Cytonn INVESTMENTS

Types of Listing

Listing a company involves placing shares on an official stock exchange. Contrary to common perception, listing shares on an exchange doesn't always involve selling shares to raise capital but may be done to enhance corporate governance as it brings in higher levels of scrutiny and hence higher compliance levels are demanded. Selling shares to raise capital is referred to as an Initial Public Offer (IPO), the amount being raised from the issue is known in advance and when no capital is being sought in the market it is referred to as a Listing by Introduction, which we will delve into as we conclude. The rules of listing by introduction came into being in 2012 and since then the companies that have listed include Flame Tree Group Holdings Ltd and Deacons (East Africa) Plc, while Superior Homes (K) Ltd is also pursuing a listing by introduction.

There are many reasons that a company can choose to list on the exchange other than raising capital which include:

1. To gain access to the capital markets in the future – the capital markets offer a ready form of funding for companies, enabling them to embark on growth and expansion plans or to fund their working capital with greater ease,
2. For share price discovery – listing will allow a company's shares to trade on an official stock exchange, with the price determined by market demand and supply forces. This will allow for generation of a market determined valuation for the company,
3. To increase transparency and disclosures to the public – when a company lists, it is subject to regulation and hence will be required to disclose certain pieces of useful information to the investing public,
4. To improve on corporate governance practices – listed companies are expected to adhere to corporate governance practices as prescribed by regulation,
5. To enhance the company's image - listed companies are usually well known by the public and viewed as more transparent and credible, having passed the regulator's keen tests. This will serve to boost confidence in the company and open up the doors to a ship load of opportunities it can explore,
6. To provide existing shareholders liquidity of their shares - once shares of a company are listed on an exchange, shareholders have an avenue to exit their shares at will to the investing public in the capital markets,
7. Make it easier for it to cross-list on other exchanges – once a company has already successfully listed on one stock exchange, it is perceived to have already been through scrutiny and due diligence procedures, and has gone through the whole listing process once, hence the process of listing on another exchange will be less tedious.

The NSE market has grown since its establishment in 1954. The most recent developments are the operationalization of the GEMS, the introduction of the derivatives trading, REITs and exchange traded funds. In 2001, the NSE was split into three market segments according to type of investment and type of asset class, and in 2013, a fourth segment was introduced to give SMEs an opportunity to access the capital markets and grow their businesses. The four segments are discussed below:

i. Main Investment Market Segment (MIMS): This is the main segment of the NSE where most companies are listed. It is suitable for bigger companies that have been around for a longer period of time as it requires submission of at least 5-years of audited financials, 3 of which should be profitable years; Kshs 50.0 mn worth of fully paid up share capital and Kshs 100.0 mn in assets,
ii. Alternative Investment Market Segment (AIMS): This market segment is better suited for medium-sized companies that have at least Kshs 20.0 mn in assets and Kshs 20.0 mn of fully paid up share capital at the time of listing,
iii. Fixed Income Securities Market Segment (FISMS): This segment was designed to incorporate listing and secondary market trading of fixed income securities, mainly corporate and government bonds,
iv. Growth Enterprises Market Segment (GEMS): GEMS was introduced to provide a regulated platform whereby SMEs could gain access to cheaper capital market funds and benefit from the regulatory environment that comes with it, promoting corporate governance and transparency.

Its requirements were made less stringent to accommodate the smaller growth companies, with requirements such as no minimum firm asset value and profitability record required, submission of audited accounts for just the year that precedes the year of listing, and a minimum of Kshs 10.0 mn in paid up share capital.

Below is a summary of ways in which companies can get listed on the various segments of the market:

i. Initial Public Offer (IPO): This is the most common type of listing and one which is commonly misconstrued as the only way in which a company can list on a stock exchange. An IPO involves a company issuing new shares while listing on the selected stock exchange that will result in a new set of shareholders from the public buying the shares at a specified share price, and hence the company raising capital from the exercise,
ii. Listing by Introduction: This type of listing occurs when a company takes its existing shares and lists them on an exchange. Given that said company is listing shares that had already been fully paid for, the aim of listing by introduction is not to raise capital immediately, but to be able to do so at a later date when the company is in need of capital. It only provides the company with a regulated environment within which to operate and a platform to trade shares with the public investors in the capital markets,
iii. Cross-listing: This occurs when a company that is already listed on one stock exchange decides to list on another stock exchange to have a larger scope of access to capital from different jurisdictions and different investors,
iv. Reverse listing: This is a rare kind of listing strategy whereby a company that is not listed on any exchange purchases a listed company and becomes automatically listed by virtue of this transaction. It is common when a company that wants to have access to the capital markets also wants to avoid the time and cost spent in a regular listing.

Despite the 4 segments discussed, we have seen only about 8 equity listings over the last 3-years; namely Atlas Development & Support Services, Deacons (East Africa) Plc, Nairobi Business Ventures Ltd, Nairobi Securities Exchange Ltd, Kirwitu Ventures, Flame Tree Group Holdings Ltd, Stanlib Fahari I-REIT and the New Gold Issuer (RP) Ltd. This can be attributed to:

1. Long and tedious listing process: companies have had challenges listing on the NSE due to the long and tedious process it takes to list on the exchange,
2. Costs incurred: costs involved with an initial listing are the initial listing fee and payments made to all transaction advisors among others, and these are considered to a great extent by a company before the decision is made to proceed. At times, these costs may be too high especially for smaller companies,
3. Extensive regulation and scrutiny: some non-listed companies shy away from listing on the stock exchange due to the harsh regulatory environment, extensive scrutiny and due diligence process and the extent of transparency and corporate governance that has to be adhered to by listed companies. This mainly affects the smaller companies that are majorly family owned and governed.

In terms of encouraging listing and access to the capital markets, regulators should focus on making the process seem less tedious, working on reducing the costs incurred when listing and educating companies on the importance of corporate governance in a company.