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Addis Ababa University

College of Business and Economics

Department of Accounting and Finance

Should Ethiopia Consider Establishing Stock Market?

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**A Thesis Submitted to Addis Ababa University Department of
Accounting and Finance in Partial Fulfillment of Master in
Accounting and Finance**

Advisor: Abebaw Kasie (PHD)

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Addis Ababa

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APPROVED BY BOARD OF EXAMINERS

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Statement of Declaration

I, Kiflework Bekele declare that this research, titled “Should Ethiopia consider Establishing Stock Market?” is done with my own effort. I have produced it independently except for the guidance and suggestions of my research advisor. I assured this study has not been submitted for any scholarly award in this or any other university.

Kiflework Bekele Beligu

Researcher

Signature

Date

Statement of Certificate

This is to certify that Kiflework Bekele has carried out his research work on the topic titled “Should Ethiopia consider establishing stock Market?” under my supervision. This work is original in nature and it is appropriate for submission for the partial fulfillment of the requirement for Master in Accounting and Finance

Abebaw Kasie (PHD)

Research advisor

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Acronyms

GDP	Gross Domestic Product
EXC	Ethiopian commodity Exchange
IOSCO	International organization of security commission
SRO	Self regulatory organization
ICT	Information and commendation technology
FDI	Foreign direct investment
NBE	National Bank of Ethiopia
DB	Dashen Bank S.C
AIB	Awash international Bank S.C
WB	Wegagen Bank S.C
UB	United Bank S.C
NIB	Nib international Bank S.C
BOA	Bank of Abyssinia
LIB	Lion International Bank
CBO	Cooperative Bank of Oromia
BIB	Birhan International Bank S.C
BUIB	Bunna International Bank S.C
OIB	Oromia internaiton Bank S.C
DGB	Debub Global Bank S.C
EBC	Enat Bank S,C
PSD	Priviate sector development
GOE	State owned Enterprise
PPESA	private and public service Agency

Abstract

The study assessed potential implication for the establishment of Stock market in Ethiopia. To achieve the overall objective of the study and data were gathered from both primary sources as well as secondary sources. Accordingly, shareholders of Banks, and Management officials of banks participated in the study as a primary sources of the study while, scholar's arguments, regulatory of the country, policy, and other related researches and articles were collected as a secondary data. Both the primary and secondary data of the study were analyzed in mixed approach. This is because, as the study is argumentative in its very nature, it was difficult to reach on conclusion only considering primary respondents view, so that the study were substantively compare and contrast respondents view with several types of scholar arguments as well as government regulatory and policies. In this regard, the collected data from several sources were analyzed using descriptive and cross-section data analysis method. And the study were generally, discussed in four main parts, in the first part the study tried to indicate respondents background, in the second part the study analyzed potential implication of stock market establishment in Ethiopia from the demand side, in the third part the study also assessed potential implication from the supply side, and finally the analysis's was tried to indicate prerequisite or major factors affecting the establishment of stock market in Ethiopia. Based on the analyses the finding implied that, the expansion of private sectors, government activities to transfer some of the public organization in to private, large illiquid assets of firms, the increasing innovators and entrepreneurs activities and other specific potentials sectors were identified as potential implication dictated the need to establishment of stock market in the country. However, the environmental challenges of the country such as, lack of regulatory law, technological development, lack of good governance, lack of corporate laws affect the establishment of stock market in Ethiopia. Based on the findings the study forwarded some of the recommendation such as, government need to established regulatory laws that enhance stock market exchange; and as stock exchange solve the problem of illiquidity of firms create a lot of opportunities for small business entrepreneurs; official in the finance sectors should give attention for the establishment of stock market in Ethiopia.

Key Words: Stock Market

CHAPTER ONE

1.1. Background of the Study

The term stock can be defined as “the capital or principal fund raised by a corporation through subscribers’ contributions or the sale of shares”. A Stock represents a share of ownership in a corporation (Murinde, 2006).

A stock market provides facilities for stock brokers, investors and corporations to trade in stocks. Stock markets generally provide the means by which companies raise capital to start new business or expand the existing business by offering new stocks to the public. It also provides a trading facility for investors to sell their share ownership in corporations. Unlike the bond market, stock market provides an opportunity for companies to finance their business through equity investment (Kumo, 2008).

Studies show that stock market can benefit the economy of a developing country in a number of ways, particularly when prices fairly and accurately reflect supply and demand (Guiso, & Jappelli, 2005) First, companies with prospective growth potential will be able to raise equity capital, forcing banks to compete to supply the same financing. Second, the public issuance of shares can provide precious investment resources for enterprises that do not have enough retained earnings or which are unable, or unwilling, to go to the banks (Belcourt, and Saks, 2000) Third, in addition to acting as a source of finance, the stock market also offers firms the opportunity of varying the costs and risks of their financing structures, potentially insulating them from higher interest rates and a credit crunch. Fourthly, introducing stock markets enhances the liquidity of assets as it provides high level of buying and selling stocks without affecting its market price. Hence, in the absence of stock market facility, the ability to convert stocks into cash quickly could be hampered. Finally, the market can also play a role in facilitating long-term asset management such as private insurance and pension funds (Murinde, 2006).

Ethiopia, the second most populous country in Africa, had passed through different economic and political changes, from the imperial feudal economy to the Derg socialist system, and the

current market economy. Although significant steps were taken since 1991 to liberalize the financial sector, it is still relatively small, closed and less developed even when compared to its neighboring countries (Alemeneh, 2015).

The country has opened its doors to previously closed sectors of the economy to foreign investment, although financial services, telecommunication and power generation are still off limits. Following the liberalization of the economy many companies have been formed in different forms, the majority of whom being in the form of private limited companies, a lot others through selling of shares to the market (Mohammed, 2010).

A growing economy like Ethiopia needs investment on a continuous basis for new ventures as well as for expansion and modernization of existing productive capacity. Therefore, to sustain the annual GDP growth, the country needs new investments, in other words, it needs capital to invest. Capital markets provide one means to raise capital, as capital markets mobilize savings for investment. Therefore, capital markets are essential for the country's overall economic growth (Anokye, 2008).

According to Ruecker (2011), since the abolition of the Addis Ababa Share Dealing Group in 1974 by the military government ruling Ethiopia at the time, no stock market has been in place in Ethiopia. The need for stock exchange market development has, however, been continually discussed by various groups, stakeholders and academics. Accordingly, various studies have been carried out by these groups to initiate the establishment of capital market in the country. For example the study conducted by Ruecker (2011) and Tessema (2003), are among those in support of establishment of stock market in Ethiopia. Treasury bills are the only active primary securities used in Ethiopia, and secondary markets still do not exist at the moment. Long-term securities such as bonds are occasionally issued by the NBE to finance government expenditure and/or to absorb excess liquidity in the banking system.

Stock market is vital to mobilize huge capital, improve financial access to private sector, and improve liquidity and risk sharing in an economy. Hence with the emergence of capitalism, many countries around the world have been moving toward market-oriented economies and securities markets sprang up recognizing their significance in an economy (Tessema A. 2003). Scholars and researchers also reveal that there exists a positive correlation between economic growth and Stock market development (Beck et al, 2006 and Bose, 2005).

Despite the growing interest of the private sector to operate the business of stock trading, the government seems to be overcautious. In 2008 the Ethiopian government instead of introducing stock market, the government introduced the Ethiopian Commodity Exchange (ECX) in 2008 as a structured market facility designed to provide fair and transparent pricing of major agricultural products. Hence, in the absence of officially structured market place for trading shares, investors and companies are forced to sell their share through bidding process or through brokers (Legesse, 2012).

The above general background of the study whether directly or indirectly indicated that, how much the establishment of stock in Ethiopia is necessary. Therefore, under considering the concepts explained in the above paragraph this study tried to investigate whether the Ethiopia establish stock market or not, through comparing and constructing several countries experiences, and scholars' arguments.

1.2. Statement of the problem

The stock market is an important element of development in the emerging economies as stock exchanges facilitate efficient resource mobilization and allocation to the corporate sectors in the economy. To shed light on how these emerging economies can develop their stock markets, it is important to see how other stock markets around the world have developed, what factors have driven their general development and which can be applied to develop the emerging economy (Guiso&Jappelli, 2005).

A well-functioning financial system requires strong institutions and a sound legal framework. Among others consumer and property rights protection, contract enforcement laws and corporate governance can be considered as the key elements for creating deep and vibrant financial markets and creating an enabling business environment. Establishing financial markets is not an easy task for the Ethiopian government. It is affected by several environmental factors emanating from different sources. For instance, the legal regime is the bedrock of robust securities markets. In Ethiopia, there is no institutional, legal and policy framework for any secondary financial market activity in the country. Regarding security issues, Ethiopia fares better compared to regional countries, implying conducive security situation to establish financial markets (Mohamed, 2010).

There are a lot of studies and scholar argument revealed regarding the benefit of stock market application in several countries. Studies conducted in the Ethiopian context show that introducing stock market, among other things, allows the “de-concentration of ownership, improve accounting and auditing standards, provide effective tools for monetary and fiscal policy and help privatization efforts”(Asrat, 2003). Another study also states that the establishment of stock market in Ethiopia could contribute to economic growth, since it encourages investment by helping traders buy and sell stocks quickly and efficiently (Kumo, 2008).. Hence, absence of stock market in Ethiopia may cause illiquidity of assets as holders of stocks may find it difficult to sell same at a fair market price. Specifically, as Ethiopian investors only have a small portion of their household income to invest, a fair priced stock trading is significant in order to avoid creating systematic losses for the general public. Consequently, in order to ensure the liquidity of assets in Ethiopia, it is vital to introduce stock market because of the limited investor and issuer base (Ruecker, 2011).

Yet the outright rejection of stock market is not a prudent option for Ethiopia as uncoordinated share trading is a common place. Thus, the issue is whether the challenges that relate to the absence of legal and institutional guidance regarding share trading in Ethiopia can be addressed because the advantages in introducing a stock market seem to outweigh these challenges.

Studies show that shareholders in widely held companies face the difficulty to get the buyer easily and sell back their shares at a fair price (Anokye, 2008) Shareholders in non-financial companies with low profit margin face the challenge of higher commission by the brokers to sell back their shares while shares of financial companies were facilitated by insider trading in which brokered shares were traded for clients on their own account (Murinde, 2006). The current limited facilities of the OTCs market in Ethiopia cannot cope with rapidly growing demand as share prices are uncoordinated between counters thereby facilitating arbitrage and manipulation.

