has been increasingly recognized as the best route to jobs and productivity. Stock Exchanges have been organized and are growing to serve their purpose in each free economy.

The long history of stock exchanges in developed countries gives adequate indications of the strengths and warnings of the perils of the business of stockbrokerage. The lessons of this history are memorialized in the rules of stock exchanges and securities laws. And there are common threads in these rules and laws wherever they have developed.

My recommendations following are also expressed in proposed stock exchange rule language prepared for the Nairobi Stock Exchange. The rules draw on commonalities which I have observed in visiting 27 securities exchanges and advising in depth some seven of them. The language and structure has depended substantially on the law and rules I know best, having written, amended, commented, and worked with most of it for more than 30 years - the United States Securities Acts and the rules of the New York Stock Exchange. But I have tried to simplify the complex legal language of these documents back to the businessman's expression of procedures and ethics on which they are based and further adapted them to the size of the Kenya market.

Further, my selection of certain choices among alternatives reflects my own convictions concerning the welfare of a developing stock exchange and stockbrokerage community. For example, there is a universal perception among investors that stockbrokers are likely to take advantage of their customers by themselves trading ahead of their customers, or by use of inside information, etc. This perception must be countered continuously be rules of ethical conduct and their strict observance and enforcement.

Some stock exchanges have attempted to eliminate this possibility by prohibiting trading of members for own account. Where this has been done, there remains an investor perception and perhaps a reality that brokers violate its intention by hidden trading in accounts of others. I favor permitting brokers to act as dealers for the liquidity it can add to the market. Limiting ethical rules can control possible excesses with records available to review compliance. Although trading by stock exchange members does not yet have profit potential in Kenya, it should not be prohibited.

Nairobi Stock Exchange's Most Needed Priority - Changed Trading Method

My number one recommendation is that the Nairobi Stock Exchange should become a stock exchange in fact as well as in name, by changing to face-to face trading sessions. Specifics are spelled out in Section Three of the proposed rules. No great cost is involved. A borrowed room can be used for the near future. The only facility needed would be a portable blackboard! The present method of settling trades between brokers can also function as true auction trading is initiated. Later, the more efficient settlement system decribed in Section Four of the proposed rules should be implemented.

From the information presented in Exhibit 6, attached, it appears that only seven listings are likely to sustain reasonable daily trading, perhaps another 10 twice a week, say on Tuesdays and Thursdays and the rest once a week. Members tell me that Kenyan small investors frequently put off security sales until the day before they need money for urgent family matters, and that daily trading is therefore important. Brokers may wish to consider meeting this need in the case of less active securities by advancing partial funds in advance of sales, of course with interest.

The new trading method should be accompanied by complete disclosure of activity. This would include for each security in published news tables high and low for the year, security name, current dividend rate, high and low and closing price for the day, share volume traded for the day, and net change for the day. A supplementary duplicated sheet should be made available to subscribers listing by security each trade of the day with price and size, and year to date statistical summary.

Broadened Membership

I advocate the control of stock exchanges by Boards of Directors composed equally of stockbroker exchange members and their constitutents, - the listed companies, institutional and individual investors or their legal and accounting professional advisors. Stock exchanges being quasi-public institutions, the interests of all should be balanced, and all should in addition help finance the enterprise. Public and governmental criticism and eventual government interference by law can be offset by the evenhanded policies which are likely to be the product of diversified Board membership. My specific recommendations for this type of Board in Kenya are in proposed rules section one. No government representation on the Board is provided as liaison with the government will be more appropriately provided by an Exchange representative on the proposed Capital Market Development Authority.

Broadening of participation in the Nairobi Stock Exchange should go beyond the Board in three areas: 1) open ownership of Members, 2) a new class of Associate Members, 3) access by Registered Securities Professionals rather than by "Agents" as at present.

