Dealing inSecurities in East Africa: Contextualizing the Origin and Development of Securities Markets in Kenya. 1900-2000

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Abstract

This study chronicles the historical underpinnings of Kenya's securities markets by highlighting the socio-political, economic and legal context in which the markets emerged and developed up to 2000.It hypothesizes that because trading in securities developed as a peripheral activity undertaken by professionals in diverse fields, this hugely contributed to its sluggish growth alongside its domination and monopolization by a minority who made no noticeable effort to encourage the Government to formulate a comprehensive policyto nurture its growth andsustainability. Neither the colonial Government nor the Government of independent Kenya considered securities markets asignificantpart of financial services. Consequently, self-regulation became the mantra until 1989 when the Capital Markets Authority Act, the harbinger to the Capital Markets Act, was promulgated. The Act established the Capital Markets Authority with regulatory and developmental responsibilities overthe embryonic securities markets.Disconcertingly, the Authority did not fundamentally change the regulatory paradigm of the markets. Stockbrokers retained manifest influence on decision making particularly on the growth trajectory of the markets. Although by 2000 the markets had imprinted an indelible mark in the financial services sector, their esoteric character coupled with the exceedingly low levels of financial literacy contributed to the low uptake of their products. The situation was exacerbated by the absence of a dynamic policy and legal framework.Throughout the period under review, performance of the securities markets remained lackluster.The study concludes that since the development of securities markets isan arduous process, it is imperative for the Government and stakeholders to assemble the necessary infrastructure.

Introduction

Tracing the origin and development of Kenya's securities markets is undoubtedly challenging. The dearth of relevant literature is perplexing. Not a single text illuminates the development of the commercial sector or corporations in East Africa generally or Kenya in particular in a comprehensive and systematic manner. Conceivably, no meaningful academic inquiry has been undertaken.Few textbooks on History and Political Economy make perfunctory reference to commerce and corporations.[1] While the former espouses the subject generally, the latter illuminatesthe influence of politics on economic policies.The fragmented treatment of the subject makes the assignment of aggregating the disjointed pieces laborious.Inescapably, there are innumerable gaps. This article endeavors to capture a comprehensive picture of the origins of the country's securities markets.[2] Elucidating the historical development of Kenya's securities markets is invariably an interrogation of the economic, socio-political, legal and other forces which impacted and consequently shaped the markets.

[1] Interestingly, all the texts in this area are written by British and American scholars who came to East Africa either as academics or researchers.

[2] It is difficult to give an accurate picture of the market between 1954 and 1963. The Nairobi Stock Exchange had no fixed place of business or members of staff other the six brokerage firms involved in trading activities. Stock brokers conducted business at the New Stanley Hotel (The Stanley). The Registrar of Companies office which is the repository of company records makes no distinction between listed and other public companies.

Through different historical epochs[3]theseare: the Pre-independence period, Independence 1963-1980, legislative intervention 1980-2000 and the current phase, 2000-Present. The last phase will be investigated in a follow-up article. The current analysis will elucidate the dynamics at play during each phase and their impact on the markets up to 2000. Each phase was shaped by different forces and concerns and had unique attributes.[4]The phases were not mutually exclusive. Intriguingly, none of the phases engendered the securities markets to the general population.[5] Relatedly, neither the colonial administration nor the government of independent Kenya articulated a comprehensive policy on securities markets and their place in the economic matrix.[6]This contributed to the absence of an efficacious legal framework for many years.

Securities Markets before Independence

This epoch is traceable to the last decade of the nineteenth century andwas characterized by European domination and monopolization of the economy in all respects except retail trade.[7] Kenya became a British protectorate in 1895 and a Crown colony in 1920.[8] After construction of the Uganda Railway in 1901 whose initial purpose was to open up Uganda, the colonial administration which had taken over the reins from the Imperial British East Africa Company realized that the hinterland was suitable for large scale agriculture.[9]The administration invited European settlers to establish large scale farms in Kenya. The administration was anxious to have the railway repay itself and reduce the cost of administration.[10] Scores of Europeans responded and it is estimated that by 1920 there were 20,000 settlers in Kenya.[11] The colonial administration alienated the best agricultural land to the settlers at nominal charges and promised them protection and support. The native population was regarded as a source of labor for European farms.[12] This was realized through punitive taxation of all adult males and other coercive measures[13]led to economic deprivation and emasculation of the native population.[14]Trading in securities emerged in the 1920s as a marginal activity of estate agents, auctioneers, accountants and lawyers.[15]Since there were no formal regulations, transactions were gentlemen's agreements based on good faith. There was no formal stock exchange, stock brokers or other securities markets institutions.[16] The few British banks that had established branches in Kenya rendered services to the resident European community exclusively. The dominant economic activity was large scale farming and all Governmental resources and efforts were channeled to this cause.[17]Interestingly, there were very few public companies with a highly concentrated ownership structure comprising family members and close friends.[18] Puzzlingly, only members of the resident European community could incorporate companies or deal in securities.

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[3] See generally WOLFF R. D., BRITAIN AND KENYA, 1870-1930: THE ECONOMICS OF COLONIZATION, (1974).

[4] See CLAYTON A. & SAVAGE D.C., GOVERNMENT AND LABOR IN KENYA 1895-1963 (1974).

[5] This assertion is borne by the fact that the number of publicly held corporations, investors and products tradable in the securities markets has remained nominal and even at times when the economy was thriving, the securities markets were not.

[6] See generally, WASSERMAN G., THE POLITICS OF DECOLONIZATION: KENYA, EUROPEANS AND THE LAND ISSUE 1960-65, (1976) Charles R. C. Pouncy, *Stock markets in SSA: Western legal institutions as a component of the neo-colonial project*, 23 U. PA. J. INT'L. ECON. L. 85 (2002).

[7]COLIN LEYS,UNDER DEVELOPMENT IN KENYA: THE POLITICAL ECONOMY OF NEO-COLONIALISM 1964-1971 33-36 (1974).

[8]NICOLA SWAINS ON, THE DEVELOPMENT OF CORPORATE CAPITALISM IN KENYA 1918-1977 5-9 (1980).

[9] See SORRENSON M. P. K.,THE ORIGINS OF EUROPEAN SETTLEMENT IN KENYA (1968)

[10]LEYS, supra note 7 at 28-9.

[11]SWAINSON, supra note 8 at 6.

[12]LEYS, supra note 7 at 29.

[13] See DILLEY M.,BRITISH POLICY IN KENYA COLONY (1966).

[14] Between 1912 and 1913 African production accounted for at least 70% of all exports but by 1929 it had fallen to less than 20%. See SWAINSON, supra note 8 at 34. See also, Jimnah Mbaru, Capital Markets and Economic Development: Law, Bond Markets and Securitization in Emerging Markets: Challenges and Prospects for Kenya. (August 2013) (Unpublished LLB Dissertation, University of Nairobi) (On file with the School of Law Library, University of Nairobi).

[15]*Id.*

[16]*Id.* 41.

[17] See SWAINSON, supra note 8 at 31-36.

[18] For example, Lord Delamere one of the most prominent settlers owned shares in three public companies. Captain Grogan, a settler politician had shares in six companies out of the 35 companies in the country. Most of these companieswere jointly owned with his wife and brother. Hunter and Fletcher had shareholding in nine companies several of which overlapped with Grogan and Delamere. Hunter was Grogan's brother-in-law.

Similarly, only foreign companies and companies incorporated by Europeans could be listed on the Stock Exchange.[19] Many foreign companies established branches in the country. Companies such as Barclays bank, A. Bauman[20], Mitchell Cotts and Gailey and Roberts became household names. The constitutive documents of publicly held companies and the legal framework excluded Asians and Africans from trading in securities.[21] The Credit to Natives (Restrictions) Ordinance 1926 and the Control of Business and Life Assurance Ordinance excluded Asians and Africans from mainstream commercial activities through denial of credit and insurance services.These restrictions excluded the African and Asians from the securities markets altogether. There appears to have been a symbiotic relationship between these restrictions and the low uptake of securities markets products by these communities and the general stagnation of the markets many years after independence.

Relatedly, the Asian community was also excluded from large scale farming and had limited access to credit. However, after 1945 the newly formed Bank of India and the Bank of Baroda extended credit facilities whichsimplified their participation in retail trade. Subsequently, these banks facilitated acquisition of European businesses by Asians.[22] After the Second World War, the Credit to Natives (Restrictions) Ordinance 1926 was amended to facilitate limited access to credit by Africans. By 1946, African entrepreneurs had incorporated a paltry twenty four (24) companies.[23]

Origin of the Nairobi Stock Exchange

The first professional stock broking firm was established by an Estate agent named Francis Drummond in 1951. The stockbroker is credited for having played an instrumental role in the establishment of the Nairobi Stock Exchange (NSE) three years later.[24] In 1954, six stock broking companies registered the Nairobi Stock Exchange (NSE) under the Societies Act to operate under the Rules and Regulations of the London Stock Exchange. Subsequently, the London Stock Exchange recognized the Nairobi Stock Exchange as an overseas stock exchange.[25] The NSE developed as a self-regulatory organization with powers to regulate dealings in securities, listing, fees, brokerage charges, admission of membership and discipline.[26] Establishment of the NSE signaled the death knell for the over-the-counter market (OTC). The NSE commenced operations with a record forty eight (48) companies on the list, four (4) stocks of the East African High Commission, several long dated Government stocks of the East African High Commission and two (2) stocks of the City of Nairobi. These stocks had their primary market in London and the secondary market in Nairobi.[27]

Since only members of the resident European community could trade in securities and membership of the NSE was restricted, this constituted the organization an exclusive association of six stockbrokers. The operations and management of the stock exchange was emblematic of a private members club.[28] This argument is embellishedby the fact that membership of the exchange stagnated at six until 1994.[29] The NSE was largely perceived as a closed shop, an image it struggled to shed off without success.[30]

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[19] See JimnahMbaru, supra note, 14 at 42-43.