A growing body of evidence suggests that financial institutions (such as banks and insurance companies) and financial markets (including stock markets, bond markets, and derivative markets) exert a powerful influence on economic development, poverty alleviation, and economic stability (Levine, 2005). For example, when Banks screen borrowers and identify firms with the most promising prospects, this is a key step that helps allocate resources efficiently, expand economic opportunities, and foster growth. When Banks and securities

markets mobilize savings from households to invest in promising projects, this is another crucial step in fostering economic development. When financial institutions monitor the use of investments and scrutinize managerial performance, this is an additional ingredient in boosting the efficiency of corporations and reducing waste and fraud by corporate insiders. But, that is not all. When equity, bond, and derivative markets enable the diversification of risk, this encourages investment in higher-return projects that might otherwise be shunned. And, when financial systems lower transactions costs, it facilitates trade and specialization fundamental inputs to technological innovation Smith (Aduda and Nykundi, 2012).

Thus, the pertinent question is how could Ethiopia harvest any perceived economic advantage from the stock exchange in the absence of legal and institutional frameworks that regulate stock market? Particularly, in the absence of mandatory disclosure requirements, shareholders could be deprived of the right to be informed and get relevant and timely information regarding the selling and buying of shares. Hence, inadequate rules on the supervision and regulation of stock trading may engender fraudulent brokerage in the process thereby affecting public confidence (Guiso, &Jappelli, 2005).

Currently there is adequate shareholding constituency in Ethiopia allowing the establishment of share companies. There are more than 60,000 shareholders in Ethiopia where there is no market for share trading and retarding implying that there is high share illiquidity. If this illiquidity persists, the existing shareholders tend to frustrate and new shareholders will be discouraged to get into share company business which in effect hinders the growth of investment and private sector involvement in the Economy (Mohammed, 2010). All the mentioned conditions signify the need for establishing financial market in Ethiopia and also this study further investigate justifications on potential implication of the need establishment of stock market in Ethiopia, considering the current environmental foundation such as, political, economic, social, and technological situations.

1.3. Research Questions

Research question is the base of the study where the research is focused to investigate the problems and to achieve objective of the research. Accordingly, the following research questions forwarded to be addressed:

1. Is there adequate demand to begin stock market in Ethiopia?
2. Is there adequate supply to establish the stock markets?
3. What are the extents of prerequisites to establish stock exchanges markets?

1.4. Objective of the study

1.4.1. General objective

The general objective of this study is to investigate whether Ethiopia consider establishing stock market or not?

1.4.2. Specific objective

1. To examine adequacy of demand for the establishment stock market in Ethiopia.
2. To examine adequacy of supply to consider establishing stock market in Ethiopia.
3. To examine extent of prerequisite for the establishment of Stock Market in Ethiopia.

1.5. Significance of the Study

The researcher finding and recommendation will be important for policy makers as a reference material. The study will also contribute for business officials, and Professionals as well as other concerned bodies who directly or indirectly concerned in the establishment of stock market and to give an attention to some of the points where corrective actions are necessary. Furthermore, this study would serve as an input and basis for other researches, academicians, consultants and some associations who conduct further researches on related fields.

1.6. Scope of the study

The scope of this study delimited on the issue that were discussed, data sources as well as time frame. Accordingly, this study delimited to give justification on the readiness of establishing stock market in Ethiopia on the collected data of 2017. In this regard the study discussed three major related areas such as, potential supply and demand implication as well as environmental foundation such as, political ideology regarding with stock market, infrastructural factors, regulatory of stock markets, technological availability, and so forth. Accordingly, the primary data collected from commercial banks shareholders and banks managers, on the other hand the study also extend its scope on the secondary materials such as, related arguments of scholars, forums reports, different countries experience etc. In this regard both the primary and secondary data were analyzed by mixing to provide relevant justification.

1.7. Organization of the study

This research will organize in to five chapters. The first chapter deals with introduction of the study, background of the study area, statement of the problem, objective of the study, significance of the study, delimitation of the study. The second chapter introduces review of related literature in the area. The third chapter deals with the research design and methodology. The forth chapter presents the analysis and the fifth chapter will contain summary of the major findings, conclusion and recommendation of the study. Finally list of references and appendix will annex at the end of the page.

CHAPTER TWO

Literature Review

2. Introduction

This chapter covered the literature review related to stock market benefit in two parts these are theoretical literatures and empirical literatures. The theoretical literatures reviewed related definitions, theories and models while the empirical literature reviewed several studies results and their recommendations.

2.1. Theoretical Review

There have been several theoretical studies related to stock market benefits of the countries. Majority of these theoretical frameworks reveals about their concepts, countries experience, policies and so forth.

2.1.1. The role of stock exchange

According to Anokye (2008) countries will benefit by establishing stock exchange market stock markets through promotion of savings by providing an alternative financial vehicle for individuals to meet their risk preferences and liquidity needs, thereby increasing the saving in the market. Stock markets also promote growth at a listed company level, as the firm can mobilize capital at a lower cost of capital as risk is shared widely in the market place. This leads to value creation. In addition, through liquidity provision, stocks markets help promote adoption of illiquid long-term projects, since investors in the firm may liquidate their stock positions through the market. African Development Bank (1014) Stock markets also promote efficient governance and control of listed companies by exerting external pressure and discipline on its management. This governance of the stock market is important in an environment characterized by incentive conflicts between corporate decision-makers and suppliers of capital.

Stock and bond issues serve to increase the national savings rate by creating incentives to invest. Since securities are risky investments, they generally earn higher returns than more secure instruments such as bank savings deposits. They also offer investors the option to diversify across industries, thus improving their risk/return tradeoff (Tessema, 2003). As indicated by Levine (1996), countries with well-developed financial sector and liquid capital market

experience faster rates of capital accumulation and greater productivity gains. As liquidity increases, firms gain increased assurance that they will be able to exit from long term investments. They therefore become more willing to make the permanent investments critical to development. Securities markets also give people (especially the poor) a chance to buy shares of listed companies and become part-owners of profitable enterprises. The people sharing the profits of businesses in turn help to reduce large income inequalities. (Etienne and Vincent, 2008) Wider distribution of corporate profits develops a general sense of ownership and an assumption of responsibility on the part of the citizen. People will be united by their common defense of their business interests, where ethnic and religious differences would gradually dissipate. (Tessema, 2003) Furthermore, self and external regulations of the stock exchange help to ensure that the market is working efficiently, fairly and transparently. Stock exchanges raise requirements for corporations which seek to be listed in a stock exchange market. These requirements relate to the submission of financial information regarding companies whose securities are sold on the stock exchange. Such requirements exercise a control on a company management; keep its malpractice in check; and improve corporate governance. (Etienne and Vincent, 2008).

In a market economy, issues of securities help raise capital for projects whose outputs are in the highest demand by society, and those enterprises which are most capable of raising productivity. Thus, efficient enterprise management is rewarded by access to investment funds. (Tessema, 2003) Without securities markets, companies must rely on internal resources (retained earnings) for investment funds, on bank financing or on government grants or subsidies. New and growing enterprises often have little in the way of retained earnings. Securities markets break the oligopoly that would be enjoyed by the banks in the absence of securities markets. Securities markets provide impetus for the establishment of financial prices based on scarcity values rather than on administrative fiat. Such market-determined financial prices and investment options, in turn, attract more savings, creating a virtual circle of innovation and mobilization that contributes to the overall efficiency of the financial system. (Tessema, 2003).

Furthermore, capital markets through the brokerage community, investment advisers, security analysts, and well developed financial journalists serve to educate the investing public. Such institutions are critical to an economy. (Etienne and Vincent, 2008) Such educated investors will help in reducing unfair trade practices in securities markets.

2.1.2. Factor Affecting Efficiency of Stock Exchange

Different authors have mentioned about the factors necessary for the well-functioning of stock markets. Fredholm and Taghavi-Amel (2006) define well-functioning markets as being characterized by high liquidity, where there are many buyers and sellers; diversity, where the investment options for the actors to choose from are not limited; low transaction costs where the transaction process is efficient and the cost of trading is low; and fair, where everyone has the same information and access to trading.

Government

It relates to the degree of stability, peace and internal security of a country and how well the government is functioning and is in control. It also relates to the rule of law and how sufficiently Strong and independent is the legal institution to protect property rights and encourage private ownership. (Fredholm and Taghavi-Amel, 2006). According to Yartey (2007) good quality institutions such as law and order, democratic accountability, bureaucratic quality as important determinants of stock market development because they reduce political risk and enhance the viability of external finance. Bekaert (1995) provides evidence that higher level of political risk Are related to higher degrees of market segmentation and consequently low level of stock market Development. Erb et al (1996) show that expected returns are related to the magnitude of political risk. They find that in both developing and developed countries, the lower the level of political risk, the lower is required returns. (Yartey and Adjasi, 2007) According to Ndikumana (2001), governments can enhance financial development by promoting a strong, independent and effective legal system, where the judiciary can play an important role in enforcing the constitutional protection of individual and property rights and by arbitrating commercial disputes.

Legal infrastructure

For an efficient market to operate there has to be a well-founded, clear, transparent and enforceable legal environment. As per the principles of financial market infrastructures issued by the Technical Committee of the International Organization of Securities Commissions (IOSCO) various points were indicated as key considerations in the legal infrastructure of stock exchanges for their efficient operation. These are:

- The legal framework should provide a high degree of certainty for each material aspect of the activities of the market in all relevant jurisdictions.
- It has to have sets of rules, procedures, and contracts that are clear, understandable, and consistent with relevant laws and regulations.
- There should be an articulated legal basis for its activities to relevant authorities, participants, and, where relevant, participants' customers, in a clear and understandable way.
- There should be clear rules, procedures, and contracts that are enforceable in all relevant jurisdictions. There should be a high degree of certainty that actions taken by the market infrastructure under such rules and procedures will not be voided, reversed, or subject to stays.

