Dynamics in the Business Environment: Effect of the Building Bridges Initiative on Performance of Nairobi Securities Exchange, Kenya

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Abstract: *Political elections worldwide create tense moments in the business environment, this tends to erode investor confidence as a result of optimism and pessimism from the public. Market bulls represent optimism while market bears pessimism. Market optimism results in higher stock returns while market pessimism in lower stock returns. Kenya had its hotly contested general election on 8th August 2017, which had a negative impact to the business environment. This was followed a political handshake between the two main competitors of the general election in trying to foster a conducive political-business environment that would result in improved investor confidence. This paper investigates whether the Handshake between the president elect and the main opponent in Kenya had statistically significant effect on the Nairobi Securities Exchange Index. The design of this paper is descriptive based. The Nairobi Securities Exchange (20) index data will be obtained 42 days before and 42 days after the handshake. The mean indices will be computed and tested for statistical significance. The independent variable is the handshake while the indices before and after the handshake are the dependent variables. The results will be tested at 0.05 level of significance.*

Keywords: *Nairobi Securities Exchange Index, Handshake, market optimism, market pessimism.*

I. INTRODUCTION

Business environment in Kenya is in most cases affected by the general elections every five years. This tends to erode investor confidence leading to a decline in returns and low trading at the Nairobi securities exchange (Kuria, 2012). This was the case when Kenya went to the general election on 8th of August 2017. The incumbent President was declared the winner of the presidential election with 54.17% of the vote, whilst his main opponent finished second with 44.94% of the vote (IEBC, 2017). The opposition appealed to the Supreme Court, citing a breach of the technical processes required by the constitution and the law, the court returned a verdict that the election had not been conducted in accordance with the constitution, cancelling the results and ordering fresh elections to be held within 60 days (Ndege, 2018).

The president elect complained that the decision was tantamount to overturning the will of the people. Nevertheless, the president elect stated that though he disagreed with the Supreme Court's decision, he would respect the decision. The main opponent on the other hand welcomed the court's verdict, saying this indeed is a very historic day for the people of Kenya and by extension the people of the continent of Africa (Omondi & Guguyu, 2018). However, in early October the main opponent announced that he was withdrawing from the repeat presidential election. President elect was declared the winner of the repeat Kenya's presidential election for the second time after receiving nearly 7.5 million votes (IEBC, 2017).

The political environment that prevailed during this period negatively affected the business environment and eroded investor confidence. This led to decline in business activities and a slow down in the economy (Warungu, 2018). To jump start the economy, enhance investor confidence and spur economic growth, there was need to initiate tranquility in the political environment and by extension, the social and economic environments (Omondi & Guguyu, 2018). As a result, the building bridges initiative was hatched by the president elect and his main opponent at Harambee house in Nairobi Kenya on 9th March 2018 dabbed the "political handshake". There was a perceived instantaneous positive reaction it the political and social environments which the researchers opined that could have also impacted the economic environment thus gave impetuous to the current study.

Statement of the problem

Worldwide, Political elections present tense business environment. These are moments of hope on one part of the society while the rest is hopeless. The contrast created by the forces of hope and hopeless cause acrimony. Therefore, the part of society that is optimistic over election results have merry and fun while the rest have ill feelings. These two opposing forces creates a harsh business environment, that erodes investor confidence leading to a slowdown in the economy. This describes the atmosphere experienced in Kenya in the months of July, August, September 2017 to March 2018. The key question being addressed in this paper, is to what extent did the building bridges initiative dabbed the 9th March, 2018 political handshake between the president elect and the main opponent influence the stock market in Kenya? After the promulgation of new constitution in Kenya in 2010, investors are curious to know the extent to which tense political environment influence their stock investment performance. Therefore, it is pertinent that investors in the Kenyan equity market know the impact of the political handshake between political leaders on their investment performance.

Research Objective

The study sought to find out the effect of the building bridges initiative on the stock market in Kenya.

Research Question

To what extent did the building bridges initiative affect the stock market in Kenya?