As defined in proposed Rule 2, Members would be corporations primarily engaged in the securities business authorized to execute trades on the Exchange through authorized employee attorneys. Associate Members would be corporations substantially engaged in the securities business not authorized to execute securities trades on the Exchange through their own employees, rather executing through a Member. Other than executions on the Exchange, both Members and Associate Members could exercise similar securities business functions. Members would have one vote, Associate Members one half vote each. Only Members could be Sponsoring Brokers for new issues. The split of commissions on a customer order originated by an Associate Member would be 50% to the Associate Member performing the selling function, 25% to the entity settling the trade (including transfer), 10% to the entity carrying the customer account, and 15% to the Member executing the order (See proposed Rule 117).

It is anticipated that leading banks and finance companies might elect to become associate members, thus broadening active participation and financial support in the Exchange. However, the actual securities trading function would remain with Members who are likely to be devoting almost full time to the securities business. It is also likely that Associate Members might wish Members to settle and transfer and perhaps carry customer accounts for business originated by the associate member.

There is a potential for new business in the Exchange also trading money market instruments in a separate environment in which both associate members and members would participate through their respective traders. I have been told that banks have agreed to organize an inter-institutional market for the recent 16% government bonds. The proposed Capital Markets Development Authority is expected to give priority to development of money market trading. The IFC/CBK 1984 study noted the desirability of independent brokers participating in such markets. Is it not an opportunity for the Nairobi Stock Exchange to be the organizational catalyst for an efficient market of this type which is likely to merit continuous trading long before equity securities do so? Such a market is not included in the proposed NSE rules as it needs separate study and approach in which potential Associate Members would be necessary planners. That market might start as daily trading sessions but rapidly move to telephone continuous trading and then to continuous trading via computer terminals.

The present term "Agent" presently used to describe entities given indirect access to the Exchange and a share of commission on their customer orders should not be used as under common law it implies a legal responsibility and financial liability of Members for the acts of agents which is not intended. Some present agents would elect to become associate members. Other such qualified persons might better be characterized as Registered Securities Professionals, with applications as individual persons rather than entities processed directly to the Exchange rather than through Members. The split of commissions with such professionals is proposed to remain at 25%. Where such a professional is an employee of an entity, the split would go to his employer.

There should be standards of knowledge, experience and good business reputation for principals of members and associate members and employees servicing customer accounts as well as capital requirements for the entities. Control of business standards should be through directors and principal officers of each member entity. Rules requiring any new owners or managers to meet qualification standards would prevent sale of members or associate members to unqualified persons. Such rules are proposed in Rules 200 ff.

Structure of the Exchange

In the longer run, it is preferable for the Exchange to be organized as a limited liability corporation, not for profit, rather than an association which remotely may give members financial responsibility for the debts of failed members. Key elements for the Articles of Association of an Exchange limited liability corporation are in Section One of the proposed rules.

Required Commissions

Ordinarily price competition is desirable to promote efficient operation of individual businesses within a private enterprise system. But for stockbrokerage communities in developing economies, the benefits of price competition are overridden by the national interest in providing the person-to - person education necessary to bring about broad shareownership and the necessary infrastructure of securities professionals and systems. Fixed minimum commissions are therefore prevalent everywhere but in highly developed economies as a method of shifting incentive to service competition rather than price competition.

Exhibit 3 demonstrates in the percentage rate column that the present Kenya commission system produces an uneven result which makes some sense if all shares were traded in 100 share lots. They are not in the present system.

Further in Rule 100 I am proposing that NSE trading should be in round lots varying with the share price, so that a trading unit would always be in the range of 3,000 to 10,000 KSh.

Even so, large buyers and sellers justifiably will properly feel that commissions simply multiplying the one unit rate are unfair. Quantity prices are usually lower than single unit prices. At Rule 117, I have suggested a commission scale varying with the size of a customer's trading in a single security on the same day (Exhibit 4) and producing about the same overall revenue as the present schedule (Exhibit 3). The discounts will be substantial for individual large trades but their impact on overall commision income is not large.