Regulation

Regulation of stock exchange market is necessary to promote public confidence, protect investors and the economy from malpractice and wild conditions (Teklehaimanot, 2014). In the international arena, the problems in financial institutions' risk management and supervision systems, which were exposed by financial crisis, have reinforced the need for strong minimum standards for firms' internal systems as well as the need for stronger regulators of the design and Implementation of the system.(Teklehaimanot, 2014). Regulation and supervision are typically aimed at the protection of investors from the potentially opportunistic behavior of insiders. Investor protection helps solve agency problems and information asymmetry arising from inside Information. (Yartey and Adjasi, 2007).

Four basic regulatory models are indicated by Carson (2011). One is government (statutory) model, where the public authority is responsible for securities regulation. The second is limited exchange self regulatory organization (SRO) model, where the public authority serves as the primary regulator and the exchange performs certain regulatory functions. The third is strong exchange SRO model, where the exchange performs extensive regulatory function, the public authority being the primary regulator. The fourth is an independent member SRO model, where the public authority relies extensively on an independent SRO.

Accounting and Auditing Standards

Accounting and auditing standards provide users of financial statements with information that is consistent, uniform, relevant and presenting the true and fair view of the financial dealings of the business. According to Osei (1998), users of financial statements may have both coinciding and conflicting needs for the various types of financial statements and reports. In meeting these needs, accountants and auditors prepare a single set of general purpose financial statements and reports that present objective, unambiguous and complete economic facts of the existence and operations of the enterprise. In order to narrow the areas of differences and minimize the dangers of bias, misinterpretation, inexactness and ambiguity, accountants and auditors have adopted generally accepted accounting and auditing principles or standards. These standards allow financial statements and reports to be reasonably compared between enterprises and between accounting periods. Since accounts of listed companies are prepared by reputable firms, accounts submitted to the stock exchange should be of internationally acceptable accounting and auditing standards.

Macroeconomic Stability

A stable macroeconomic environment is crucial for the development of the stock market. Macroeconomic volatility worsens the problem of informational asymmetries and becomes a source of vulnerability to the financial system. Low and predictable rates of inflation are more likely to contribute to stock market development and economic growth. Both domestic and foreign investors will be unwilling to invest in the stock market where there are expectations of high inflation. (Yartey and Adjasi, 2007) As per Garcia and Liu (1999), sound macroeconomic environments and sufficiently high income levels GDP per capita, domestic savings, and domestic investments are important determinants of stock market development

Technological infrastructure

Information and communication technology (ICT) has become a powerful tool for development extending its role from improving education and health system to widening business opportunities. For actors in the capital market, ICT is vital to communicate and exchange information swiftly; hence, make capital markets more efficient by including all information in stock prices. (Teklehaimanot, 2014) Automation helps to speed up operations and activities of exchanges and reduces cost associated with manual systems. In addition, automation makes it

easier to extend trading days and hours due to less cumbersome procedures. Automated trading also eliminates the need for trade intermediation since investors can log onto systems to monitor markets and also trade on markets, thus bypassing the use of brokers. (Yartey and Adjasi, 2007)

Number of Companies

The number of companies which could be enlisted in a stock exchange market affects the future and current potential of the capital market. A large number of listed companies not only means more diversity for investors, but is also a source of income through recurring listing fees for issuers for a sustainable stock exchange. (Fredholm and Taghavi-Awal, 2006).

Institutional Investors

According to Yartey and Adjasi (2007), the involvement of institutional investors often are at the Fore front in promoting efficient market practices and financial innovation. They typically favor greater transparency and market integrity in both primary and secondary markets, seek lower transaction cost, and encourage efficient trading and settlement facilities. Pension funds, insurances and other institutional investors can therefore act as a countervailing force to commercial and investment banks as well as other market intermediaries, forcing them to be more competitive and efficient.

Financial sector Development

According to Yartey and Adjasi (2007), developing the financial intermediary sector can promote stock market development. A support service from the banking system contributes significantly to the development of stock markets.

Public awareness of stock markets

Awareness about stock exchange markets affects the degree of participation in the markets. If the public is unaware about what stock markets are, the associated benefits and risks and what actions to take whenever some market incidents occur, potential market participants will diminish, hence creating a barrier to entry. Awareness could emanate from formal education, the media or experience gained through participating in the markets.

According to Guiso and Jappelli (2003), learning occurs when potential investors interact sequentially with another investor, and as such, if one is aware then the other one becomes aware, which they call such learning as social learning. Guiso and Jappelli (2003) further held that social learning amplifies the effectiveness of a given signal which has a better chance of reaching a potential investor.

Public Trust

Trust plays a central role in the way in which financial services organization present themselves to customers (Ennew, 2008), and this is particularly apparent in stock markets. Research by Sapienza and Zingales (2005) suggests that true insights into the root causes of a nation's financial strengths or weakness lies in trust. They noted that trust increases the probability of direct participation in the stock market. Trust captures investor optimism in that optimistic investors may be induced to participate in the stock market by their inflated expectation of returns. Trust is defined as the subjective belief about the likelihood that a potential trading partner will act honestly. (Lintari, 2006)

Economic Growth

Garcia and Liu (1999), in their research conducted on 15 countries in Latin America and East Asia Countries, have found out that sustained economic growth, high saving rate, liquidity and developed banking sector determine stock market development in a country, implying that economic development plays an important role in stock exchange development.

Inflation

A high rate of inflation increases the cost of living and causes a shift in resources from investments to consumption. This leads to a fall in the demand for market instruments and subsequently leads to a reduction in the volume of stock traded. Also the monetary policy responds to the increase in the rate of inflation with economic tightening policies, which in turn increases the nominal risk free rate and hence raises the discount rate in the valuation model. (Tweneboah, 2011).

Foreign Direct Investment (FDI)

Foreign capital inflows have significant contributions to a country's economic growth and development by lessening and cushioning shocks resulting from low domestic saving and investment. Hence increased FDI has positive effect on the liquidity of stock markets. Besides, Adam & Anokye et al (2008) establish a triangular relationship on the effect of FDI on stock market development; where FDI stimulates economic growth, economic growth exerts positive impact on stock market development, therefore implying that FDI promotes stock market development. However, Rukhsana Kalim (2009) founds the role of FDI in stock market development being twofold, where it may either complement or substitute the development of Stock market in a country

Corporate Governance

According to Fredholm and Taghavi-Awal (2006), good corporate governance is important to give investors the confidence that the assets they own will be well run and the profits returned to them. If corporate governance is deficient this will affect the willingness to invest negatively. Also, as per Mikdashi (2003), companies with better corporate governance outperform their peers. Thus, corporate governance affects the capital market both through the capital availability (affecting the willingness to invest) and through the investment opportunity availability (by creating more successful companies that survive and grow).

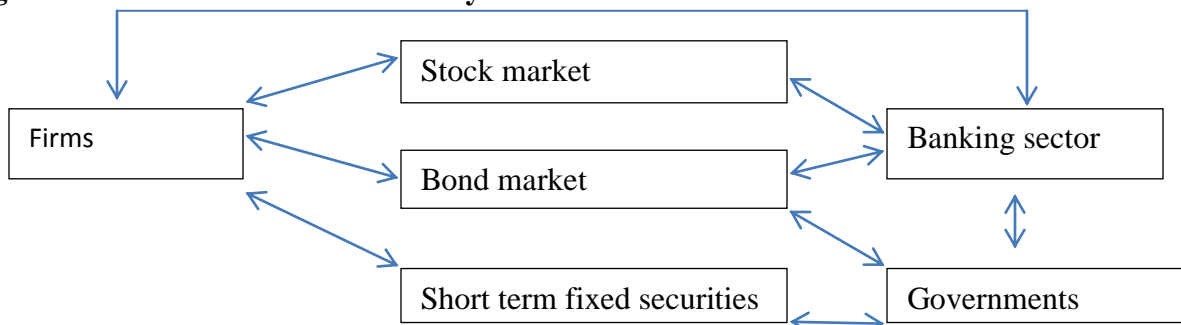
2.1.3. Financial system structure and functions

The financial system plays the key role in the economy by stimulating economic growth, influencing economic performance of the actors, affecting economic welfare. This is achieved by financial infrastructure, in which entities with funds allocate those funds to those who have potentially more productive ways to invest those funds. A financial system makes it possible a more efficient transfer of funds (Anokye, 2008). As one party of the transaction may possess superior information than the other party, it can lead to the information asymmetry problem and inefficient allocation of financial resources. By overcoming the information asymmetry problem the financial system facilitates balance between those with funds to invest and those needing funds (Aduda and Nykundi, 2012). According to Guiso, & Jappelli, (2005) the financial system of an economy consists of three main components:

- 1) Financial markets;
- 2) Financial intermediaries (institutions);
- 3) Financial regulators.

Each of the components plays a specific role in the economy. According to the functional approach, financial markets facilitate the flow of funds in order to finance investments by corporations, governments and individuals. Financial institutions are the key players in the financial markets as they perform the function of intermediation and thus determine the flow of funds. The financial regulators perform the role of monitoring and regulating the participants in the financial system.