[20] Though trading in this company's shares on the Nairobi Stock Exchange is currently under suspension, this company remains one of the oldest listed companies in Kenya.

[21] See generally, Leys, supra note 7.

[22] Swainson, supra note 8 at 53-55.

[23] *Id.* at 194.

[24] Records reveal that Francis Drummond approached the then Finance Minister Sir Ernest Vasey and impressed upon him the idea of setting up a stock exchange in East Africa. The two approached the London Stock Exchange which agreed to recognize the Nairobi Stock Exchange as an overseas stock exchange on condition that it adopted the Rules and Regulations of the London Stock Exchange, which the two undertook to facilitate. This led to the birth of the Nairobi Stock Exchange 1954. Francis Drummond was the first chairman of the NSE and his firm sponsored most listing of new companies between 1954 and 1977.

[25] See Mbaru, supra note 14 at 41, see, Justus Ondari, *NSE*: *Going Public*, FINANCIAL POS, Oct. 2, 2005, at 2.

[26] See generally Rules of the Nairobi Stock Exchange 1954, File No.3540, Registry of Societies, Nairobi, Kenya.

[27] See Mbaru, supra note 14 at 42.

[28] Leys, supra note 7 at 35.

[29] Between 1994 and 1995, the Capital Markets Authority licensed fifteen more stockbrokers who were admitted as members of the Nairobi Stock Exchange.

[30] See generally Peter Biddlecombe, *Africa's business "knights" boosts stock exchanges*, DAILY NATION, Oct. 26, 1989, at 6; Francis Makokha, *Players at Stock Exchange lack technical ability*, DAILY NATION, July 13 1993, at 4; MarubuMunyaka, *A caseof the "big bang" on the stock market*, DAILY NATION, Aug. 16, 1994, at 1; S. Aduol, *Stock Exchange must open* up.

Although the number of private companies increased significantly after 1945, the number of publicly held companies remained small and concomitantly the number of listed companies. During the 1950s the NSE registered dismal performance as the country was under a state of emergency.[31] No company listed on the exchange. In 1961, the Legislative Council promulgated the Companies Act,as the corporate law for the colony.[32]This statute was a replication of the United Kingdom's Companies Act, 1948.On balance, it is not implausible to conclude that securities markets in Kenya originated as an inessential activity undertaken by professionals engaged in other businesses and analogous to other sectors of the economy,it was monopolized by the resident European community to the exclusion of other communities. It was managed by the private sector with no elaborate state sanctioned regulatory framework.

As adverted to elsewhere, the Nairobi Stock Exchange developed as an exclusive club owned and managed by a few stockbrokers. Significantly,apart from facilitating the establishment of the stock exchange, the colonial administration made no recognizable attempt to promote the development of securities markets. Consequently, trading in securities emerged to serve the interests of particular classes of persons as opposed to the general population.[33] It is the only segment of the financial services sector whose operations are not forthrightly appreciatedby the bulk of the population.[34] Because of retaining their pre-independence attribute of exclusivity, the securities markets have the lowest market penetration in the financial services sector. Their products are perceived as esoteric. The markets are predominantly for the wealthy and those with financial knowhow.[35] Needless to accentuate, the securities markets have the potential to make a significant contribution to the economy.[36]The equities market is currently dominated by retail investors holding minuscule chunks of securities primarily for speculative purposes.[37]Conversely, the debt market is dominated by institutional investors.

Government involvement in the economy and investment

Throughout the colonial period, the government played a facilitative role as opposed toa direct participant in the colony's economic activities or investment. This policy was informed by the desire not to compete with the private sector.[38] Before the Second World War, substantial efforts were expended on promoting European large scale farming. After the war, Asians and Africans became active participants and by the late 1950s and early 1960s, the settler community which previously monopolized all sectors of the economy was losing ground.[39]

DAILY NATION, July 13, 1993, at 8., Daniel Kamanga, *Stock markets and politics,* KENYA TIMES, May 19, 1990, at 11; Stephen M. Maina, *NSE remains a closed shop for a select few*, THE EAST AFRICAN, Aug. 14, 2005, at 28; Samuel Kumba, *Taking the Stock exchange to the classroom*, FINANCIAL POST, Oct. 14, 2005, at 14; JimnahMbaru, *Is NSE a private members club*?SATURDAY NATION, Dec. 30, 2006, at 8; Jackson Okoth, *Foreigners controllingthe Nairobi Stock Exchange,*FINANCIAL POST, Jan. 15, 2007, at 2; John Otieno, *Kenya's Stock market cries for reform*, KENYA TIMES, Feb. 20, 2007, at 11.

[31] See generally BENNET G.,KENYA, A POLITICAL HISTORY, THE COLONIAL PERIOD, (1963).

[32] Before 1961, the United Kingdom's Companies Act 1907, which replaced the Indian Companies Act in 1922, was the operative law. The Companies Act, 1948 remained the operative statutory framework until September 2015 when the new Companies and Insolvency Acts were promulgated.

[33] See generally Francis Makokha, *Stock Exchange silent on criticism*, DAILY NATION, July 20, 1993, at 6.

[34]Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets,*48 UCLA L. REV. 781, 831-38 (2001); Pouncy, supra note 6 at 98-99; Polycarp Ngonje, *Why you must be an educated investor*, FINANCIAL POST, Jan., 13, 2007, at 17; Washington Gikunju, *Women investors in plea to NSE on market information*, THE STANDARD, June 27 2007, at 21.

[35] See generally Biddlecombe, Supra note 30.

[36] The total number of individuals and corporations who operate bank accounts exceed by far those who deal in securities markets products. Whereas banks have limited presence in the rural areas, securities markets do not. Broker/ dealers are concentrated in Nairobi although a few firms have branches in smaller cities. Others operate through agents.

[37] Several listed company have previously petitioned the Capital Markets Authority for permission to purchase their shares from the public in order to reduce the number of shareholders which in some cases is too large. Section 56 of the Companies Act prohibits companies from purchasing or financing the purchase of their shares except in three specific instances. Since companies have been incurring enormous cost on printing of annual reports and postage, the law has been amended to enable companies send their annual reports, financial statements and notices of general meetings to members online. Paradoxically the majority of retail investors have neither access to computers nor the internet.

[38] See generally Swainson, supra note 8.

[39] This was mainly due to the change in colonial policies by the British Government and the Mau Mauuprising which was fomented by land alienation and mistreatment of local communities by the colonial government.

However, colonial government participation in the economy and investment remained minimal. In 1942, the Government formed the Industrial Management Board under the Defense Regulations to guarantee the supply of essential goods to the armed forces. The arrangement was envisioned as temporal. In 1945, the Board paid dividend to the Treasury and subsequently sold two thirds of its shareholding to the Colonial Development Corporation.[40] Serious Government investment is traceable to the formation of the Industrial Commercial and Development Corporation (ICDC) in 1954.[41] The corporation was intended to facilitate industrial and economic development by initiating, assisting, expanding industrial, commercial and other undertakings in the colony.[42] After independence, the Government used the corporation to advance loans to African entrepreneurs and large Kenyan owned companies.

By 1963, Government policy on participation in the economy and investment had undergone a complete metamorphosis. The Government was more forthright and deliberate in participating in the economy. Although initial acquisitions of equity were justified on the need to acquire interest in strategic ventures, such as electricity generation,[43] oil refining[44] and banking,[45]subsequent acquisitions could not be justified on grounds other than commercial and general facilitation of economic activities.[46] The motivation was both the desire to benefit from the bourgeoning sectors such as banking and insurance and to promote commercial and industrial enterprises through credit. Africanization played a critical role too. The Development Finance Company of Kenya (DFCK) and the East African Development Bank (EADB) were established in 1963 to finance industrial projects, promote tourism, manufacturing and forestry. Similarly, formation of Kenya National Assurance Company in 1965 exemplified the Government's appetiteto participate in the insurance sector.[47]The need to extend credit facilities wider led to the formation of the Industrial Development Bank in 1973, acquisition of Kenya Commercial Bank in 1976[48] and establishment the National Bank of Kenya in 1968. Attempts to acquire equity in Standard Bank DCO and Barclays Bank in 1971 fell through. By 1976, the Government owned forty two (42) corporations in diverse fields of business, held majority interest in another twenty four (24) and a minority interest in seventy five (75).[49]The Government of Kenya still owns many corporations and holds equity in many listed companies. Of the more than two hundred (200) Government corporations eligible for privatization, less than twenty (20)have been privatized.[50]

Securities Markets after Independence: 1963-1980

Kenya attained her independence from Britain in December 1963.[51] The Government assumed office with promises to Africanize the civil service and the economy.

[40] This was a company formed by the Labour Government as a compromise against nationalization of companies operating in the colonies. Its purpose was to facilitate investment in important areas of the colonial economies not initially attractive to the private sector and acquisition of equity in companies operating in the colonies.