Also notice on Exhibit 4 that NSE commission income comes largely from shares selling in the 10 to 30 Ksh range. The percentage reduction in commission on lower price shares therefore does not have a major impact overall but appears infinitely more fair.

It is a social responsibility in a fixed commission environment for a stock exchange to review the commission structure periodically for fairness and for its accomplishment of social objectives, including a profit which gives sufficient incentive without excessive enrichment. Such review is specified in Rule 117. For its administration, it will be important to require Members and Associate Members to submit annual profit and loss statements on their securities business, and that these reports be audited (Rule 366). Sooner or later government review of any fixed commission schedule can be expected, and such documentation can well satisfy such future reviews.

<u>Settlement of Trades and Protection of Customer Property</u>

For the present and in the early stages of the proposed new trading system, the present system of direct deliveries between brokers and from brokers to transfer agents will suffice. But preparation should be made now for increased volume which will cripple the present methods. The proposed method is presented in Section Four of the proposed rules for a Settlement Agency, initially through contract with a bank.

The Settlement Agency would initiate processing directly from the locked in trade information from each Exchange trading session. It would supply relevant print outs to each member and associate member, strike balances of securities and monies owed or to be received by each member or associate member for each settlement day, centralize transmission of certificates to transfer agents, negotiate and lobby for improvements in the transfer system, even evolve in due course to a securities depository. It would maintain a clearing fund of deposits by participants which would individually and severally guarantee members and associate members against loss in the event of failure of one. The deposits in this fund would be a basic factor in computing a variable capital requirement for members and associate members as described in Rule 356.

Further the Settlement Agency should provide a facility for carrying customer accounts of members or associate members who are either too small or undercapitalized to to so or do not with to distract their sales efforts by administrative responsibilities. Such a facility can desirably convert fixed costs to variable costs for brokers using it.

Section 8 of the draft rules specifies protections within firms carrying customer property or the Settlement Agency of customer property through bookeeping, security, records retention, statements to customers, security counts, capital, audits, and use or custody of customer property.

Because death and probate can cause long delays in receiving property by customers of a sole proprietor, no provision is made in the draft rules for membership by a sole proprietor, obliging all members to act as corporations. If there is some good reason for a member organizing as a sole proprietor or partnership, that might be permissible if all accounts were introduced on a disclosed basis and all transactions settled through the Settlement Agency.

The Settlement Agency contract also should provide for such services as a central registry of lost and missing certificates, production of market statistics, daily trading record publication, approximate gross commission income, and the stock exchange index. Such services have income potential.

<u>Use of Computers</u>

Computeriztion in a securities industry falls into three general categories: 1) records of trades, customer accounts and associated processing, 2) securities and portfolio analysis, 3) securities trading systems. There is currently no computerization in the NSE community.

The earliest needs for computer assistance by NSE and its members will be in the first two categories.

As volume grows, post-trade processing will become a tedious burden beset by errors if processed manually. Errors translate to financial risk for brokers. At early stages, the cost of computerization will seem out of reach for members separately. It will be a great savings for members over the years to start and develop one post trade amd customer accounting computer system jointly for use by all. If my other recommendations are followed, the logical start will be in the Settlement Agency by a bank already computerized and with a staff for building new systems. Part of the settlement contract should be that the computer system constructed shall be Exchange property, with the customer account section built for independent use by members and associate members who elect to carry their own accounts. Initially, the bank should offer to do the computer processing for such firms until their volume merits a dedicated computer. Settlement agency computers should also turn out as a by-product trading information for publication and analytic use.

Portfolio and securities analysis is likely to be differently tailored by different analysts and is not as subject to jointly developed computer systems. The basic information base of facts on listed companies, however, is a public property, available now in a condensed form in the NES publication "Quoted Company Results." It should be economic to computerize this data and additional detail both for production of the present book and for sale of data disks to other brokers, financial institutions and investors for analytic use. The feasible way to computerize initially would doubtless be through existing computers of the Secretariat of the Exchange or the Settlement Agency.