Figure 1: The structure of financial system

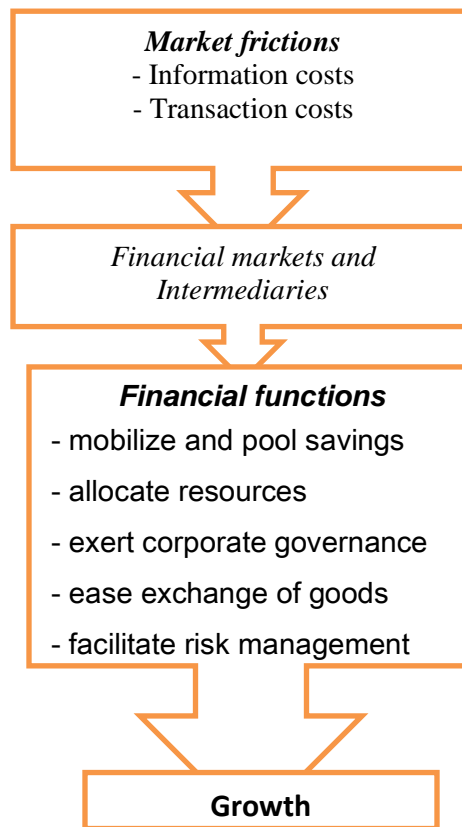


Sorce, Guiso, & Jappelli, (2005)

2.1.4. Theory

In theory, the costs of acquiring information and making transactions create incentives for the emergence of financial markets and institutions. Theoretical models show that financial instruments, markets, and institutions may arise to mitigate the effects of information and transaction costs. It should be noted that different types and combinations of information and transaction costs motivate distinct financial contracts, markets, and institutions (Kumo, 2008). Anokye (2006) refers to Levine and suggests that well-developed financial systems ease the exchange of goods by providing payment services; help mobilize and pool savings from a large number of investors; allocate society's savings to their most productive use by increased information on enterprises and investments; monitor investments and exert corporate governance; and help diversify and reduce liquidity and intertemporal risk. The model below visualizes how the theoretical approach to the link between financial development and growth:

Figure 2: A Theoretical Approach to Stock Market and Growth



Source, Originated from Levine (1997) and slightly modified

Creating an efficient financial system, that more effectively channels society's savings to their most productive use, requires i) macroeconomic stability, ii) a good legal environment and iii) an information framework (e.g. free press). Macroeconomic stability is characterized by low and stable inflation and provides incentives for financial forms of savings. A working legal environment has positive effects by preserving rights and imposing obligations both vis-à-vis other private parties and vis-à-vis the government. Finally, benefits can be reaped in many areas by reducing information asymmetries that prevent direct interaction between multiple savers and investors (Beck 2006)

2.1.5. Stock Exchange in Ethiopia

Ethiopia does not have a stock exchange market nor does it allow companies to be listed in foreign countries until now. Due to this, share trading has been carried out through various means like part-time brokers or through the invested companies or the seller has to find buyers by themselves, exposing the seller to unfair prices and delays. This is not because of the lack of buyers and sellers in the market; rather, it is because of the lack of the proper institutions that could facilitate the trade. (Tsegaye, 2007).

2.1.6. Critics on financial markets

The role of financial markets in economic development continues to attract increasing attention both in academia and among policy-makers. Evidence from recent empirical studies suggests that deeper, broader, and better functioning financial markets can stimulate higher economic growth (Loayza and Beck, 2000). Although evidence on Africa is still limited, the results from existing empirical work supports the view that financial development has a positive effect on economic growth in African countries (Ndikumana, 2000).

To the contrary, scholars also stated some arguments against financial markets saying that establishing financial markets is a mixed blessing, rather it has considerable limitations. The first critic is that financial market prices do not accurately reflect the underlying fundamentals when speculative bubbles emerge in the market. In such situations, prices on the financial market are not simply determined by discounting the expected future cash flows. Under this condition, the financial market develops its own speculative growth dynamics, which may be guided by irrational behavior. This irrationality is expected to adversely affect the real sector of the economy. Critics further argue that financial market liquidity may negatively influence corporate governance because very liquid financial market may encourage investor myopia. Since investors can easily sell their securities holdings in more liquid financial markets, their commitment and incentive to exert corporate control may be weakened. In other words, instant financial market liquidity may discourage investors from having long-term commitment with firms whose securities they own and therefore create potential corporate governance problem with serious ramifications for economic growth.

Critics also point out that the actual operation of the pricing and takeover mechanism in well functioning securities markets lead to short term and lower rates of long term investment. It also generates perverse incentives, rewarding managers for their success in financial engineering rather than creating new wealth through organic growth. This is because prices react very quickly to a variety of information influencing expectations on financial markets.

Therefore, prices on the securities market tend to be highly volatile and enable profits within short periods. Moreover, because the stock market undervalues long-term investment, managers are not encouraged to undertake long-term investments since their activities are judged by the performance of a company's financial assets, which may harm long run prospects of companies.

In addition, empirical evidence shows that the takeover mechanism does not perform a disciplinary function and that competitive selection in the market for corporate control takes place much more on the basis of size rather than performance. Therefore, a large inefficient firm has a higher chance of survival than a small relatively efficient firm. These problems are further magnified in developing countries especially sub-Saharan African economies with their weaker regulatory institutions and greater macroeconomic volatility

2.1.7. Supply and demand prospects for securities market

The Ethiopian finance sector is dominated by the commercial banks (private and public) whose focus is on mobilizing short-term liabilities and extending short term loans. These banks have limited capacity and are less reliable to support Project Financing. The banks, expected to extend loans for projects with long-term pay back have limited resources of their own to sustainably support long-term credit supply to the economy. This clearly shows that a securities market is a missing element in the financial structure of the country (Yishak, 2000).

2.2. Empirical study

Several empirical studies justify importance of stock market establishment in different countries and produced some important insights. Earlier studies based on international panel data returned differing results. For example, uiso & Jappelli, (2005), using a data set of 39 countries over the period 1980–1988, found that a strong, positive and statistically significant relationship existed between stock markets and economic growth. However, Anokye (2008) later criticized this result

on the basis of the methodology employed. Using an expanded data set and an alternative model specification (Anokye , 2008) concluded that the evidence suggesting that stock markets promote economic development was “at very best weak”. More studies by (Levine and Zervos, 1998) and (Khan and Senhadji , 2000) have been particularly informative owing to the utilization of nested models and more detailed model specifications that consider separately the channels through which financial institutions and markets impact upon economic development. The findings of these studies suggest that a) stock markets and financial institutions are not necessarily competing in nature, but rather are complementary with both positively impacting on economic development, and b) the stock market has its greatest impact on economic development through its creation of liquidity. This finding acts as confirmation for earlier theories postulating that the liquidity provided by the stock market raises the productivity of capital in an economy on a broad basis because it facilitates longer-term, profitable investment (Demirguc-Kunt and Levine, 1996).

Another important contribution of recent empirical studies has been to show that the benefit of stock markets on economic development appears to display considerable diversity between individual countries. For example, evidence presented by Murinde (2006) concluded that the relationship between stock markets and economic development in the US was largely positive, but insignificant in the case of Germany. Such findings should not be surprising. Guiso, &Jappelli, (2005), for example, earlier noted that the causal link between financial factors and economic development is crucially dependent upon the nature and operation of financial institutions, markets and policies pursued by individual countries. Therefore, while the findings of studies using international data are informative, they also need to be complemented by individual country case studies.

Catalan, Impavido, and Musalem (2000) examine the determinants of stock market establishment for some emerging markets, studying 27 countries in total. They find that, apart from macro stability and legal rights, the size of the institutional investor bases positively affects stock market development, and report evidence of a causal time series relation between institutional investors and stock market development. In another study, Voronka and Bohl (1999) examined the behavior of pension fund investors on the Polish stock market. Their entrance on the Polish stock market due to the national pension system reform in 1999 provided a unique opportunity to

obtain a deeper insight into the behavior of institutional investors in an emerging capital market. The results showed that the investors represent a key group of institutional investors on the Polish stock market. The result also showed that the pension fund managers in Poland are apt to track positive feedback trading strategies, being actively engaged in selling stocks of smaller companies that performed poorly in the previous period and acquiring well-performing stocks with large capitalization. These activities of the institutional investors have led to the development of the Polish stock market.

A study Aduda (2012) Overseas studies have conclusively documented a direct link between privatization and stock market establishment. These studies implied that governments choose privatization as a means of developing their stock markets. The analysis of stock market growth via privatization programs has evolved from this recent trend by governments; and has produced a new stream of literature fuelling the debate on the benefits of privatization.

Claessens, Djankov, and Klingebiel (2001) investigated the development of stock markets in a group of transition economies and highlight the role of privatization for stock market development in this sample of countries. Pagano (1993 a) argues that companies seeking listings create an externality for other companies because their shares increase the potential for diversification for all investors. As the original owners incur some floatation costs but do not receive all the benefits of diversification, there will be an undersupply of new listings. Privatization may resolve this “low listing trap” by adding diversification possibilities, encouraging both investment and listings by private companies. In addition, increasing overall liquidity due to new privatization related listings could have a self-reinforcing effect on the willingness to hold shares, removing the local market from a “low liquidity trap”.³ These gains in market deepening and broadening could of course be the result of new private listings as well. Another possibility would be that such listings are forthcoming once the number of prior listings reaches a critical point.

According to Kumo (2008), most African stocks exchanges are still at early stage of development and face several constraints facing such challenges like political instability in some

Economies, high volatility in economic growth, macroeconomic uncertainty, liquidity constraints, limited domestic investor base, underdeveloped trading and settlement structures and limited market information.

The study Murinde V. (2006) indicates that the development of stock markets in Africa tends to show an evolutionary process with various stages characterized by type of regulatory system, trading method and the scope for market participation. In general, most of the main markets in Africa started with no formally laid- down rules and regulations; trading activities were based on interpersonal relationship. Formal markets were then established, driven either by the desire of traders to diversify sources of investment funds or by the need of governments to establish a formal market to float their debt stocks. Formalization and revitalization process saw changes in the regulatory framework, trading system and composition of market investors.

Anokye (2008) has also identified factors that could hinder stock markets in Africa. One is the issue of macro-economic and political stability with regard to rates of inflation, the levels of domestic saving and investment, quality of institutions such as law and order, democratic accountability, the rate of changes in government policies. The second, as per the study, emanates from the depreciation and wide fluctuations in the values of African currencies. The third relates to the crisis of international confidence which stems from images of war, famine, massive corruption, failed projects, undisciplined governance and gross violation of human rights. This information has the consequences for the stock markets and financial system in general.

CHAPTER THREE

Methodology of the study

3.1. Research Design

The study used descriptive and cross sectional research design. According to Muranaga and Ohsawa (2002), a descriptive and cross sectional research design is important for a research types if the dependent variable affected by several independent variables. Based on this stock market establishment in Ethiopia can be affected through several variables such as, political regulator law, legality, security issues of firms, technological situation, society level of awareness, and economic condition of the country. Based on these on the descriptive parts of the study data described respondents view that were selected through structured questioners and also the study used cross sectional research design to compare and contrast respondents view with the country overall environmental situation such as, what are the determinant factor in applying the stock market establishment, scholar view, government reason, potential demand of stock market establishment, potential suppliers side of stock market exchange, and regulatory of the country regarding stock exchange.