[41] The Government owned 57% of the company's share capital, commercial banks held 18%. The Swiss and West Germany governments held 1% and 7% respectively while other foreign interest held the balance.

[42] Memo on industrial development in Kenya, prepared by A. Hope Jones, the member for Commerce and Industry, MCI, KENYA NEWS AGENCY, May 16, 1952.

[43] East Africa Power and Lighting Company Ltd.

[44] East Africa Oil Refineries Ltd and Kenya Pipeline company

[45] National and Grindlays Bank Ltd. (renamed Kenya Commercial Bank)

[46] Companies such as, Kenya Airways Ltd, Tea Factories throughout the country, Housing Finance company Ltd (mortgage firm), Hotels, Sugar factories, transport company, East Africa Portland Cement Company Ltd. See Lubar C. G. *Government Protection of Foreign Investment in East Africa*, 7 E.A.L.J. 108. 121-22 (1971).

[47] In 1972 the Government ventured into reinsurance business through the Kenya Re-insurance Corporation which remained the sole reinsurance company for many years. It is still one of the four re-insurance companies in the business to date.

[48] This bank has the most extensive network in the country including mobile banking in remote parts of the country. The object was to make banking service accessible to as many people as possible.

[49] See SWAINSON, supra note 8 at 246-49.

[50] This is attributable to the absence of political will on the part of the Government. Before 2008, there was no legal framework on privatization. Government owned corporations are the principal avenues through which friends, relations and tribesmen and women as managers and directors, who generally employ their relatives.

[51] See generally, GHAI Y. P. &MCAUSLAN J.P.W., PUBLIC LAW AND POLITICAL CHANGE IN KENYA: A STUDY OF THE LEGAL FRAMEWORK OF GOVERNMENT FROM COLONIAL TIMES TO THE PRESENT, (1970).

Disconcertingly, although the president had publicly declared that the Government would not be a "gangster Government,"[52] it turned out to be with respect to securities markets. The policy and ideology of the Government was encapsulated in a policy paper adopted by the National Assembly in 1965.[53] The document espoused the principles of sanctity of private property and enterprise but was unequivocal that foreign companies would be compelled to Africanize their management and float shares to Africans who wished to subscribe for them.[54] Although Asians and Africans were now free to participate in commercial activities and deal in securities, the uptake of securities markets' products remained dismal.Whereas in 1961[55] the Nairobi Stock Exchange had fifty five (55) listed companies, by 1969, the number had plummeted to thirty six (36). Remarkably, the number of listings reachedits highest watermark at sixty seven (67) in 1971. However, by 1977, the number had tumbled to 61 and for several decades, the number vacillated between forty five (45) and fifty six (56).[56]

Because theAsian and African communities were largely excluded from dealings in securities for many years before independence, the business was substantially in the hands of the resident Europeans. It took time before the two communities could embrace this seemingly impenetrable business. At independence, the NSE had one stockbroker of Asian origin.The first African owned stock broking firm became a member of the stock exchange in 1964.[57]Undeniably, few Africans and Asians were knowledgeable about dealing in securities.

Africanization

A critical driving force during this epoch was the philosophy of Africanization.[58] This was a well-orchestrated Government scheme to wrestle businesses and equity from non-citizens and Asians ostensibly to put Africans in control of the economy albeit through unorthodox means. The Kenya National Chamber of Commerce (KNCC) spearheaded the move. The quintessence of Africanization was exquisitely captured by the then chairman of the Kenya Association of Manufacturers (KAM)who was unequivocal that:"No one is being requested to hand out free shares in his industry for the sake of Africanization, neither is anybody being requested to risk blindly by placing investments in the hands of poor and incompetent management in the interest of Africanization…All of us here can assist in the task of Africanization in various ways, for example: conversion of private companies to public company with a view to offering substantial shareholding to Africans, manufacturers could gradually and firmly build African distributors and wholesalers, existing distributors and wholesalers could assist the Africans to share in the market rather than try to prevent their entry into the market, by inviting African partners and participants in the new ventures you are planning to establish and by giving African management opportunity in your organization and also providing him with management training opportunities."[59]The upshot of the paragraph is that Africanization was a scheme to perpetuate the *status quo* by accommodating the African elite.

During the political campaigns preceding the 1963 general elections, the Kenya African National Union (K.A.N.U.) advocated for Africanization of the civil service and the economy. The party won the election on that platform. To decontaminate Africanization and accord it some aura of political legitimacy, the National Assembly adopted the policy statement on *African Socialism and its Application to Planning inKenya*in 1965. This statement cleared the last hurdle for entrenchment of the African elite in commerce and the civil service.

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[52] See LEYS, supra note 7 at 62.
[53] This was Sessional Paper No. 10 of 1965 entitled; African Socialism and its Application to Planning in Kenya.
[54]LEYS, supra note 7 at 222.
[55] In 1961, a Swiss Mission visiting Kenya noted among other things that: "There is complete lack of a stock market in East Africa, though the yield is phenomenal. We must encourage foreign investment in these shares. First some improvement in income tax was necessary"
[56]Mbaru, supra note 14 at 42.
[57] Francis Thuo and Partners Co. Limited. The firm collapsed in 2007 under the weight of mismanagement after the death of its founding chairman Mr. Francis Thuo.
[58] The concept of Africanization was as nebulous as its implementation by the Government and was not informed by the need to develop the country but to promote the local bourgeois. Its effects were not felt by the general population. To the political elite, independence meant replacing Europeans and to some extent Asian domination in all respects including management of private foreign companies operating in the country with Africans. Why did it have to be Africanization NOT Kenyanization? The breadth of the latter is wider than that of the former.
[59] See Record of Kenya Association of Manufacturers Annual General Meeting, March 30, 1967, by MainaWanjigi, reproduced in supra note 7 at 145-46.

Relatedly, the Government tightened its control over foreign corporations by amending the Exchange Control Act[60] to regulate foreign exchange remittances.[61]To operationalize the scheme, the Kenya National Trading Corporation (KNTC) established in 1965 and the Trade Licensing Act, 1967 were the principal instruments at the disposal of the Government. For securities markets, the main drivers of Africanization were the Industrial and Commercial Development Corporation Investment (ICDCI), the Industrial and Commercial Development Corporation (ICDC) and the Capital Issues Committee (CIC).[62]Whereas the Trade Licensing Act was used to coerce Asians and Europeans to sell their businesses to Africans their entrepreneurial skills notwithstanding, the KNTC ensured that European and Asian companies and businesses distributed their products through outlets owned by Africans.[63]To finance the take-over of businesses and establishment of distribution outlets, the ICDC extended credit to Africans. Between 1972 and 1975 many small scale non-citizen traders sold their businesses to Africans. However, the financial services sector remained under the wraps of Europeans and Asians. In its effort to enable Africans acquire equity in foreign companies listed on the NSE, the Government incorporated ICDCI in 1967. The arrangement was that ICDC would purchase securities in profitable companies and then issue its own shares to Africans. The purpose of the scheme was to encourage Africans to invest in the securities markets. Implausibly, by 1970, Africans owned a paltry £ 0.75 million worth of shares.[64] The arrangement failed to entice Africans to the securities markets. Their participation on the Nairobi Stock Exchange was nominal. Similarly, although the number of private companies incorporated by Africans grew by leaps and bounds, accounting for nearly 50% of all new companies, the number of publicly held companies fell and new issues of securities were non-existent.[65] Analogously, African participation in directorships and top management of local and foreign owned companies was negligible. Although the number of Africans holding directorships in listed companies grew by 80% between 1968 and 1974, the actual increase was imperceptible.[66]

The absence of a facilitative legal and institutional framework for securities markets is traceable to the 1950s. From January 1962, preparation of company prospectuses was regulated by the provisions of the newly promulgated Companies Act.The Act prescribed the contents[67] of prospectuses, and provided for its publication and registration by the Registrar of Companies.[68] Although the Companies Act was substantially based on the notion of publicly held corporations emblematized by free transfer of securities, it lacked specific provisions on securities markets. New issues of securities were approved administratively by the Ministry of Finance. However, in 1971, the Capital Issues Committee(CIC) took over the responsibility of approving new issues of securities. Regrettably, provisions of the Exchange Control Act made it difficult for foreign owned listed companies to do business in Kenya. Under section 10(1), a listed company could not issue securities to a foreigner without authority of the Central Bank of Kenya. Relatedly, the quantum of profit a company could repatriate abroad was limited to between 20 and 25% of its share capital. By the same token, from 1975 to 1985, the capital gains tax was levied on transfers of shares of listed companies.

Capital Issues Committee

The Committee was established by the Minister of Finance, not to develop the embryonic securities markets but it "epitomized the development of more stringent nationalistic control over the economy."[69] It drew its membership from the Ministries of Finance, Commerce and Industry and the Central Bank of Kenya.[70]The Committee became the principal regulatory instrument for securities markets for a considerable length of time and inevitably, its operations had far reaching consequences on the markets. The Committee was mandated to:

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[60] Cap. 113.
[61] See LEYS, supra note 7 at 126.
[62] This committee was established on June 17, 1971.
[63] SWAINSON, supra note 8 at 187.
[64] LEYS, supra note 7 at 165.
[65] See SWAINSON, supra note 8 at 195.
[66] *Id.* at 202-205.
[67] § 40
[68] § 43
[69] See SWAINSON, supra note 8 at 17.
[70] See generally SWAINSON, *The rise of a National Bourgeoisie in Kenya*, 8 REV. AFR. POL. ECON.49 (1977).