Computerized trading is not likely to become economic for an extended period of time. Many exchanges believe that the excitement of a physical trading crowd is a marketing tool worth keeping even when computeriztion is an alternative for part or all of such trading. Experience of computerized exchanges is also often that some person-to-person facility must be maintained for negotiating very large block trades.

Exchange Revenues

The cost of an exchange is eventually passed on to shareowners regardless of the method of collection. An exchange gives value to the shareholders who do not trade as well as those who do - in continuous valuation, in collateral creation, in measurement for investment decision. Therefore it is fair that inactive shareowners pay part of the cost of an exchange.

This can be done through charges to listed companies which also benefit as entities from exchange activity. Some 30 to 50% of an exchange's costs should fairly be raised from initial and annual continuing listing fees. In Kenya national progress would seem to merit listed companies paying an even larger percentage until the brokerage community itself becomes stronger. Listed companies do now provide about 65% of NSE revenues and it is important that they provide substantially more. My computation of listed company fees at the published rates are shown in Exhibit 11 as totalling about 143,000 KSh (US$8,411); however the Exchange operating statement shows only 98,800 received. Delisting should be considered for delinquent companies, neverthless continuing unlisted trading as provided in draft Rule 107. Unlisted companies would not be included in listed transaction tables furnished to newspapers. This plus the embarrasment of delisting should prompt payment of delinquent listing fees.

Exhibit 13 shows a recommended method of increasing listing fees to 500,000 KSh or more and this charge is included in Rule 51. I prefer the method of fees based on market value of outstanding shares as fairest. The minimum fee for a $571,000 total would be 3,500 KSh (US$205) and the company with the largest fee would pay 74,904 KSh (US$4,365), all to me still embarassingly low for company prestige. With adequately explained plans for KSE growth even larger fees should be supported by listed companies. Some should be willing in addition to make special grants to underwrite specific projects such as educational programs.

The current new listing fee of 1,000 KSh and 5% of the sponsoring broker's fee also seems below actual cost to the NSE Board. A fee which is a fraction of one percent of the issue price of each new issue seems reasonable. If my recommended method of annual listing fee is adopted, the initial listing fee might be a multiple of the annual fee, say 20 or 40 times, thus carrying through to initial fees the minimum annual fee concept as well as fees based on market value. Rule 51 is drafted at the 30 times midpoint.

Another 30-50% of Exchange income should eventually be realized from a charge to brokers of a percentage of their commission income plus an equivalent fee on firm account trading. In view of the modest present income of brokers, it is currently not feasible to charge members this large a total. Members should and do also pay a basic annual fee for their membership to which should be added a fee for each approved person. The principle of Exchange sharing in commission income should, however, be established now with a charge of say 1% of gross securities income. This would currently produce between 55,000 and 103,000 KSh per year depending on whether the informal reports of members or my calculations of required commissions as explained above are correct.

Associate Members should be expected to pay the same fees as Members. Hopefully there would be a number of new associate members bolstering Exchange revenues. Further many are likely to be convinced that strengthening the stock exchange is in the national interest and their own business interest and are financially more able than brokers to do so. They might therefore be called on for supplementary support for a development budget.

Registered Securities Principals should pay an initial processing fee and annual fees related to similar fees for other approved persons, plus a similar fee on their share of commissions.

In summary, the recommendations would change the NSE income stream in KSh as follows:

Present Income		Proposed Income	
Member Fees	24,000	Member Fees	24,000
		New Assoc. Mem.	45,000
		1% Commissions	75,000
		Processing Fees	10,000
		Apprvd Pers Ann	20,000
Listed Co Application	3,000	Listed Co Applic	35,000
Listed Co Annual	98,000	Listed Co Annual	571,000
Agent Annual	13,600	Reg Sec Prof	5,000
Sales	1,800	Sales	2,000
Interest	5,000	Interest	5,000
Total	145,400	Total	792,000
		Voluntary	

Contributions to Development	500,000

The Exchange should pay attention to protecting its legal property rights in continuous bid, asked and last sale quotations against the future when a fee can be charged to each recipient of such information by ticker tape or computerized data flow. Sale of continuous quotations and current prices can produce an important income as trading sessions become long enough for customer participation during the trading session. In general, all services performed by the Exchange should produce at least enough revenue to support that activity. For example, there should be fees for applications, for statistical information produced, for arbitration (perhaps at a loss for customers but not members), etc.