3.2. Research Approach

According to Creswell (2009), there are three basic research approaches; these are quantitative, qualitative and mixed research approaches. In this research study depend on both quantitative as well as qualitative approach; this is because the data were collected quantitatively using structured questioners from commercial banks shareholders as well as managers and/ from related arguments, forums, reports of international institutions, several countries results, from webs as well as organizations. Therefore, as quantitative research approach is systematic empirical investigation of observable phenomena via statistical, mathematical or computational techniques it is important for this study. The process of measurement is central to quantitative research because it provides the fundamental connection between empirical observation and mathematical expression of quantitative relationships.

3.3. Population of the Study

The entire population of the study was management bodies and shareholders of the Private Banks of Ethiopia. This is because that population relatively has knowledge related with the stock market as indicated by preliminary observation. According to NBE annual report (2015/16), Ethiopia consists of 16 Private commercial banks such as, Dashen Bank S.C (DB), Awash International Bank S.C (AIB), Wogagen Bank S.C (WB), United Bank S.C (UB), Nib International Bank S.C (NIB), Bank of Abyssinia S.C (BOA), Lion International Bank S.C (LIB), Cooperative Bank of Oromia S.C (CBO), Berehan International Bank S.C (BIB), Buna International Bank S.C (BUIB), Oromia International Bank S.C (OIB), Zemen Bank S.C (ZB), Abay Bank (AB), Addis International Bank (ADIB), Debu Global Bank (DGB) and Enat Bank (EBC).

3.4. Sample design and Technique

3.4.1. Sampling Frame

The study used purposive sampling technique. This is because the researcher need to collect research sample respondents by convincing the research purpose, especially shareholders respondent and who have knowledge regarding the stock market issues and purposely selects sample respondents, from banks management and shareholders who have adequate knowledge of the study areas. The study was identified respondents specifically, shareholders educational levels and convinced them before distributing the questioner and in this ways attempts were tried to include shareholder respondent who have knowledge on the area.

3.4.2. Sample size

Sampling size can be defined as the number of units in a population to be studied. Researchers need to have a large sample size in order to get more accurate results and have a high likelihood of detecting a true result. Since the number of banks in the country is small and manageable, the study gathered data from all banks. There are 78 senior management bodies in all commercial banks in their head quarter who were considered to have knowledge in the area, however, it is difficult to understand shareholders for each banks so, that the study considered all of the management bodies (78), this is because they are manageable and 90 shareholders, who have knowledge about the stock market, using convenient sampling technique.

3.5. Data sources and type of data

In order to carry out any research activity information should be gathered from proper sources. Therefore, the achievement of the objective of this study used both primary and secondary sources of data. The primary data were collected from banks managers and shareholders using structured questioner and unstructured interview, in the questioner the study tried to provide similar questions both for shareholders as well as managers of the banks while, question respecting with shareholders and management were also collected using interview. The study also collect secondary data secondary from several sources such as, argumentative articles related with stock market establishment and journal results, policy of the country.

3.6. Method of Data analysis and presentation

The collected data using structured questioner and others sources of secondary data were analyzed using mixed approach. The data that obtained through questionnaires first were edited for their some error, and then after they were analyzed using percentage, frequency, mean and standard deviation using a tables and graphs. On the other hand secondary data also analyzed mixing with primary data to give further justification.

CHAPTER FOUR

Data Analysis and Interpretation

Introduction

This study discussed on the establishment of stock market in Ethiopia, the discussion took place based on primary and secondary data sources. In Ethiopia there is no secondary market, however, the study tried to assess several scholars' literatures, as well as commercial banks management bodies and shareholders view on the establishment of stock market. Accordingly, the respondents view was also supported and explained using several argumentative literatures. Generally the study assessed financial market necessity of the country providing relevant question from the demand and supply side, environmental analysis from legality perspective, infrastructural availability, knowhow of society, technological availability and others related factors with the establishment of Stock market foundation. Generally, the study was presented in four parts in the first part of the study general background of respondents and some market activities determinates were discussed, in the second part the study assessed stock market establishment potentials through the demand side, in the third part the study assessed implication of stock market establishment need from the supply side and Finally the study discussed on the environmental foundation and its effect on stock market establishment and readiness of the country in establishing the market. In this ways the study discussed the collected data from respondent in the form of discussion (description) mixing with relevant literatures to strengthen or criticize respondents view by comparing with relevant materials.

4.1. Background of respondents

The study totally distributed 168 questionnaires for 78 management bodies of the banks as well as 90 shareholders totally the study distributed 168 questioner however, the analysis were done based 158 the rest 10 questioners were omitted for their errors' 8 of shareholder questioner were not returned back, while 2 of management bodies were not returned back similarly.

Table1: Characteristics of respondents

	Frequency	%
Participants		
Shareholders	82	52
Managements	76	48
Total	158	100

Sources questioner, 2017

As indicated from the above table the study includes both shareholders from the commercial banks as well as management of each bank. Accordingly, the study were included management bodies in this study from head office of each private commercial banks, while shareholders were included, through contacting to understand their knowledge of Stock market, and some of the shareholders actually need some kind of explanation on the concept of stock market. In this regards respondents were included as much as possible who have basic knowledge on the stock market issues. And as much as possible the study also consider their educational background specially, shareholders (respondents) as the research topic is argumentative it also need an academic background. Accordingly, the following table has showed respondents' educational level (Background)

Table2: Respondent educational Level

	Shareholders		Managements	
Educational level	Frequency	Percentage	Frequency	Percentage
Junior	-	-	-	-
High school	3	4	-	-
Diploma	24	29	-	-
Degree (B.A)	35	43	54	71
Degree (M.A)	20	24	22	29
Total	82	100	76	100

Sources questioner, 2017

As indicated from the above data of educational background the study as much as possible tried to consider respondent both shareholders and management bodies who have good educational background, as the study need an expertise analysis. Accordingly, out of 158 total participants of this study most of the respondents (89) are first degree holders and the next largest figure is 42 which is the number of second degree holders among the respondents and both degree holders represents shareholders and managements' group respondents, the next from the last are 24 diploma holders and in the last 3 high school complete respondents and the last two groups represents only shareholders respondents.

4.2. Demand and Potential on the Establishment of Stock Exchange

In the descriptive analysis part the study tried to discuss the collected data divided in to three sections these are, views of respondents as well as related relevant materials on the establishment of stock market in Ethiopia. Accordingly, the study tried to analyze the necessity of stock market argument from demand and supply side. Finally the study tried to assess the prerequisites or major factors influencing the establishment of stock market in Ethiopia. In line with the objectives articulated under chapter one here effort was made to analyse respondents view on the provided a five scale likert types of questions. Rrespondents" feedbacks were captured along the 20 items equations and respondents responded on the readiness of the country in establishing stock market. In this regard the descriptive part of this study was analyzed based on statistics of mean and standard deviation. Accordingly, the composite mean value shows the average of all respondents perceptions on a certain questions. While, standard deviation shows how diverse are the perceptions of respondents for a given questions.

For instance deviation means that the data are wide spread, which implies respondents give variety of opinion while, low standard deviation implies respondents close opinion whether positively or negatively. Based on these, the result mean score value and standard deviation of the study determined using rule of thumb that pertaining to the intervals for breaking the range in measuring variables that are captured with five point scale (that ranges from strongly disagree to strongly agree) is 0.8, which is actually found by dividing the difference between the maximum and minimum scores to the maximum score (Thumb, 2012). Hence, a calculated composite mean value that ranges from 1 to 1.80 implies strong disagreement, whereas the remaining ranges of

1.81 to 2.6, 2.61 to 3.40, 3.41 to 4.2 and 4.21 to 5.00 representing respondents' perceptions of disagreement, neutrality, agreement and strong agreement respectively. Therefore, composite scores of mean and standard deviation were calculated for each of the variables as follow:

4.2.1. Assessment on the demand of stock market

Regarding the demand of stock market the study assessed respondents using structured questioner and the result of the respondents view and other relevant literatures on the area were discussed below

Table 3: Respondents View on the Demand of Stock market in Ethiopia

Potential Demand of Stock market Need Analysis	N	Mean	Std. Deviation
The increasing number of share companies and shareholders in Ethiopia, implied there is a wide-ranging prevalence of share illiquidity and implication of high demand of Stock exchange market	158	3.5380	1.03835
The high demand of Bank loan is an implication of the need of optional or competitive financial market.	158	3.3481	1.15061
The mismatch between the low interest rate for saving and high interest rate for loan is the implication of lack of Stock market computation on the country.	158	3.8228	1.06788
To cop up with challenges of inflation savers need to invest on an opportunity investment like stock market.	158	3.5823	1.22196
The government's commitment to privatize public enterprises has certainly increased the private sector investment in the economy, which is an indicator of potential demand for financial markets	158	3.7911	1.11763
The increasing entrepreneurial practice of the country and their need of money is an implication of the market need competitive secondary market	158	3.6646	1.20303
The ground need to reduce dominancy of small owners of share companies is an implication of the need to establish stock market in the country	158	3.4747	1.20349
The overall growing of the Economy requires more financial sources, and a financial market that can fulfill such potential gap	158	3.7595	1.09096

Source questioner, 2017

The above table implied respondents view on potential demand of stock (financial market) in Ethiopia, as indicated in the methodology part respondents in this study were included from top level of banks management and shareholders. The analysis in this part were done considering

average responds of respondent, and comparing with other related academician and experts view on the area from related journals, researches, policy and regulatory of the country as well as forum and seminar results.:

To analyzed respondents view on the potential demand of stock market, the study provide 8 related questions using five types of likert scale the scale indicated 1 for strong disagreement, and 5 for strong agreement) the rest 2, 3, and 4 at the middle, disagreement, neutrality and agreement. However, in this study respondent's view were represented in aggregate using mean and standard division. Accordingly, the analysis of the study done as follow:

A. Share companies growth and their Potential demand of Stock Market

The study forwarded related questions, whether increasing number of share companies and shareholders in Ethiopia is an implication of demand of Stock exchange market or not. In this regard majority of respondents at a mean score value of 3.5380 with 1.03835 standard deviation implied their agreement that, the increasing number of share companies and shareholders in Ethiopia, implied there is a wide-ranging prevalence of share illiquidity and implication of high demand of Stock exchange market. With related to this idea, Mohamed (20006), explained that, currently there is high rate of shareholding companies establishment. There are more than 60,000 shareholders in Ethiopia where there is no market for share trading and re-trading implying that there is high share illiquidity. If this illiquidity persists, the existing shareholders tend to frustrate and new shareholders will be discouraged to get into share company business which in turn hinders the growth of investment and private sector involvement in the Economy. This is one of the implications of high demand of stock market establishment in the country.