- Advise the Minister on matters relating to all public issues of equity and rights issues to existing shareholders in publicly traded companies having a substantial foreign interest, including the issue of debentures and loan stock.
- Advise the minister on the amendment of foreign investment protection certificates, applications by foreign companies for local credit in excess of 20% of their foreign equity and all management and royalty agreements involving external payments of over £25,000 a year.
- Approve the price of issues, timing of sales and allotment, especially between institutions and individuals, residents and non-residents.[71]

Despite its declared mandate, it was envisioned that the committee would wheedle foreign corporations to dispose portions of their share capital through the NSE by offering securities to the local population. Puzzlingly, the committee used intimidation and coercion to attain its objectives and several companies went "public" at the behest of the Capital Issues Committee. The Brook Bond Liebig Co Ltd and Lonrho (E. A.) Co Ltd conundrums exemplify this hypothesis. Brooke Bond Liebig Limited was a private company and a subsidiary of another company based in the United Kingdom.[72]The case of Lonrho is more fascinating.Unbeknown to the company, its phenomenal growth in Kenya during the late 1960s and early 1970s was displeasing certain politicians. Consequently, the CIC prevented the company from acquiring local firms in several instances. To assuage nationalistic pressures, the company Africanized some management positions in 1973.

Unlike Brooke Bond Liebig, Lonrho's survival strategy in Africa was to forge alliances with local politicians and the bourgeois.[73] These instances provide cogent circumstantial evidence that the CIC was a stratagem to ensure that the local bourgeois acquired interest or controlled foreign-owned corporations.[74] The scheme was largely unsuccessful as only a handful of companies floated nominal portions of their share capital.Subsequently, an insignificant number of Africans acquired securities in these companies. Noteworthy, these scenarios epitomized the actuality that dealing in securities had not been widely embraced in the country. Arguably, the methods employed by the CIC to procure floatation's were inimical to market growth and heralded the decline of issues particularly by foreign-owned companies which dominated the NSE.[75] The full impact of CIC's interference with the market dynamics were manifest after 1973 when new issues dried up.[76]There were no newissues between 1978 and 1983. Although the discreditable state of affairs wassomehow attributable to the uncertainty created by the new political dispensation,[77] CICs' contribution could not be underestimated. Unprecedentedly, a new president had assumed office and succession politics had taken center stage.On balance, neither the CIC nor the ICDCI engendered securities markets to the dominant African population. Relatedly, by 1973 few Africans were well educated to appreciate the dynamics and significance of securities markets.[78]

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[71] See generally IFC/ CBK Report and Recommendations of the Development of the Money and Capital Markets in Kenya, Oct. 9, 22-23 (1984) (On file with the Capital Markets Authority, Nairobi).

[72] See SWAINSON, supra note 8 at 256-257. The company was well entrenched in the tea industry owning about 15,000 hectares of agricultural land in the Rift Valley. In 1972 the CIC begun pressurizing the company to go public and after lengthy negotiations the company agreed to reconstitute itself as a Kenyan public company to facilitate the sale of 13% of its share capital valued at K£ 750,000. A negligible number of local investors subscribed for 2% of the share capital and the Government took up 11per cent. Pressure on the company eased until it made an offer to purchase a profitable coffee estate owned by European farmers who accepted the offer. The government refused to approve the sale and the transaction fell through. Paradoxically, the Government was a shareholder of the company and was acting in a manner inimical to the company's prosperity. Subsequently, and through CICs intervention, the Government acquired more shares of the company, and by 1975, its shareholding had risen to 20%.

[73] *Id.* at 280.

[74] *Id.* at 49.

[75] See IFC/CBK Report, supra note 71 at 94. From 1972 to 1983, only nine companies listed on the Nairobi Stock Exchange.

[76] In 1966 for example, the exchange had 64 listed companies and by December 31st 1971, the Nairobi Stock Exchange had a total of 66 publicly held companies. See NAIROBI STOCK EXCHANGE YEAR BOOK, 12 (1972). By 1990, the number was 56. Currently the number stands at 54.

[77] On August 22nd 1978, the first president of the country died and the then Vice-President, Mr. Daniel Moi, whose neither political philosophy nor economic policies were known and who lacked the charisma of the former president took office. Inearly August 1982, an attempt by the Kenya Air force to overthrow the Government of President Moiwas ruthlessly clashed.

[78] In 1971 for example, the total value of all the quoted shares on the Nairobi stock Exchange was £ 50 million and the total aggregate held by Africans was less than £5 million.

Furthermore, the middle class was too small to have any significant impact.Primary and secondary market performance during this epoch remained lackluster. Records reveal that between 1966 and 1984 there were only twenty four public issues and seven private placements.[79] In 1965 for instance, the Nairobi Stock Exchange share index stood at 100 points. By1970 it had risen to 250 points.Implausibly, the Government of Kenya perceived Africanization as an end to itself. Instead of educating the population on the contribution of securities markets and the need to save, diversify investments or develop a comprehensive policy on the markets, the elite was preoccupied with the acquisition of businesses and equity in foreign owned companies.An operational stock exchange was sufficient signification that securities markets were gradually claiming their share of the financial services sector and had to be nurtured. The Government did not appear to appreciate that the markets were an essential part of financial services. It espoused policies and constituted institutional arrangements whose overall impact on the markets was insignificant. This somewhat explicates the diminutive growth of the markets after independence.Unsurprisingly, the first two decades of independence witnessed no coherent attempt by the Government to promote securities markets. The Nairobi Stock Exchange had no reporting obligations and remained unknown to the bulk of the population.

Legislative intervention: 1980-2000

This phase had both profound and negative effects on securities markets. It is credited for having heralded the transformation ofthe markets to growth platforms through divestitures and product diversification. Although the 1980s was generally characterized by dismal performance of the primary and secondary markets, the scenario changed in the 1990s and the Government appeared to recognize the role of securities markets.[80]The driving forces during this epoch were the International Monetary Fund and World Bank's Structural Adjustment Program which precipitated economic liberalization and divestitures by the Government. Similarly, clienteles and participation of foreign investors were contributory factors.

Structural Adjustment Programs (SAP)

In economic parlance, the phrase "Structural Adjustment Programs" (SAPs) denotes economic policies which the World Bank and the International Monetary Fund advised developing countries to implement in order to qualify for new funding.[81] The mainspring was to integrate global economies by requiring developing countries to shift from the self-directed model of development to a global focused model premised on economic liberalization and international trade. The underlying challenge was poverty reduction through reduction in Government spending, privatization of public corporations to increase efficiency, increased tax collection, promotion of exports and financial liberalization.[82] Criticisms of the programs culminated in the change of their designation to the Poverty Reduction Strategy Papers. These programs had far reaching economic and political effects in developing countries, including an increase in the poverty index. Kenya embraced the SAPs and implemented several prescriptions. However, privatization of state corporations and other reforms have been work in progress for many years. Adoption of a market economy had profound effects on securities markets.

Particularism[83] and corruption

The period under consideration coincided with the entrenchment of authoritarianism and particularizes in Kenya. Particularism denotes the exclusive attention or devotion to one's own interests or interests of one's family, sect or ethic group.

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[79]See generally IFC/CBK Report, supra note 71.

[80] See Darin Gunesekera, *Exchanges have a mission Objective*, DAILY NATION, May 4, 1993, at 8 (alluding to the importance of Governmental policy and participation in the development of securities markets. He uses the South East Asian experience as his springboard and argues convincingly that Government involvement is critical).

[81]See Structural Adjustment Programs *available at* http://www.whirlednank.org/development/sap.html (visited on Feb. 22nd, 2010)

[82]See Structural Development Programs and Developing Countries, *available at* http:// www. Globalissu.org/article/3/structural adjustment. (Visited on Feb. 34, 2010); http//www.fpif.org/reports/structural adjustment (visited on Feb. 15, 2010).

[83] This is a system (mostly political) where persons are only concerned with their personal interest or those of their family, ethnic group or political associates. It promotes cronyism, sycophancy and corruption.

It is inextricably intertwined with patrimonialism under which power flows directly from the leader. Patrimonialism describes situations where the administrative infrastructure is beholden to the top leader.[84] Similarly, individuals in political and state institutions are guided by particularistic norms and motives. Such conduct is antithetical to what may fairly be regarded as universal orientation of public good.[85]The executive wielded pervasive powers conferred by the Constitution[86] and participated in all importantdecisions affecting the country. The presidency trusted friends, associates and political allies exclusively.[87] This xenophobic behavior originated from an attempted *coup de tat*by members of the armed forces in August 1982. Government functionaries could not contradict the presidency. Sensitive cases were adjudicated in favor of the Government or left in abeyance until the presidency's predilectionswere deciphered.[88] The presidency filled key appointments with friends, loyalists and supporters.[89] The *locus* of political and economic power revolved around the presidency.

Before 1992, Kenya was a *de jure* one party democracy. Commentators on constitutionalism in Africa defensiblyhypothesizethat in one party democracy, the presidency epitomizes the party and its decisions have primacy over other organs of Government.[90]Owing to its loose architecture and amenability to manipulation, the party becomes a formidable organ of governanceat the disposal of the presidency. This certainlyundermines formal institutions of governance. But what made Kenya's situation extraordinary and exceedingly untenable was that the one party hegemony had permeated to all spheres rendering formal institutions dysfunctional. Political patronage and ethnic background guided most appointments to public office. Government institutions had to contend with the caprice of party machinations in serving parochial political interestsof party functionaries.Formal institutions were sacrificed at the altar of personal aggrandizement.[91] Corruption[92] and clienteles[93] became the fulcrum on which crucial governmental matters were determined.[94]Corruption was not only grand and petty, butsystemic.[95] Political patrons and their followers bonded on the basis of mutual material benefit, primarily employment or money.[96] Being a weak state, Kenya presented a veritable pageant of patrimonialism, cronyism, favoritism and outright theft.[97]Highlighting the debilitating effects of corruption, one commentator submits that:"When it is pervasive and uncontrolled, corruption thwarts economic development and undermines political legitimacy.