Significance of the Study

There is a growing need to increase the level of investments at the Nairobi securities exchange in Kenya. However, during the electioneering periods in Kenya the level of investments at the Nairobi securities exchange tend to slow down. Investors are curious to know the extent to which tense political environment influence their stock investment performance, hence the need to understand the effect of political environment on the performance of Nairobi securities exchange. The investors in Kenya may use the findings from this research to strengthen their investment strategies in order to always maximize their returns from the investments they make. The government may use the findings to formulate policies that will enhance the political environment and in effect create a conducive business environment that will attract more investments at the Nairobi securities exchange. For the scholars that may be interested in pursuing knowledge in related areas, this study will provide some critical insights and guidelines on the effect of political environment and by extension the economic environment on the performance of Nairobi securities exchange.

II. LITERATURE REVIEW

This part covers the theories that lays the foundation for this study. The theories discussed are the efficient market hypothesis and modern portfolio theory.

Efficient Market Hypothesis

The theory Efficient Market Hypothesis (EMH), was postulated by Markowitz in the year 1952 and later named by Fama in the year 1970. The theory assumes that financial markets incorporate all public information and asserts that share prices reflect all relevant information. Correct information is important in forming expectations and allowing investors to correctly process all available information, and where the discount rate is consistent with a normatively acceptable preference specification (Fama, 1970). The EMH's concept of informational efficiency has a Zen-like, counter-intuitive flavor to it. The more efficient the market, the more random the sequence of price changes generated by such a market, and the most efficient market of all is one in which price changes are completely random and unpredictable.

Modern Portfolio Theory

The theory of modern portfolio by Markowitz (1952) explains how investors select a portfolio with the highest possible return given a certain level of risk. There exists a positive correlation between expected return and risk of a financial asset. This implies that if an investor takes high risk, he/she is compensated for with a higher return. (Markowitz, 1952).

Empirical review

Extant literature abounds on the impact of political climate in electioneering period and stock performance. kabiru, Ochieng, and Kinyua, (2015) investigated the cumulative abnormal returns and found that the results were not significant in 2002 and 2013 elections, but found the results significant during the elections of 1997 and 2007 at 0.05 level of significant. (menye, mwangi, & Kimani, 2014), unlike Kabiru et al., (2015), analyzed the effects of general elections in 1997, 2002, 2007 and 2013. They found abnormal share returns; actual share returns and expected share returns were higher before elections than after elections.

Kuria, (2012) studied the impact of political process and gross Domestic product (GDP) for Kenya in the years 1992, 1997, 2002 and 2007. He found that elections have a strong effect on the sustainability and performance of an economy. Floros (2008) did a study on the effects of political election on performance of Stock Exchange of Athens (SEA). The study found two months prior to an election, there was a positive impact on share returns while one month prior to an election there was an inverse relationship. On the over all, political election had a negative effect on the performance of ASE. In Pakistan, Khan, Rehman, and Hussain, (2016) found negative relationship between the general election and performance of stocks. Sagita (2017) has shown that political events in USA have negative effect on the equity market in Indonesia. Therefore, announcement effect could result from events away from home.

In Malaysia, Shen and Celis, (2015) found that political business cycles and stock market volatilities existed and were statistically significant. In Kenya, Menge, Mwangi, and Kimani (2014) analyzed the effects of elections on the abnormal, actual and expected returns and found that the pre-elections stock returns were higher than the post-election returns. In USA, (Brock & Gregory, 2001) assessed the impact of the political business cycle on the economy and conclude that under democratic presidents the economy expands while under

Republican president the economy contract due to ideological differences. They further alluded that presidents whose parties retain the presidency perform better than average performance.

III. METHODOLOGY

Kabiru et al., (2015) adopted event study methodology in establishing cumulative abnormal return. But, Menge et al., (2014) applied event study methodology in computing actual return, expected return and abnormal returns without computing cumulative abnormal return. Floros (2008) used the ordinary least squares (OLS) in both before election and after election. Unlike these researchers, the study used test for differences in the indices before and after handshake to determine whether the differences were significant at 0.05 level of significance. The researcher used indices derived from Nairobi Securities Exchange (20) index. Nairobi Securities Exchange indices were obtained 42 days before the 9^{th} march 2018 political handshake and 42 days after the handshake. The data was analyzed to provide trend and magnitude. Two-sample test of means was applied. Z score was computed and subjected to the standard Z score. The means of the indices and the standard deviation were calculated, thus the desire to apply the two sample test of means. Indices were obtained from 29^{th} January, 2018 to 9^{th} March 2018 and 12^{th} March to 20^{th} April 2018. Therefore, the study focused on the days of capital market trading.