B. The Relation between Demand of loan and Stock market

According to Legesse (2012) in Ethiopia demand of bank loan became increasing through the year increase by 2.7%. With regard to this the study were forwarded for respondents that, a related questions the growing demand loan is an implication of the stock market establishment or not. Accordingly majority of respondents at high mean score value of 3.3481 implied their agreement that there is high demand of loan from the society however, the banks mostly provide loan for specific areas priory such as, for manufacturing and export sectors. This is because each

of private banks is governed by NBE regulatory. In this regard Asrat (2003) stated that, in countries like Ethiopia, bank loans are the most important source of capital, however, its amount and accessibility is limited by the amount of deposits of banks and ability of mobilization. As a result, banks tend to be very conservative in their lending policies, thereby penalizing younger or emerging companies whose business risk is higher than those faced. Since banks in emerging economies are also mostly owned and run by governments, they extend loans to priority sectors in response to government directives without due regard to quality, and often at interest rates below the bank's cost of funds. This leads to inefficient resource allocation and widespread loan delinquencies. The prevalence of these problems reduces the level of private investments, productivity of capital and the volume of savings (Asrat, 2003). As well as if banks' lending policy is highly restricted for well-established sectors its activities may affect innovators that may have not collateral and investment startup cost. This can affect innovative investment and discourage entrepreneurial development of the country.

C. The mismatch between the low return interest from saving and high interest rate for loan

The study assessed the arguments that the mismatch between the low return interest from saving and high interest rate for loan is the implication lack of Stock market computation in the country. Accordingly, respondents of the study implied their agreement at the highest mean value of 3.38228 with a few respondents which implied their disagreement represented at Std. deviation 1.06788. The responses show that the competition among financial institutions/banks in providing balance saves and loan interest is weak in Ethiopia. According to this Idea a Study Alemneh (2016) implied that, there is large gap between deposit rates for savers (which tend to be very low) and interest rates for borrowers (which tend to be very high). Establishing financial markets cultivates channels for firms to issue various debt instruments and raise equity, while simultaneously providing more long-term options for saving and asset management for investors that will benefit enlarging economies by increasing market efficiency.

D. Importance of Stock Market To cop up with Inflation

The study also assessed the demand implication of stock market of the country to minimize inflation problem. Accordingly, the study invited respondents to give their view for the provided

question such as, to cop up with challenges of inflation, investors or individuals need to invest on an opportunity shareholder investment. Accordingly respondent agreed on the idea at a mean value of 3.5823, they explained that, high rates of inflation in the country increase the cost of living and causes a shift in resources from investments to consumption. This leads to a fall in the demand for market instruments and subsequently leads to a reduction in the volume of stock traded. Also the monetary policy responds to the increase in the rate of inflation with economic tightening policies, which in turn increases the nominal risk free rate and hence raises the discount rate in the valuation model.

This is supported by the data obtained from African Economic Outlook (2014), which indicates inflation rate of the country in 2012 as 20.8%, decreasing in the subsequent years of 2013 and 2014 to 7.9% and 7.4% although the rate has been showing a decreasing trend in the current times, it is an issue to be dealt with properly by the Government of Ethiopia. When we compare likes with Kenya, Rwanda and Uganda, whose general inflation rates of 2014 are 5%, 6.9%, and 4.7% respectively is the result of stock market regulators and activities. In compare with those relative countries in Ethiopia Stock market Establishment is still not allowed by the government and relatively inflation rate is higher than the country that follow stock market principle. Ethiopia's inflation rate is higher and if Ethiopians are able and willing to invest domestically, they only have very limited possibilities of inflation. Besides putting the money under the pillow, potential investors can put their assets into savings accounts (current return 5%), government bonds (current return 5.5%) and/or venture capital. As the inflation rate is much higher than the return of the savings account and the government bonds, local investors currently do not have an adequate investment possibility to achieve returns higher than the current inflation, with the exception of direct investment in the form of (unregulated) venture capital. This is a strong indicator for the theoretical demand of alternative investment opportunities, such as equity securities. If securities markets exist in Ethiopia, investors can put their assets into savings accounts, government bonds, corporate bonds, and stocks. As the inflation rate is much higher than the return of the savings account and the government bonds, local investors currently do not have an adequate investment possibility to achieve returns higher than the current inflation. This is a strong indicator for the theoretical demand of alternative investment opportunities such as equity securities.

E. Privatization Promotion of Government and Stock market Relation

The Ethiopian government, in line with its commitment to the development of the private sector, has so far taken broad based economic reforms one of which is the privatization program. In order to implement this program, the government established and empowered the Privatization and Public Enterprises Supervising Agency (PPESA) under the Ministry of Trade. State owned enterprises are transferred to private investors through the Privatization and Public Enterprises Supervisory Agency (PPESA). The PPESA has transferred 314 enterprises through direct sales as of May 2015 and earned 18.8 billion birr (PPESA, 2016). The government's commitment to privatize public enterprises will certainly increase the share of the private sector in the economy, which is indicative of potential demand for financial markets as the private sector is the major stakeholder in the financial markets. However, the privatization scheme of the government didn't help the formation of share companies as the public enterprises are transferred to buyers individuals and companies but not for the general public in the form of shares. Also this idea were supported by respondents of this study respondent at a mean value of 3.7911 as the value of the respondents implied the trend indicated in the market is the need of the establishment of stock market in the country. Although the Government of Ethiopia seems to understand the potential importance of financial liberalization, it is widely believed that liberalization may result in a partial or even total loss of control over the local economy and may not even be economically beneficial. Because of that, the NBE maintains control on all foreign exchange transactions and supervises all foreign exchange payments and remittances. However, in recent years, the GoE (Governed of Ethiopia) has allowed the local private sector to participate in banking, although foreign ownership and branch operations remain strictly barred.

No securities market, except short term government treasury bills, is present yet in the financial market. But in 2008 the Ethiopian Commodity Exchange (ECX) was introduced by a group of highly devoted local experts. On the ECX, coffee, sesame, haricot beans, wheat and maize are traded. The ECX is a new initiative for Ethiopia and the first of its kind in Africa. The vision of ECX was to revolutionize Ethiopia's tradition bound agricultural system through creating a reliable and sustainable marketplace that serves all market participants, including farmers, traders, processors, exporters and consumers.

Based on the above arguments provided by respondents and scholars the study deduced that, the GoE is committed to alleviating poverty through private sector development (PSD) and through integrating Ethiopia into the global economy. However, the GoE does not seem prepared to privatize the largest State Owned Enterprises (SOEs) like CBE, Ethiopian Electric Power Corporation, Ethiopian Insurance Corporation, Ethiopian Telecommunications and Ethiopian Airlines⁵ nor allow for private ownership of land or opening the financial sector to foreign participation and/or competition.

F. The Effect of Financial Market for Entrepreneurial Development

With related to the establishment financial market of the country and entrepreneurial development the study forward a related question, Such as, ‘the increasing entrepreneurial practice of the county and their need of money investment is an implication of the market need of competitive financial market’ in this regards respondent implied their agreement at a mean score 3.6646. In these some of the respondent in their response explained that, there are a lot of innovators and entrepreneur that need financial access from each banks, however because lack of competitive stock market, most of the Banks are rather than investing on innovative ideas, on investors which only provide reliable collateral. These activities discourage many of young innovators and entrepreneurial activities of the society. With regard to this ideas, Ruecker (2011) indicated that, Lack of secondary markets promote economic efficiency by channeling allocation of money from those who do not have an immediate productive use for it to those who do. A well-functioning financial market, coupled with a developed financial sector, is the main asset for every national economy since it promotes economic growth and supports the eradication of poverty

G. Stock market Allow deconcentration of ownership

Equity sales provide for a wider participation in enterprise management and for a wider distribution of corporate profits. These factors would help allay the fear that a few individuals or groups would dominate the private sector. Wider distribution of corporate profits develops a general sense of ownership and an assumption of responsibility on the part of the citizen. People will now be united by their common defense of their business interests, ethnic and religious differences would gradually dissipate. Accordingly the study also asked respondents of this

research whether they agree on the idea stated by Asrat (2003), or not, the response of the respondent at a mean score 3.4747 implied their agreement.

H. The Character of GDP of Ethiopia and financial Sectors

Financial markets provide for access to and easy movement of financial resources which fundamentally influences the prospects for private sector growth in developing country economies. Existence of financial markets enhances the extent that existing firms can borrow and grow, the ability of emerging firms to act entrepreneurially, their willingness to invest in assets, and the ability to allocate their assets freely. All these enhancements ultimately lead to economic growth. For instance, India and China are adding hundreds of companies in their stock exchange annually. The immediate benefit of the flourishing capital market activity in Asia is reflected in the sizeable increase in the momentum of private sector development (Applegarth, 2004). In these concept the study were discussed with respondents on the idea forward such as, ‘the overall growing of the Economy, requires more finance sources, and a financial market can fill such potential gap’ accordingly respondent implied a mean score value of 3.7595 implied their agreement on the idea discussed above. Some of the respondents also strengthen the idea in the assessment such as, they were analyzed that, the country GDP growth Rate was one of the undeniable for the past ten years Ethiopia GDP were grown by 10%, in aggregate with a slight ups and downs of the percentages, which is one of the biggest growth rate or double the average GDP growth of Sub-Saharan Africa 5%, however, these growth were mostly supported by government financial sectors and some of the finance were loan received from several donors. In Addition, the growth rate of the country were recorded in some mega public project that, with limited individual participation. Therefore, even though the growth rate of the country achieved its highest score however, it was owned by small proportion of providers as well as state owned infrastructural activities. Therefore, the GDP still implied that, an establishment of financial market that can provide competitive money for individuals, this might solve the problem of small owner of investors and Share Equity for the society. Based on these (Alemayehu, 2008) states that Ethiopia’s poor economic and social indicators, one may expect Ethiopian financial intermediation to perform poorly. However, this is not borne out by all the financial intermediation indicators noted in the above discussion. Such as, in 2012, credit issued to the private sector in Ethiopia was 19.1 percent of GDP (the 2nd highest in East Africa and the 5th in

SSA), and liquid liabilities were 44.6 percent of GDP (the largest in East Africa and the fourth in SSA).