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[84]See Derick W. Brinkerhoff & Arthur A. Goldsmith, Clientelism, Patrimonialism and Democratic Governance: An Overview and Framework For Assessment and Programming, *available at*
http:// www.abtassociates.com/reports/2002601089183_30950/pdf (visited May 12, 2009); Mary H. Moran &Anne Pitcher, Rethinking Patrimonialism and Neopatrimonialism in Africa,AFRICAN STUDIES REVIEW, 2009, *available at* http:/www.britannica.com.bps/additional content/18/ 138813541/pdf (visited on May 12, 2009).

[85] See generally Uslaner Eric, *Trust and Corruption*, in Johann Graf Lambsdorff et al, Eds. THE NEW INSTITUTIONALECONOMICS OF CORRUPTION, London (2004).

[86] § 23

[87] See generally SCHMIDT ET AL, FRIENDS, FOLLOWER'S AND FACTIONS: A READER IN POLITICAL CLIETELISM, (University of California, Berkeley Press, (1977).

[88]David Furnivall, *Political Patronage, Corruption threat to Kenya's Unity*, DAILY NATION, June 17, 1995, at 19. The president who made speeches every day except Sunday would comment on virtually every issue.

[89] See MIGDAL JOEL, STRONG SOCIETIES AND WEAK STATES: STATE-SOCIETY RELATIONS AND STATE CAPABILITIES IN THE THIRD WORLD, (1988); Note, *When the Multinational Meets the Patrimonial State: Prospects of Improving Transnational Liability,* 5 J. INT'L L. &PRAC. 417 428 (1996).

[90] See generally NWAMBUEZE B. O., CONSTITUTIONALISM IN EMERGENT STATES (1973); OJWANG J. B., CONSTITUTIONAL DEVELOPMENT IN KENYA, INSTITUTIONAL ADAPTATION AND SOCIAL CHANGE, (1990).

[91] See ROSE ACKERMAN & SUSAN, CORRUPTION: A STUDY OF POLITICAL ECONOMY, (1978).

[92] Corruption is defined as the abuse of public office for political gain and operates at several levels from petty to grand corruption and looting. It is a multifaceted phenomenon with many causes and effects. See, Indira Carr, *Corruption in Africa: Isthe African Union Convention on Combating Corruption the Answer?*J.B.L. 111, 115 (2007). See also. MUTONYI J.P. FIGHTING CORRUPTION, IS KENYA ON THE RIGHT TRACK? (2000).

[93]Clientelism is a patron- client system where relations between politicians and their followers are defined by material benefits. The patron supplies the resources while the clients furnish the necessary support.

[94]Luth H. *Informal Institutions and Democracy.*DEMOCRATIZATION 21-25 (1987).

[95]JOHN GITHONGO, TRANSPARENCY INTERNATIONAL-KENYA, CORRUPTION: ARE WE INNOCENT? (2000).

[96]Kettering Sharon, *The Historical Development of Political Clientelism,*18 J. INTERDISC. HIST. 419-447 (1988).

[97]SeeSAMUEL HUNTINGTON, POLITICAL ORDER IN CHANGING SOCIETIES, 34-38, 59-72, 79-92(1968); Andrew S. Levin, *Civil Society and Democratization in Haiti,*9 EMORY INT'L L. REV. 389, (1995).

Less pervasive variants result in wasted resources, increased inequity in resource distribution, less political competition and greater distrust of the government.Creating and exploiting opportunities for bribery at high levels of government also increases the cost of government, distorts the allocation of government spending, and may dangerously lower the quality of infrastructure. Even relative petty or routine corruption can rob government of revenues; distort economic decision making and impose negative externalities on society, such as dirtier air and water or unsafe buildings."[98]

Irritatingly, economic imperatives were sacrificed at the altar of political expediency.[99] These practices had devastatingeffects on the financial services sector generally. The Capital Markets Authority was inauguratedduring this period and it is unclear what criteria were applied to appoint the first and subsequent members of the Authority until 2000.[100]Although the law did not ordain it, the first three chief executive officers of the Capital Markets Authority (1990-2008) were not competitively sourced.[101]The unrestricted discretion of the executive to appoint the chief executive officer and members of the Authority comported well with the culture of rewarding friends,political supporters and other sectarian interests.[102]

Resultantly, enactment of the Capital Markets Authority Act in 1989 was an anti-climax. The legislation did not fundamentally rework the regulatory terrain. It drew accolades from the stock brokerage fraternity ostensibly because it substantially retained the *status quo*.Monopolization of the NSE by a few stockbrokers remained unchallenged although the role of the Exchange as a self-regulatory organization was tampered with.[103] The Exchange could not vary, amend or rescind its rules without prior approval of the Authority.[104]Relatedly, it had to be notified of any disciplinary action taken by the Exchange against its members or listed companies within seven days.[105] The law appeared to favor market players as opposed to securities markets. The purported restructuring of the board of directors of the NSE through an amendment in 1994 was largely cosmetic.[106]

The NSE remained an exclusive club of eighteen Stockbrokers. It was until the unprecedented collapse of three stock brokerage firms that the Capital Markets Authority changed its ambivalent enforcement philosophy to dismantle the cartel-like structure of the NSE. There was overwhelming evidence that the Authority had failed to discharge its mandate of *inter alia*, ensuring that the stock exchange and market intermediaries discharged their functions honestly, efficiently and transparently.[107]Outstanding enforcement actions by the Capital Markets Authority vindicated commentators who unfailingly maintained that the Authority had abdicated its responsibilities.[108]

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[98] Elliot K.A., *Corruption as an International Policy Problem: Overview and recommendations* in K. A. ELLIOT, (Ed.), CORRUPTION AND THE GLOBAL ECONOMY 175-176 (1997)

[99]See Anyang Nyong'o, *How bad Governance Strangles Business,*DAILY NATION, June 10, 2001, at 8.

[100] See CAPITAL MARKETS AUTHORITY ANN. REP. 6-7 (1990-91).

[101] This illustrates the pervasive powers exercised by the presidency. The Minister of Finance could not appoint persons to the board of the Authority without the president's concurrence.

[102]See David Furnivall, supra note 88 at 19.

[103] It was no longer the sole regulatory body for the secondary markets. § 19 obligated the NSE to apply to the Capital Markets Authority for approval within six months of promulgation of the Act.

[104] § 21

[105] § 22

[106]§ 20 provided that any securities exchange applying for approval by the Capital Markets Authority had to be a company limited by guarantee (previously any company registered pursuant to the provisions of the Companies Act qualified for approval) and had to constitute its board of directors in accordance with the provisions of the Act i.e. five persons were to be elected from amongst the stockbrokers, two other persons elected by members of the stock exchange were to represent listed companies and another three would be appointed to the board on the basis of their knowledge and experience in investment. The chief executive of the securities exchange was also constituted a member of the board. Members of the board other than the chief executive would elect a chairman.

[107] See Editorial, *CMA must crack whip on errant Stockbrokers*, THE STANDARD, Feb. 27, 2007, at 12; Editorial, *CMA must put its act together or close shop*, THE STANDARD, Feb. 17 2007, at 12; Editorial, *Stock Market:When will CMA lead from the front?*FINANCIAL POST, Feb. 25, 2007, at 6; Martin Mutua, *Passing the buck on FrancisThuo and Partners Limited*, THE STANDARD, April 4, 2007, at 22.

[108]*Id.*

Legal framework: The conundrum

The legal framework on securities markets in Kenya is traceable to 1907 when the United Kingdom's Parliament promulgated an Order-in-Council declaring *inter alia*that the sources of law of Kenya would henceforth be the Statutes of General Application, the substance of common law as modified by the doctrines of equity and judicial precedent.[109]This transplanted English law to Kenya. For Corporate law, the United Kingdom's Companies Act of 1907 was adopted in 1922 and remained in force until 1961 when the UK Companies Act, 1948, was adopted in Kenya. The Act became operational on January its, 1962. Before 1989, Kenya's securities markets were largely self-regulating with no significant government involvement. The Nairobi Stock Exchange operated as a self-regulatory organization. However, formation of the Capital Issues Committee in 1971 heralded the era of government regulation.[110]Companies wishing to list had to prepare prospectuses in accordance with the provisions of the Companies Act[111] and submit copies to the Ministry of Finance and the Nairobi Stock Exchange for approval. Similarly, a copy had to be delivered to the Registrar of Companies for registration.Once listed; companies were governed by the Listing Rules of the Nairobi Stock Exchange.[112]

The Capital Issues Committee remained the *de facto* regulator for the primary market until March 1990 when the Capital Markets Authority was inaugurated.As mentioned elsewhere, althoughthe self-regulatory system appear to have served the securities markets soundly,[113]it was characterized by inefficiencies in enforcement.[114] Relatedly, amending the Exchange Control Act in 1965 to limit the amount of foreign exchange foreign investors could repatriate abroad impacted negatively on investment and the securities markets.[115] Foreign owned companies could only remit earnings on capital which had been brought from abroad. Similarly, enactment of the Prevention of Frauds (Investment) Act in 1977[116] was also bootless. The Act was intended to formalize operations of Capital Issues Committee[117]and address certain aspects of the securities markets including market integrity.[118]The Act was never operational zed. This was *prima facie* evidence of the Governments' ambivalence towards securities markets. Nevertheless, this was the first significant attempt to establish some semblance of a regulatory framework for the markets. Attempts to institutionalize Governmental regulation of the securities markets came to fruition in 1989 when the necessary legislative framework was institutionalized.Prior to the enactment of the Capital Markets Authority Act,there was no distinctive branch of law on securities markets in Kenya. The operative United Kingdom's Companies Act, 1948 had no substantive provisions on dealings in securities other than general disclosure by companies,[119] annual returns,[120] transferability of shares,[121] contents,form and registration of prospectuses and liability for untrue statements. The Act made it unlawful for any person to deliver an application form for securities without a prospectus.[122] All issues of securities had to be approved by the Capital Issues Committee. Government securities were regulated by the Constitution.[123] This period signaled a fundamental change in the legal landscape for securities markets.