Possible government financial support for Exchange development and operation also should not be overlooked. For example the government of Jamaica turns over stock transfer tax income to the Jamaica Stock Exchange, and for about 8 years subsidized the growth of that Exchange through the Bank of Jamaica by providing office space and seven employees free. Egypt gives tax concessions to companies listed on the Cairo and Alexandria Stock Exchanges, inducing listed company income to these exchanges from broadly and narrowly held companies. One of the keyturning points for the Korean Stock Exchange came in the early 70s in the form of government tax incentives for listing. Jordan law requires that all companies with limited liability status must go public.

A Full Time Staff

The Pannell Bellhouse Mwangi study of the cost of an initial full time Exchange staff at about 1 million KSh (US$58,823) seems reasonable. Initially I agreed with that study that such an expenditure seemed out of reach for the Exchange. After studying the revenue possibilities outlined above, however, raising the necessary funds seems feasible.

I am much in favor, however, of providing for the income stream before expenditures are committed. Exchange adoption of my key recommendations on trading, marketing, broadening participation and customer protection should merit financial support of the Kenya financial community, government and international aid sources for Exchange staffing and promotion of shareownership.

Certainly a full time staff with an aggressive but diplomatic and capable leader could substantially accelerate the development of shareownership in

Kenya. The staff could be a catalyst for coordinating the expression of business opinion to government on removing inhibitions to shareownership. It could stimulate an educational campaign on shareownership by brokers and listed companies. It could encourage distribution of shares by presently narrowly held Kenyan companies and privatization of suitable government companies. It should not become bogged down in the minutiae of Exchange administration. Continuance of a part-time secretariat as at present and expansion of processing by a Settlement Agency would minimize distraction of full time staff from the most important development tasks.

Listing Requirements

The proposed rules on listing are incomplete for two reasons. First, business judgement must be applied as to the practicality for Kenya of otherwise desirable requirements. Second, a separate study is needed of the corporate law of Kenya compared with protection for minority shareholders in the law of developed countries. These measures to protect minorities which are feasible for Kenya might be incorporated into NES listing agreements prior to their adoption as law.

Present published listing standards have three undesirable features: 1) The recommendation that listed shares have at least 5 KSh nominal value. Nominal value should be deemphasized as an indicator of value. 2) The requirement that companies transfer only shares processed through NSE members. I am advised that this is contrary to Kenyan law, unenforceable, and frequently ignored. 3) Cancelling or suspending of quotation without any reason given. This and similar provisions for denying membership approval, and removing agents from the register appear arbitrary denials of human rights. They should be replaced by opportunity for hearings in procedures such as those in Rule 207.

The principles being discussed in a new draft of standards for listing seem generally in order. One suggestion is that much information stated as required to be submitted to the Exchange would cease to appear to be inside information given first to the Exchange if it were expresed where appropriate as a requirement to make available such information to the public and simultaneously or immediately thereafter to the Exchange. I recommend also against any firm requirement of years of operation for a newly listed company. That should remain open for judgement of the Board in admitting to the list initial public offerings. Prompt disclosure by companies of information material to share prices should be emphasized.

Finally, the present prohibition of member brokerage of shares of companies not admitted for quotation should be given up in favor of unlisted trading as provided in Rule 107.

The Stock Exchange should also initiate a program to review compliance by listed companies with Exchange listing requirements, especially accounting standards. An initial step could be review of required financial statements for adequate disclosure, auditing, etc. Such a review could be contracted with a committee of the chartered accountants society or one accounting firm as a one time project with the intention of repeating it in 3 to 5 years. Such a one time project might well qualify for foreign aid financing.