IV. RESULTS AND FINDINGS

Table 1 shows the mean and standard deviation of the indices before 9th March political handshake and after. The means of the indices were 3729.120 before the political handshake and 3763.680 after the political handshake. Therefore, the mean indices were higher after the political handshake.

Table 1: Descriptive statistics of the NSE index 42 days before and after the 9th March 2018 political handshake

		N	Mean	Std. Deviation	Std. Error Mean
NSE 20	After the Handshake	28.000	3804.150	42.836	8.095
Index	Before the Handshake	30.000	3733.330	17.880	3.264

Table 2: Independent Sample t-test of the NSE index 42 days before and after 9th March 2018 political handshake

	t-test for Equality of means						
	Mean Diff.	Std. Error Diff.	t	df	Sig. (2-tailed).	95% conf. inter. of Diff.	
						Lower	upper
Equal variances assumed	70.820	8.516	8.316	86.000	.000	53.761	87.879
Equal variances not assumed	70.820	8.729	8.113	35.618	.000	53.111	88.529

Hartley test for equal variance: F = 14.719, Sig. = 0.0000

Table 2 shows the mean difference of 70.820 which was statistically significant based on the resultant P-value = 0.000.

V. CONCLUSIONS

The study concludes that the political handshake in Kenya had a significant effect on the NSE indices. Indeed, the mean difference of 70.820 was attributed to the political handshake between the president elect and the main opponent. The study also concludes that a stable political environment creates a conducive business environment which improves investor confidence, thus increasing their investments.

Area for Further Study

This study was limited to Nairobi securities exchange and therefore the results might not be generalized to other organizations. Therefore, a similar study targeting other organizations should be conducted.

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Appendix I: NSE index (20) Before the Political Handshake

Dates	NSE index (20)
Mar 09, 2018	3,720.21
Mar 08, 2018	3,719.86
Mar 07, 2018	3,740.97
Mar 06, 2018	3,735.95
Mar 05, 2018	3,726.74
Mar 02, 2018	3,755.95
Mar 01, 2018	3,774.04
Feb 28, 2018	3,750.75
Feb 27, 2018	3,735.00
Feb 26, 2018	3,704.02
Feb 23, 2018	3,710.97
Feb 22, 2018	3,719.91
Feb 21, 2018	3,730.24
Feb 20, 2018	3,727.33
Feb 19, 2018	3,719.47
Feb 16, 2018	3,713.25
Feb 15, 2018	3,703.28
Feb 14, 2018	3,707.29
Feb 13, 2018	3,727.65
Feb 12, 2018	3,729.32
Feb 09, 2018	3,741.02
Feb 08, 2018	3,746.18
Feb 07, 2018	3,729.34
Feb 06, 2018	3,759.95
Feb 05, 2018	3,755.77
Feb 02, 2018	3,758.18
Feb 01, 2018	3,752.48
Jan 31, 2018	3,737.27
Jan 30, 2018	3,727.73
Jan 29, 2018	3,739.69

Appendix II: NSE index (20) After the Political Handshake

Dates	NSE index (20)
Apr 20, 2018	3,710.32
Apr 19, 2018	3,727.69
Apr 18, 2018	3,745.01
Apr 17, 2018	3,770.92
Apr 16, 2018	3,801.65
Apr 13, 2018	3,805.23
Apr 12, 2018	3,820.26
Apr 11, 2018	3,830.94
Apr 10, 2018	3,817.04
Apr 09, 2018	3,809.86

Apr 06, 2018	3,820.81
Apr 05, 2018	3,836.49
Apr 04, 2018	3,820.84
Apr 03, 2018	3,832.12
Mar 29, 2018	3,845.34
Mar 28, 2018	3,816.56
Mar 27, 2018	3,822.12
Mar 26, 2018	3,831.16
Mar 23, 2018	3,847.18
Mar 22, 2018	3,851.37
Mar 21, 2018	3,862.27
Mar 20, 2018	3,850.56
Mar 19, 2018	3,840.08
Mar 16, 2018	3,801.79
Mar 15, 2018	3,767.23
Mar 14, 2018	3,760.87
Mar 13, 2018	3,745.16
Mar 12, 2018	3,725.44