4.2.2. Assessment on Supply side (issuer base) of Stock market

Issuer base refers to the potential number of issuers of securities and the amount of capital to be raised. In Ethiopia there are several types of Implication of stock market establishment potential suppliers (issuers' base), the study assessed several respondent and potential implication of the need to establish financial market in Ethiopia. Below in the table implied respondent view on the potential implication of stock market potential suppliers. Table 4.7 Potential implication stock market from Supplier

Table 4: Factor Affecting Stock market Establishment

<i>Supply side (issuer base)</i>	N	Mean	Std. Deviation
Issuing short term (Treasury bill) implied potential supply of stock market need.	158	3.7152	1.11213
The highest rate of illiquidity of Ethiopia companies is an implication of the existence of potential supplier's stock market.	158	3.6456	1.08302
Government activities in privatization of public companies is potential implication of Stock market	158	2.9557	1.29352

Source Questioner, 2017

Based on the above respondent, view below the study discussed their view mixing with some of prominent reports, and researches on the area.

A. How Issuing short term (Treasury bill) implied potential supply of stock market need.

Regarding debt securities, the only issuer is the Government of Ethiopia. The government is issuing short term (treasury bills) and long term debt securities to finance mega projects (bonds). There are not corporate bonds currently issued in the market. Even in the absence of the

corporate bonds, there is a huge supply of government bonds to finance mega projects (e.g. the Great Renaissance Dam). Similarly majority of the respondents at a mean value of 3.7152 also assures that, the activities such as Treasury bill, and selling bonding for several mega project in the country are the implication of the potential of suppliers of if the financial market established in the country. In this regard annual regular infrastructure needs for a country like Ethiopia (excluding the Great Renaissance Dam) are expected to be between ETB 41 billion (USD 2.4 billion) and Birr 53 billion (USD 3.1 billion), creating a potential for a remarkable and sustainable government bond supply (Ruecker, 2011). It is also noted that the Government of Ethiopia is heading to privatization except the big five state owned enterprises i.e., Commercial Bank of Ethiopia, Ethiopian Airlines, Ethiopian Electric Power Corporation, Ethiopian Insurance Corporation, and Ethiopian Telecommunications which are considered as the most profitable public enterprises. Moreover, some argue that the ongoing issuance of debt instruments (bond) by the government for state financing seems to have induced disinterest on the part the government in alternative investment options or capital market competition (Mohammed, 2010).

The Government Bond (Treasury Bill) Market is the only active primary money (not capital) market in the country. Tenders are offered periodically by the NBE. The government offers 28 day, 91 day and 182 day bills. Interest rates are negative in real terms. Of the total outstanding bills, the majority is held by banks.

According to the Development Bank of Ethiopia (DBE), the following bonds are on sale:

- 2000 Millennium Bond; - for sale to the Diaspora by the Ethiopian Electric Power Corporation. This bond sale has been going on since the new Ethiopian millennium over 2 years ago.
- DBE corporate bond to CBE – so far sale of ETB 1.5 billion. Ethiopian Government Saving Bond, including ETB 82 billion, for the Great Renaissance Dam Project, and ETB 11 billion for the regular DBE bond. Besides the financial products mentioned here, no other financial products are officially traded.

B. Liquidity Potential of Private companies

The private sector involvement in the economy may take the form of share companies. It is undisputed that share companies play a significant role in today's economic world. A share company is a form of business organization where, in most instances, a large group of people invest cash or in-kind contributions in a company (administered by strangers) in return for units

of ownership representing a proportion of the company's capital in the form of shares. Despite the vital role share companies play in the economy, the peculiar nature of shares in Ethiopia is their illiquidity. Rather than being an instrument frequently traded in the market, Ethiopian shares are mostly locked in the drawers praying for dividends which may or may not come and later inherited to successors if the company does not die earlier than the owner of the share. According Access for Ethiopia (2008), studies on position of commercial banks liquidity, most of the Ethiopian commercial banks have excess liquidity. In this regard respondent were asked the high liquidity position of each commercial banks is the potential implication of the establishment of stock exchange in Ethiopia from the supplier side accordingly respondent, at a mean value 3.6456 implied their level of agreement that the excess liquidity of each commercial banks need the establishment of liquid market. Therefore, illiquid securities carry higher risks than liquid ones; this becomes especially true during times of market turmoil, when the ratio of buyers to sellers may be thrown out of balance. During these times, holders of illiquid securities may find themselves unable to sell them at all, or unable to do so without losing a lot of money. For a financial market in Ethiopia liquidity is even more important because of the limited investor and issuer base. As Ethiopian investors only have a small portion of their household income to invest, a fair priced - liquid - market is imperative in order to avoid creating systematic losses for the general public.

C. Privatization Activities of Government

The Privatization and Public Services Agency (PPESA) has transferred 314 state owned enterprises through direct sales as of May 2012 and earned 12.8 billion birr (Elleni, 2012). Nine enterprises have been transferred through a joint venture agreement and five have been leased to private investors. There are currently 48 enterprises left under the PPESA which are going to be privatized in the upcoming years. The government's commitment to privatize public enterprises will certainly increase the share of the private sector investment in the economy, which is an indicator of potential supply and demand interest of financial markets as the private sector is the major stakeholder in the financial system. However, the privatization scheme of the government didn't contribute to the formation of private corporations/share companies as Government of Ethiopia transfers the public enterprises only via the open bid/tender to selected investors not to the general public on share basis. For Example the following public company that transferred to

the private sectors are an implication of the potential the need for the establishment of the stock market.

Table 5: Privatized Companies in several years

Name of Enterprise	Privatization Modality	Year of Transfer
Adami Tulu Pesticide Processing Sh.Co.	Joint Venture	2009/10
Anbessa Shoe Sh.Co.	Joint Venture	2009/10
Bebeka Coffee Plantation	Tendering	2009/11
Bedele Brewery Sh.Co	Joint Venture	2009/11

4.2.3. Assessment of Prerequisites to establish Stock Market

With Regards to the establishment of the stock market in Ethiopia, the study assessed several scholars literatures as well as respondents of these studies view For instance, Asrat (2003) identified such challenges as low level of public awareness about securities markets; lack of public confidence in share investment; lack of institutional capacity to facilitate securities trading; underdeveloped state of the bond (debt) market; low level of private sector development and a low level of market orientation in the economy; easy access to loans by wealthy Ethiopians; problems with the supply and demand for securities at least initially. There is neither the tradition nor the trust in share companies; due to the historical prominence of bank financing; there is still government interference in the market; there is no mechanism in place to solicit input from the business community as a cause for the challenges stated above.

Financial managers, investors and investees don't operate in a vacuum they make decisions within a large and complex environment. The prerequisite environmental factors for a well-functioning financial markets and system are macroeconomic stability, adequacy and independence of the judicial system, political stability, security, good corporate governance, accounting and auditing standards, transparency and availability of information, institutional framework, initiation and promotion of privatization, potential investor base, potential issuer base, financial literacy, technological factors, etc (Dahou, Omar and Pfister, 2009).

Based on the concept the study assessed respondents views through related questions, on the factors that can affect the establishment of Stock market in the country. Accordingly Below in the table the study indicated respondents view on the following points.

Table 6: Respondents view on the Prerequisites to Establish Stock market

Factor Affecting Stock market Establishment	N	Mean	Std. Deviation
security challenge	158	3.3162	1.12013
Corruption and lack of good governance	158	3.3477	1.03516
inadequacy of the Judicial System	158	3.8259	1.25798
Low level of corporate governance	158	3.6327	1.29696
Lack of technology	158	3.4165	1.32029
Low awareness level of the society about stock exchange markets	158	2.3696	1.03516
Lack of (inadequate) regulation and laws	158	3.9747	.75671
Lack of public trust	158	3.6329	1.19636
Macro-economic situation of the country	158	2.7405	1.29271

Source questioner, 2017

As indicated in the table 6 above respondents gives their respective view on the provided questions related to the prerequisites of stock market establishment's practice of the country.

A. The issue of security

The security situation that prevails in a given nation determines the level of private sector involvement in the economy and financial market development. With regard to security factor for the operation of the private sector in the country, which has direct bearing on the financial markets, Ethiopia fares better compared to regional countries. As implied by majority of the

respondent at a mean value of (3.3162) still there is no that much types of security problem that the firms faced. According to this idea World Bank (2008), studied security challenges of the several countries in comparative form, specifically the result report of Ethiopia were indicated in compare with the whole security challenges of African countries and all countries average results below the table implied the World Bank assessment of 2008.

Table 7: Security factors

Crime	Ethiopia	Africa	All
Percentage of firms paying for security	91.93	63.83	62.71
Losses due to theft, robbery, vandalism, and arson against the firm (% of sales)	1.44	3.28	1.8
Security costs (% of sales)	1.1	1.95	1.62
Products shipped to supply domestic markets lost due to theft (in %)	0	0.48	0.42
Percentage of firms identifying crime, theft and disorder as major constraints	11.64	26.56	21.15

Source: World Bank 2008

As the report implied, only a few firms (1.5 percent) report the existence of theft, robbery and the occurrence of vandalism in Ethiopia. Despite that however, close to 92 percent of the firms do procure security services. The table tells us that the security situation is very conducive for the establishment of financial markets in Ethiopia.

A. Corruption

With regard to corruption and establishment of stock exchange in Ethiopia the study assessed respondents view as well as related results that are strengthens view of respondents. In this regard respondents at a mean value of 3.3477 their level of disagreement which implied that lack of stock market access in the country exposed many officials and management bodies engaging in corruption transfer share. In this regard,

The study World Bank (2008) in the study of environmental legality character for the establishment of stock exchanges by assessing firms, found in Ethiopia through comparing with

African countries as well as average world results. Accordingly, the study implied that, the degree of corruption is relatively lower in Ethiopia compared with both African countries and the total sample average of the less developed countries. But much more needs to be done to make the business environment free from corruption because a significant number of firms (23 percent) perceive corruption as a major constraint. In relative terms, Ethiopia is an attractive place for domestic and foreign investors who are presumed to be active players in the financial market if established in Ethiopia. As a result it is possible to deduce that the threat of corruption is less compared to the regional countries but a lot shall be done to improve the situation.