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[109] § 3(1) Judicature Act, Cap. 8.
[110] See generally, IFC/CBK Report, supra note 71
[111] See Part 1 and II of the Third Schedule to the Act; Muthua N.T., Trading in Company Shares: A Study of the Nairobi Stock Exchange, (June 1995) (unpublished) LL.B Dissertation, University of Nairobi (on file with Parklands Library, University of Nairobi).
[112] The Rules created a contractual relationship between the company and the stock exchange. The publicly held company is contractually bound to comply with the rules.
[113] See IFC/CBK Report, supra note 71 at 25 (Between 1967 and 1973, 26 companies listed on the Nairobi Stock Exchange).
[114]See Nixon Kareithi&SeneiyaWaiganjo, *ICDC Shares Puzzle*, KENYA TIMES, Oct. 11, 1989, at 1; Nixon *Kareithi, Stock Exchange turn down Timsales plea*, KENYA TIMES, Mar. 29, 1990, at 15.
[115] Listed companies were forced to devise various ways to disguise repatriation of profit abroad.
[116] Act No. 1 of 1977.
[117]§ 4 (1)
[118] § 16
[119] §384
[120] § 125-128.
[121] § 75-85.
[122] § 40
[123] § 99

Startlingly, the Government Economic Survey for the year 1983 while underscoring the need to strengthen the Central Bank of Kenya's regulatory role of the banking sector[124] made no specific reference to securities markets. Inexplicably, it took external prompting and financing to conduct a detailed study on the viability and sustainability of securities markets in Kenya. The International Finance Corporation (IFC) and Central Bank of Kenya (CBK) study on "**The Development of Money and Capital Markets in Kenya**" was commissioned in April 1984.[125] The objectives of the study were to:[126]

- determine the scope for improvement in the operations of a money market by introduction of new instruments and procedure,
- determine the scope for improvement in public debt management that would serve to facilitate development of both money and Capital Markets and
- Determine the scope for improvement of corporate debt and equity financing including the possibility of making the NSE into a more dynamic and useful institution.

The study focused exclusively on securities markets[127]and became the blueprint for structural reforms for the sub-sector. It recommended *inter alia* the enactment of a securities statute and the creation of a Capital Markets Development Authority to oversee the development of the securities markets.[128] The study was unqualified that while regulating the securities markets was necessary, their growth was an imperative. The experts were concerned that elevating regulation to the level of development at the initial stages would stifle the markets. Instructively, the study highlighted numerous ways of nurturing and enhancing securities markets.[129]

After indefensible delay, the Capital Markets Advisory Council was appointedin November 1988 in consonance with the recommendations of the IFC/CBK Report.[130]This development culminated in the operationalization of the Capital Markets Authority Act in December 1989.[131] The Act established the Capital Markets Authority with the mandate to promote and facilitate the development of orderly, fair and efficient securities markets in Kenya.[132]Inauguration of the Capital Markets Authority in 1990 was hailedas a milestone by the Government to imbue dynamism and vitality in the securities markets.[133]Subsequently, the Authority published Regulations and Guidelines on various aspects of securities markets, including, rating agencies, corporate governance, issuance of bonds and commercial paper and foreign investors. The bulk of the subsidiary legislation came into operation in 2002.[134] Towards the end of 1990s, the Authority undertook a comprehensive review of the legislative framework to accommodate market dynamics and enhance regulatory powers. Resultantly, a hodge podge of amendments were madeto the Capital Markets Authority Act in 2000.

The title of the statute changed to the more appropriate Capital Markets Act to encapsulate the focus of the legislation. The Central Depositories Act, 2000 was enacted to provide the legal and institutional framework for electronic trading in securities.Throughout the 1990s, enforcement of the regulatory framework by the Authority took the form of licensing market practitioners and monitoring compliance with specific regulatory requirements. This was intended to strengthen the oversight function. Several market intermediaries lost their licenses in 1999.[135]

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[124]ECONOMIC SURVEY, Government Printers, Nairobi, 59 (1984).
[125]See generally IFC/CBK Report, supra note 71.
[126]*Id.* at 2.
[127]*Id.* at 1.
[128]*Id.* at 52.
[129] *Id.* at 41-57.
[130]The Terms of Reference of the Capital Markets Advisory Council were to: (i) study and identify impediments to the development of vibrant capital markets in Kenya (ii) Carry out ab in-depth analysis and discussion of the existing institutions and instruments available in the market and recommend additions or amendments as necessary (iii) Make appropriate recommendations to the Minister for Finance on the necessary measures and policies to be implemented with a view to creating a vibrant capital market in Kenya (iv) Draft the Capital Markets Authority Bill to facilitate the establishment of the Capital Markets Authority.CAPITAL MARKETS AUTHORITY ANN. REP., supra note 100 at 17.
[131] December 15th 1989.
[132] § 5 and Preamble to the Act.
[133] Members of the Authority were appointed in January 1990 and the Authority was inaugurated by the Minister of Finance on March 7th 1990.
[134]CAPITAL MARKETS AUTHORITY ANN. REP., 7 (2002).
[135] Middle Africa Investment Limited, Megraj Investment Services, Sterling Securities and Town and Country Securities.

In addition, at least four companies were suspended and eventually delisted from the official list of the NSE.[136] To enhance financial stability of stock brokers and Investment Advisers, the Capital Markets Authority reviewed the minimum capital requirements upwards to Kshs. 5 million and Kshs. 1 million respectively.[137] To domesticate the precepts of the World Bank's Structural Adjustment Programmes, the president prevailed uponGovernment owned banks to sell securities to the public.[138]

The Kenya Commercial Bank took the challenge and off-loaded twenty (20) per cent of its issued capital to the public in 1988. The issue was oversubscribed by 150 per cent.[139] This heralded the era of divestitures by the Government through the NSE. Subsequently, the Government divested fromUchumi Supermarkets Limited, East African Oxygen, Cooper Motors Corporation Limited, Firestone (East Africa) Limited and the National Bank of Kenya.[140]Shockingly, the Government was emphatic that divestitures through the NSE were not envisionedto promote the securities markets but to demonstrate its commitment to the SAPs.[141]Opportunely, the public psyche was against other privatization mechanisms.

The first amendment to the Capital Markets Authority Act in 1994 introduced several of adjustments to restructure the NSE and its board of directors. It provided *inter alia*that stock exchanges had to be registered companies limited by guarantee and their boards of directors had to reflect the diversity of stakeholders. These changes had no noticeable impact on the operations and governance of the NSE.[142] Stockbrokers retained monopoly over the Nairobi Stock Exchange. For instance, before 2009, the chairmanship of the NSE board of directors was a preserve of stockbroker's representatives on the board. In March 2009, theMinister of Finance was quoted as having ordered the NSE and its affiliate, the Central Depository and Settlement Corporation (CDSC) to reconstitute their boards of directors. The order was demonstrably *ultravirus* the Minister. Being private entities,the two companies were subject to the provisions of the Companies Act, as opposed to ministerial caprice. However, in an arrangementcalculated to placate the Minister and endear the exchange to investors, a non-stockbroker representative was subsequently elected chairman of the NSE board of directors.One of the noticeable shortcomings of the Capital Markets Act which the Capital Markets Authority has had to contend withwas its failure to provide thebenchmark for licensing new stockbrokers. The licensing of thirteen (13) new stockbrokers between 1994 and 1995 which raised the number to eighteen (18)did not placate the market. [143]The Authority is inundated with applications yet the number has stagnated at twenty two (22).

Foreign investors

Before 1995, foreigners could not participate in Kenya's securities markets. This changedin early 1995 whenthe necessary Regulations were promulgated. Foreign portfolio investment was permitted as part of the liberalization package.[144] The Regulations capped individual and corporate holding at 5% and 40% in aggregate in any listed company. The Regulations were subsequently amendedto extend the aggregate to 60%. Foreign investors could now acquire up to 49% of local stock brokerage firms and up to 70% of fund management companies.[145] Foreign investor participation heightened performance of the securities markets and contributed to increased turnover in subsequent years. An increased net inflow from 1995 wascredible evidence that foreign investors had an impact on the markets.

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[136]CAPITAL MARKETS AUTHORITY ANN. REP., 37 (2001).