Advertising

The special committee headed by J.M. Mbaru which considered the present prohibition of advertising by members is surely correct in recommending that this prohibition be repealed. Their approach to standards for advertising is also generally desirable. Proposed Rule 261 is additionally specific.

There are two points in the committee report with which I differ. Telephone solicitation should not be prohibited when conducted with the same dignity as other permissible types of member communication. And legal advice is desirable on the paragraph that asserts that members may restrain a former employee from soliciting clients he serviced at that firm. Agreements designed to enforce such conditions in the United States have generally been found by courts to be unenforceable.

The expense of paid advertising is currently unrealistic for Members. It would be in the interest of the entire Kenyan business community for the Exchange to fill the gap in initiating a coordinated educational and promotional campaign on corporate organization and shareownership. Such a campaign begins with a few basic readable booklets on the nature of corporations, shareownership, primary and secondary markets, and elementary securities analysis and the language of investing. Such source information can be distributed by members and listed companies in appropriate form to clients, employees, schools and colleges, service clubs, etc. It can be translated into newspaper and magazine articles, company employee and shareholder publications, school curricula, speeches, television shows and many other media.

Investment Trusts

One method to increase the supply of securities available to the public in Kenya would be through closed end mutual funds - that is fixed pools of capital invested in diversified investments with shares traded on an Exchange and varying with investor's perception of the value of the underlying investments.

In developing countries particularly, there is an opportunity for development banks to spin off some shares in their portfolio of already going companies into a closed end fund which the development bank continues to manage. This gives the development bank a fresh supply of venture capital and public investors diversified and managed participation in emerging businesses.

There may be a potential also for closed end investment trusts, whose shares are held by Kenyans but whose capital is invested in foreign securities, to help limit flight of capital. Although such funds initially are negative to foreign exchange, the later inflow of foreign dividends and capital gains can be positive.

Additional USAID Assistance

This review has suggested several projects which may qualify for USAID assistance. They include:

a) a legal review of the proposed KSE rules for compliance with Kenyan law and practice, and preparation of Articles of Association for conversion of KES to a limited liability corporation not for profit as outlined in Section One of the Rules.

b) A legal and accounting review of Kenyan corporate law in comparison with laws of developed countries for differences in minority shareholder protection, recommendation of those feasible for Kenya and drafting of listed company agreements incorporating such protections together with related listed company rules.

c) Printing of final Rules as adopted by the KSE Board

d) Writing and printing of basic educational booklets on corporate structure, shareownership and markets.

e) A foreign consultant on marketing and promotion of shareownership

f) A study of potential for the KSE to establish a trading mechanism for money market instruments. This would probably involve a foreign expert interviewing a broad cross section of potential participants in such a market.

g) A video of trading on other small and medium stock exchanges, interpreted and explained in English for education of stockbrokers in Kenya and other countries, lessening the need to send key stockbrokers and securities regulators to other countries.

h) Accountants review of listed company compliance with accounting and disclosure standards for listing.

More Complete Procedural Rules

Many pages of the proposed rules suggest operating procedures for the immediate and intermediate stages of development of the Nairobi Stock Exchange. They are too detailed for enumeration here. There are also sections on ethics for the industry already recognized by NES members but which should be expressed for the public to see. There is a section to bring fairness into disciplinary procedures, and a section on resolution of disputes by arbitration.

Conclusion

Altogether the proposed rules weave a fabric for fair dealing, efficient operation and good reputation for the Kenyan securities community for the coming years of development. The good sense of a diversifed NES Board can be counted upon for the specific implementation dates for steps in growth. I urge boldness of vision, trying for more than appears immediately attainable, and marshalling of the entire Kenyan business community in the effort. A Stock Exchange can and should be the quasi-public representative of business and of shareowners, rather than of stockbrokers alone. The Nairobi Stock Exchange will prosper if that is its goal.

Robert M Bishop

Robert M. Bishop at Westfield, New Jersey, USA, May 16, 1988