[137]CAPITAL MARKETS AUTHORITY ANN. REP., 27 (1993). Previously the amount was capped at KShs. 1 million ($12,500) for Stockbrokers and KShs. 100,000 ($1250) for Investment Advisers.

[138] Chris Musyoka, *Sell shares: Moi tells state banks,* DAILY NATION, AUG. 27, 1987, at 1.

[139] See AndereaMorara, *Kenya Commercial Bank to float its shares in June*, DAILY NATION, April 15, 1988, at 12.

[140] See CAPITAL MARKET AUTHORITY ANN. REP., 84-5 (1997).

[141] See Francis Makokha, *Nairobi Stock Exchange "under scrutiny*," DAILY NATION, July 10, 1993, at 4 (the then Minister of Finance was quoted saying that: ''The Government is closely watching the performance of the NSE. The Government hoped to privatize many companies through share issues on the exchange. However, if we conclude that this route does not serve our objectives well, other attractive options for disposal of state companies remain open to us").

[142] See WachiraKanga'ru, *How Treasury Forced NSE to do its Bidding*, SUNDAY NATION, May 2, 2009, at 8.

[143] See generally CAPITAL MARKETS AUTHORITY ANN. REP., (1995).

[144] Capital Markets Authority (Foreign Investors) (No.2) Regulations, Legal Notice No.291 (1995).

[145]See CAPITAL MARKETS AUTHORITY ANN. REP., supra note 140 at 17.

Market performance: An analysis

Raising capital through securities markets is a process of disintermediation where corporate organizations, Local Authorities, state corporations and the Government Issue securities or investment products to investors. During the period under review, securities markets facilitated the raising of significant amounts of capital by corporations and the Government through divestitures or privatization. Between 1990 and 1993 there were seven public issues of 58.5 million shares rising about Kshs. 900 million ($11.25million).[146] 1994 was exceptionally active with three public issues comprising an offer of 98 million shares which raised about Kshs. 2.8 billion ($350 million).[147], the fact that there were no public issues in 1995[148]accentuates the intermittent utilization of securities markets by corporations and the Government.Public issues reached their crescendo in 1996. The year witnessed five public issues comprising about 367 million shares which rose about Kshs. 5 billion ($625 million). The following year had only two issues which raised Kshs. 400 million ($5million).[149] Additionally, one of the public listed companies made a rights issue amounting to KShs.1.5 billion ($187 million) bringing the total raised to Kshs. 1.9 billion. ($ 200 million).1998 witnessed one privatization and a rights issue. Both raised Kshs. 2 billion ($200 million). There was no public issue in 1999.The statistics show that Kenya's securities markets had unexploited potential and were an important segment of the bourgeoning financial services industry.

During the same period, the NSE share index reached unprecedented levels. From 1990 to 1994 the index maintained an upward trend attaining its highest watermark of 5031 points in 1994. This unparalleled development made NSE one of the leading markets in Sub-Saharan Africa in terms of equity investment return in dollars equivalent.[150] However, from 1995 to 2000, the index plummeted from a high of 3,469 to 1,913.[151]Although the NSE 20-share index declined towards the end of the century, overall market performance was positive.For instance, market capitalization rose from Kshs. 11 billion in 1990 to KShs.129 billion in 2000. Relatedly, market turnover appreciated from Kshs. 230 ($24) million in 1990 to Kshs. 4billion in 2000.

Performance of the equities market: 1990-1999.

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
NSE 20-Share Index (End of year)	915.	958.2	1167.2	2513.7	4559.4	3468.8	3141.1	3115.1	2962.0	2303.1
Volume of Shares traded (million)	11	16.6	14.8	27.2	42.7	62.1	113.5	143.6	111.5	157.4
Turnover (billion)	0.23	0.30	0.38	0.82	3.08	3.34	3.96	6.15	4.58	5.12
Market Capitalization (billion)	10.9	12.7	23.0	72.3	136.8	107.20	98.7	114.3	129	106.7
New Issues (IPO & Rights)	1	1	3	2	3	0	5	3	2	1

Bond market

In most emerging securities markets the debt market is not infrequently overshadowed by the more scintillating equities market.[152]In the United States of America, debt is greater than equity. In emerging markets, issuance and trading in equities preceded the emergence of the corporate debt market. From its inception, the bond market in Kenya was dominated by Government Treasury Bills and bonds.[153] Government decision to list its Floating Rate Treasury Bonds (FRTB) on the NSE in 1997 was a major boost for the nascent bond market.[154] In 1999, the Government issued Floating Rate bonds amounting to Kshs. 26.4 billion ($ 3.3 billion) which were floated on the NSE.[155]

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[146] See CAPITAL MARKETS ANN. REP., supra note 137 at 58-9.
[147]*Id.*
[148]*Id.* at 60.
[149]CAPITAL MARKETS AUTHORITY ANN. REP., 16 (2006).
[150] See CAPITAL MARKETS AUTHORITY ANN. Rep., 31 (1994).
[151]CAPITAL MARKETS AUTHORITY ANN. REP., 17 (2000).
[152] See Felicia H.K., *The Regulation of Corporate Bond Offerings: A Comparative Analysis*, 26 U. PA. J. INT'L. ECON. L. 409 (2005).
[153] See Suntra Stockbrokers Limited, *Balance needs to be restored,*DAILY NATION Jan. 6, 2004, at 3; Fixed Income Securities Markets Segment, Nairobi Stock exchange, *available at* www.nse.co.ke/newsite/ (visited on Mar. 3rd, 2010). Out of the total 102 bonds listed on the exchange, there were only 11 corporate bonds. Government bonds accounted for over 90%.
[154]CAPITAL MARKETS ANN. REP., supra note 143 at 14.
[155]CAPITAL MARKETS AUTHORITY ANN. REP., 14 (1999).

In 2000, the Government issued twenty (20) new bonds worth Kshs. 37.9 billion ($ 4.7 billion) which raised Kshs. 28.7 billion ($3.6 billion).[156] Noteworthy, the Government was relying heavily on the securities markets to bridge its budgetary deficit.Significantly, this period witnessed the emergenceof two financial products, corporate bonds and commercial paper.[157] Corporate bonds were few and far apart because many firms in East Africa relied on traditional bank loans and overdraft facilities to finance their activities and expansion. Owing to historical factors, the banking sector had a healthier footholdand wider penetration of the market. Banks were reluctant to encourage their premium customers to experiment on products outside banking.[158]If the amountto be borrowed was large, the loan would be syndicated by a pool of banks.[159]Needless to emphasize, such amounts could have been raisedmore cost effectively through the securities markets.[160] Sadly, syndication of loans became an established practice.

The foregoing setback notwithstanding, corporate bonds made their debut in the market in 1996 when East Africa Development Bank floated a three-year bond.[161] Undesirably, it was the only corporate bond in the market until December 2000 when Shelter Enrique issued a Kshs. 150,000 million ($1.8 million) bond.[162]Commercial Paper on the other hand is a short term working capital financing instrument.The first paper was issuedin 1997 after the Authority had promulgatedthe Guidelines for the issuance of Bonds and Commercial Paper. In 2000, new Commercial Papers worth Kshs. 600 million ($7.5 million) were issued and by the end of the year, the total amount raised from Commercial Papers stood at Kshs. 12.2 billion ($1.5 billion).[163]The bond market had within a short time established itself as an important market segment with potential to dominate the securities markets. Regrettably, Government domination of the segment did not augur well with overall growth of the securities markets.

Infrastructure

On infrastructural development of the markets, the NSE had a physical presence with a trading floor.[164] In order to enhance efficiency and transparency in securities trading, the antiquated "call over" system of trading was replaced with the "open outcry."[165] The "call over" system characterized the markets until the Automated Trading System was institutionalizedin 2004.

Incentives

Governmental policies and support structures play an elemental role in the development of securities markets.[166] During the period under review, the Government introduced certain measures ostensibly to support the growth of securities markets.[167] As mentioned elsewhere, foreign investors could now participate in domestic securities markets. This development opened the markets to a wide spectrum of clientele with diversified sources of capital. However, their impact on the markets was not remarkable. The fiscal measures introduced included:

- Transfer of listed securities was exempted from stamp duty and value added tax.
- Withholding tax on dividend income from listed securities was reduced from 15% to 5% for local investors and 7.5% for others. Similarly, withholding tax on income from fixed income securities such as bonds and bank deposits was reduced to 15% and made a final tax.
- Costs of credit rating and initial public offerings were made tax deductible.
- Transfer of listed securities by insurance companies was exempted from capital gains tax.
- Venture capital funds income would not be subject to taxes for 10 years.

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[156]CAPITAL MARKETS ANN. REP., supra note 151 at 18-19.
[157]As a consequence, in March 1997, Capital Markets Authority promulgated Guidelines for Issuance of Corporate Bonds, Commercial Paper and other Debt Instruments, 1997.
[158]*See Maurice Otieno, NSE boss appeals for fair dividend policies,*DAILY NATION, June 20, 1995, at 13
[159]See OdhiamboOcholla, *Syndicated Loans:The new debt capital vehicle of choice,*THE STANDARD, Feb. 11 2010, at 18(underscoring the popularity of syndicated loans among companies in East Africa).
[160] See OdhiamboOcholla, *Syndicated Loans vs. the Corporate Debt*, FINANCIAL STANDARD, Oct. 30, 2007, at 11.
[161] See generally MunaWahome, *Bank's KShs. 2b ($25,000,000) bond to boost NSE,*DAILY NATION, Apr.24, 2001, at 4.
[162]CAPITAL MARKETS AUTHORITY ANN. REP., supra note 145 at 18.
[163]CAPITAL MARKETS AUTHORITY ANN. REP., supra note 136 at 18.
[164] SeeCAPITAL MARKETS AUTHORITY ANN. REP., 20-1 (1991-92).
[165]*Id.*
[166]See Black, supra note 34.
[167] See CAPITAL MARKETS AUTHORITY ANN. REP. AND REV., 16-17 (1990-1998).

- Income earned by Unit Trusts and Mutual Funds exempted from tax.
- Foreign brokers and fund managers permitted to participate in Kenya's securities markets through joint ventures provided local investors held 51% and 30% of the shareholding respectively.
- Foreign investors were free to acquire up to 40% of the share capital of any listed company.[168]

Lamentably, these incentives were not informed by a comprehensive or coherent strategy for the promotion of securities markets. They were unsystematic and fragmented. Relatedly, it was unclear whether the incentives were intended to enhance the primary, secondary or bond markets. On balance, the incentives were not audacious enough to have a significant impact on the securities markets generally.

No new thinking appear to have gone into other multifarious ways of promoting securities markets other than fiscal incentives whose impact is likely to be more pronounced in more developed markets. Notwithstanding these incentives, market performance maintained a downward trend. Similarly, although the Government had embraced privatization under the World Bank's Structural Adjustment Program, divestitures were intermittent notwithstanding the large number of corporations designated for privatization.[169]Although the 1990s emerged as the most active decade, the number of companies exiting the Nairobi Stock Exchange exceeded the number that listed. The number of listed companies stagnated at fifty five (55).

Remarkably, the securities markets generated unprecedented excitement and many people and institutions diversified their investment portfolio by subscribing for securities during initial public offerings (IPOs) generated by a few divestitures by the Government.

Enforcement

Prior to the promulgation of the Capital Markets Authority Act, the Nairobi Stock Exchange was primarily responsible for all regulatory aspects of the secondary market.[170] Other regulatory agencies were the Adhoc Capital Issues Committee and the Registrar of Companies. On listing, a company *ipso facto* became the subjectof the Listing Manual of the NSE. Listed companies were contractually bound by the Listing Rules.[171]On the other hand, members of the NSE were bound to observe Membership and Trading Rules.[172] Typical of exchanges vested with enforcement powers, the NSE did not adopt a robust enforcement philosophy.[173]The exchange acted with restraint[174]and seldom interfered with trading.[175] Whereas the Capital Issues Committee approved new issues, the Registrar of Companies registered prospectuses and was the repository of annual returns.

As envisioned by the IFC/CBK Report, the Capital Markets Authority Act gave the Authority wide-ranging market developmental responsibilities.[176]Relatedly, it was empowered to regulate the securities markets, promote self-regulation and protect the interests of investors.[177] The gamut of regulatory powers was embodied in section 11(2) of the Act.

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[168] *Id.*

[169]See Maureen Kakah, *Court blocks plan to sell sugar firms*, DAILY NATION, April, 12, 2016 at 6. (Explaining that Justice George Odunga of the High Court, Nairobi, had restrained the Privatization Commission of Kenya from proceeding with the privatization of Nzoia, Chemilil, South Nyanza Muhoroni and Miwami sugar factories pending the hearing and determination of a case filed by the Kisumu Senator, Anyang' Nyong'o.

[170] Rules of the Nairobi Stock Exchange of 1954 (as amended in 1981) and subsequently the Articles of Association of the Company after 1991 when the stock exchange was incorporated into a company.

[171] Listing creates a contractual relationship between the company and the stock exchange. The company is bound to observe the Listing Rules.

[172]SeeSupra note 170.

[173] Stock Exchanges are not generally associated with enthusiasm in enforcing their rules on members and listed companies.

[174] Nixon Kareithi, *Stock Exchange turns down Timsales plea*, KENYA TIMES, Mar. 29, 1990, at 20.(Timsales Limited, a listed company had applied for trading in its shares to be suspended to facilitate a takeover bid which was contested by employees. NSE declined on the ground that disclosure by the company was insufficient); Peter Warutere, *Timsales: Brokers worried*, DAILY NATION,Apr. 5, 1990, at 10.

[175] See Alex Chege, *NIC Issue to liven up activity in the market*, DAILY NATION, Aug. 2, 1994, at 7. (Barclays Bank of Kenya Limited intended to offload 51% of its shareholding in National Industrial and Credit Bank Limited (NIC) and CFC Bank had intimated its intention to take up the shares but was taking unreasonably long to conclude the transaction. The NSE had recommended to the CMA that trading in the shares of NIC on the NSE be suspended but Authority declined on the ground that the action would be interpreted negatively by the market.

[176] § 11(1)

[177]*Id.* (b) and (c).

The enforcement jurisprudence of the Authority was encapsulated in its first Annual Report which was unequivocal that:"At this initial stage of market development, the priorities of CMA are to enhance market activities and growth with minimum regulation or interference. Emphasis has been placed on self-regulation by all licensed persons in the market. Nonetheless, CMA has an important role to ensure that all market players comply with the requirements of the regulatory framework set for the purpose of ensuring market discipline and investor confidence."[178]There is considerable merit in surmising that the Authorityhad preponderantly construed its regulatory mandate judiciously. As contemplated, few enforcement actions followed. In 1995, the CMA declined to approve the listing of Trade Bank Limited for non-compliance with the disclosure regulations.[179]Similarly, the Authority refused to renew the license of an Investment Adviser and suspended a broking firm from the NSE.[180] The Investment Adviser appealed to the Minister but the appeal was unsuccessful. Suspension of trading in the shares of Kenya Finance Bank Limited after the Central Bank of Kenya had placed it under statutory management was intended to protect investors.[181] In 1997, trading in the shares of African Tours and Hotels Limited and King Fisher Properties Limited was suspended for non-compliance with listing requirements and to facilitate restructuring respectively. An appeal by King Fisher Properties Limited to the Minister was unsuccessful.[182]Troublingly, the takeover of Kenya Breweries Limited by Guinness PLC, the Standard Newspapers Ltdby foreign investors andthe CMC Group Ltd bya group of shareholdersrespectively, in contravention of the regulatory framework provoked no enforcement action from the Authority.[183]The inaction typified ambivalence on its part.

Conclusion

This study sought to illuminate the context in which Kenya's securities markets originated and developed. It has *interredalia* demonstrated that trading in securities evolved as a supplementary activity undertaken by estate agents, accountants and lawyers and predates the NSE. The lacklustre performance of the securities markets from its inception in the 1950s to 2000 was largelyattributable to the socio-political and economic circumstances in which the markets emerged.Neither the ColonialGovernment nor the Government of Kenya invested sufficiently to galvanize the securities markets to the next level. The absence of a coherent policy framework and a facilitative legal environment emblematized the markets for many years.Trading insecurities was controlled by a handful of stockbrokers who owned and managed the Nairobi Stock Exchange. Thesestockbrokers enjoyedexclusive and non-transferrable trading rights. The situation was exacerbated by the absence of a defined admission criterion. These developments constituted the securities exchange an exclusive members club. Belated attempts by the Capital Markets Authority to license additional stockbrokers in mid-1990s could not camouflage the reality that the Authority lacked the gumption to contend with market dynamism. This bolstered the entrenchment ofstockbrokers and compounded the challenge of exclusivity of the securities markets. Similarly, the half-hearted attempts by the Government to institutionalize selected fiscal incentives and increase foreign shareholding of listed companies to encourage investment were largely inconsequential.Finally, the Capital Markets Authority failed to originate and sustain an adaptable enforcement philosophy to endear itself to the securities markets. Nefarious or egregious conduct by stockbrokers and listed companies were seldom penalized. Paradoxically as Kenya was engrossedwith percentages on foreign ownership of listed companies and market intermediaries,progressive jurisdictions had already liberalized investment by foreigners to position themselves strategically as investment destinations. Singapore is the *locus classic us* illustration. Predictably, the two jurisdictions hold contrasting flanks of the continuum in the size of their securities markets. The study demonstrates that because "creating strong securities markets is hard,"[184]the infrastructure necessary for their growth and sustainability isan imperative.

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[178]See CAPITAL MARKETS AUTHORITY ANN. REP.,supra note 100 at 25.

[179] Trade Bank Limited, which had just concluded a private placement applied for listing on the NSE. The CMA rejected the application citing insufficient disclosure. The NSE approved the listing. The bank unexpectedly collapsed soon thereafter under the weight of massive fraud and the Capital Markets Authority was vindicated.

[180] Middle Africa Investment Limited and Bob Mathews Limited respectively.

[181] Action by the CMA in the circumstances was justified since the company had ceased to carry on business.

[182]CAPITAL MARKETS AUTHORITY ANN. REP., supra note 143 at 18.

[183] In all the three cases, neither the Capital Markets Authority nor the Nairobi Stock Exchange was notified of the impending takeovers. See Samuel Nduati, *CMC cries foul over 25,000shares deal*, DAILY NATION, Feb. 8, 1994, at 13; Maurice Otieno, *Were CMA Rules followed in sale of Standard*? DAILY NATION, Aug. 29, 1995, at 4; Mohua Mukherjee, *Rate fall good news for Capital Markets,* DAILY NATION, Jan. 20, 1999, at 10.

[184]See Black, supra note 34 at 782.