Table 8: Corruption

Corruption	Ethiopia	Africa	All
Percentage of firms expected to pay informal payments (to get things done)	12.42	45.54	36.23
Percentage of firms expected to give gifts to get an operating license	2.7	17.93	16.69
Percentage of firms expected to give gifts in meeting with tax inspectors	4.35	19.89	26.37
Percentage of firms expected to give fits to secure a government contract	11.8	42.87	26.9
Percentage of firms identifying corruption as a major constraint	23.08	34.39	32.7

Source: World Bank 2008

Contrary to the above findings, other studies showed such as a study by Alemayehu (2014) implied that there is popular corruption in Ethiopia though the country has taken very important steps to combat it. To mention some, Ethiopia has ratified the UN Convention against Corruption and the African Union Convention on the Prevention and Combating of Corruption. Ethiopia is ranked 113th of 174 nations in Transparency International's 2012 Corruption Perception Index. Ethiopia with a score of 33 falls in the fourth top category counted from Highly Corrupt. Of the 174 countries considered, 70% of them scored less than 50 out of 100 and 43 is the world average. Therefore Ethiopia's score is less than the world average indicating prevalence of corruption in the global context. Recently the Government of Ethiopia has taken tangible

measures (arrested key government officials engaged in corrupt practices) as part of its move towards combating corruption.

B. In adequacy of the Judicial System and Stock Exchange in Ethiopia

The most important provision regarding share issuing and trading is the 1960 Commercial Code of Ethiopia. The Commercial Code is not up-to-date and has many grey areas. Addis Ababa Stock Exchange Rules and Regulations Manual (Volumes I and II) were prepared in 1999. However, it is at a working draft level and not up-to-date. There is no system of civil courts where securities cases can be prosecuted by a dedicated governmental authority. There are no specific training programs to educate prosecutors and judges on capital market regulation, including corporate governance. There are commercial courts that specialize in hearing commercial cases, but there are no courts that specialize in hearing only securities law and company law cases. There are provisions in the jurisdiction's laws that may be used to prosecute securities violations, pyramid and Ponzi schemes. The fact was supported by majority of the respondents of this study also as implied by 3.8259 average mean value respondents.

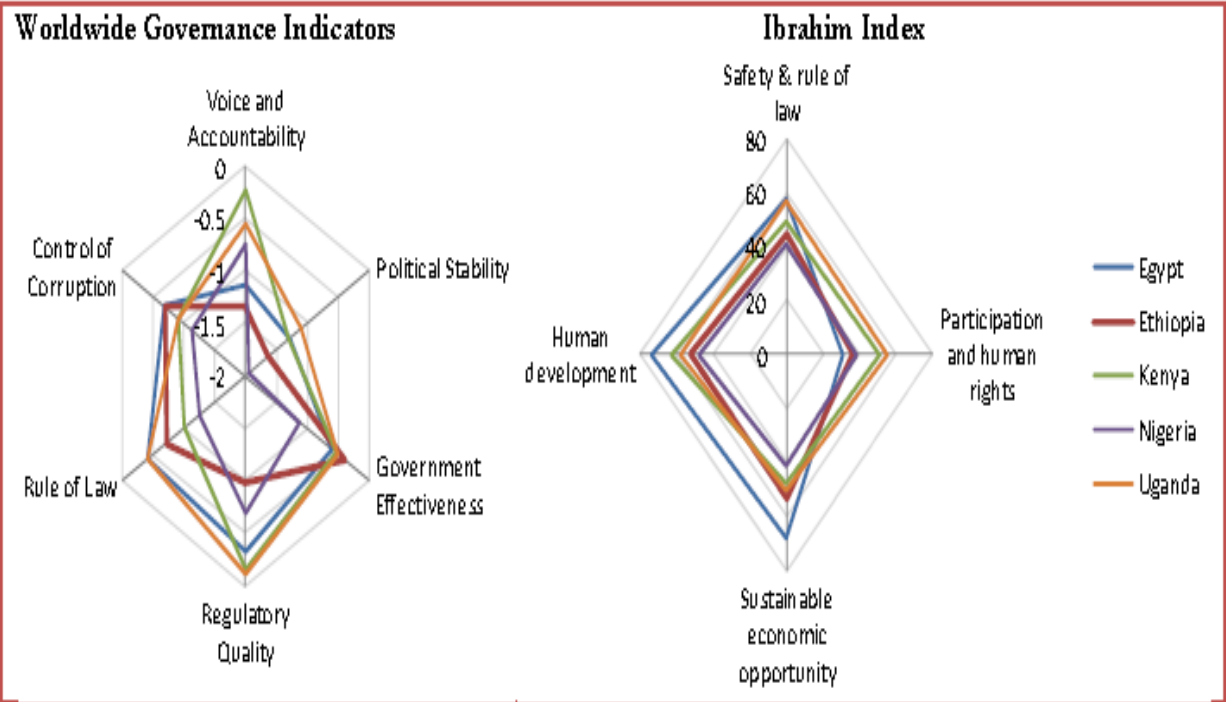
C. Corporate governance in Ethiopia

The study assessed respondents view as well as related areas results, as implied by majority of the respondents at average mean value of (3.6327) the overall standard of corporate governance is low. More specifically, the legal and constitutional instruments do not provide an adequate regulative framework, key international conventions and standards are not ratified, investor and creditor protection laws are inadequate, and the absence of an organized capital market is a remarkable deficit and contributes to a lack in transparency.

However, recent developments prove an emerging commitment to corporate governance standards and a corporate governance code is expected to be introduced in the near future. Among the governance institutions, a study conducted by the Private Sector Development (PSD) Hub Programme of AACCSA noted that the revision of the 1960 Commercial Code is underway by the Ministry of Justice. The revision of the Commercial Code is a vital part of improving and upgrading of corporate governance standards in Ethiopia. In this regard the study were tried to indicate the level of corporate governance Ethiopia using worldwide governance indicator as a

whole. The following figure shows the governance in Ethiopia compared to selected African countries. Ethiopian overall governance is in the middle of the pack on most indicators, with the strongest suit being government effectiveness, an area where there has been marked improvement since 2000.

Figure 3: Worldwide Governance Indicators and Ibrahim Index – Ethiopia Vs Regional



HenockAssefa, DerkBienen, Dan Ciuriak December 2012. Ethiopia Investment Prospects: A Sectoral Scan, BKP Development Research and Consultancy, Munich

D. Technological effect on the establishment of Stock Market in the country

Currently use of state of the art technology is becoming a must to do efficient business in the world. Similarly majority of respondents in this study also implied at means core value of 3.4165 their agreement on the issues implied their level of agreement. In this regard one of the study that was took place by Alemayehu (2008) clearly shows that Ethiopian firms technology usage is poor compared to regional countries of Africa and South East Asia countries . To be specific Ethiopian firms seem less inclined to use the World Wide Web, and are very limited in the use of licensed technology, both by regional and the total sample standards. The World Bank survey

indicates that only about 4 percent of the firms have both ISO certification and employ licensed technology which is about threefold less than the sample and the region's average. This shows how weak Ethiopian firms are when it comes to use of technology and signify that it is one of the potential challenges of establishing financial markets.

Table 9: Use of technology

Technology	Ethiopia	Africa	East Asia
Percentage of firms with ISO certification ownership	4.16	11.69	13.82
Percentage of firms using technology licensed from foreign companies	4.19	11.39	11.75
Percentage of firms using the Web to communicate with clients/suppliers	4.01	21.78	39.57

Source: World Bank 2013

As indicated the World Bank report of, Ethiopia is less in development of technology even the average rate of African as well as east Asian Countries. This implies that technological development have its own contribution in challenging the establishment of Stock market in the country

E. The Effect of Awareness level on the establishment of Stock market

Awareness about stock exchange markets affects the degree of participation in the markets. If the public is unaware about what stock markets are, the associated benefits and risks and what actions to take whenever some market incidents occur, potential market participants will diminish, hence creating a barrier to entry. Awareness could emanate from formal education, the Media or experience gained through participating in the markets. Accordingly the study were assessed respondents level of awareness, how much professionals, politicians as well as investors awareness level affect the establishment of stock market in the country, in this regard about 2.3696 respondents implied their disagreement, which implies that, still the problem of level of awareness even exist among professionals. According to Guiso and Jappelli (2003), learning occurs when potential investors interact sequentially with another investor, and as such, if one is aware then the other one becomes aware, which they call such learning as social learning. Guiso

and Jappelli (2003) further held that social learning amplifies the effectiveness of a given signal which has a better chance of reaching a potential investor. In this regard Richard (2013) also explained that not only investors or politicians and ordinary society, but also it is difficult for professionals unless and otherwise they develop experience of stock market in practice. The result of this study also implied, that, most of the respondents of this studies are professionals and found in the management position however, the result implied still there awareness challenge.

In this regard Asrat (2003) implied that, a stock market does not automatically provide any of the Indicated benefits. This is because it relies on an array of institutions for its benefits to be realized. For instance, institutions, such as a free press, an efficient and independent judicial system, corporate lawyers and accountants, professional underwriters and a group of mature institutional investors are difficult to establish at an early stage of economic development. Therefore the result implied that even though the country is needed to establish a stock market however, awareness of society about the markets system should be created first.

G. Legal and Regulatory Framework Challenges on the establishment of Stock market

One of the principal challenges a country must struggle with in the development of deep and vibrant securities markets is how to constitute an effective legal and institutional framework. Efficient and robust securities markets are dependent on institutional building blocks and the mainstream institution is the legal architecture.

Stock market exchange cannot flourish without an appropriate legal framework that reduces subjective decision making and encourages transparent and objective enforcement of laws and related regulatory framework. Certainty as to the working and fairness of the systems will attract more participation in financial markets and will curb interest groups that benefit from its weaknesses. Law should also build upon social and cultural factors that enjoy similar force or obedience such as customary law.

Similarly, the response of the respondents also implied at the highest mean score 3.9747 implied inadequacy of regulatory frame work affect the country from the establishment of the stock market.

H. the Effect of Public trust on the establishment of Stock Exchange

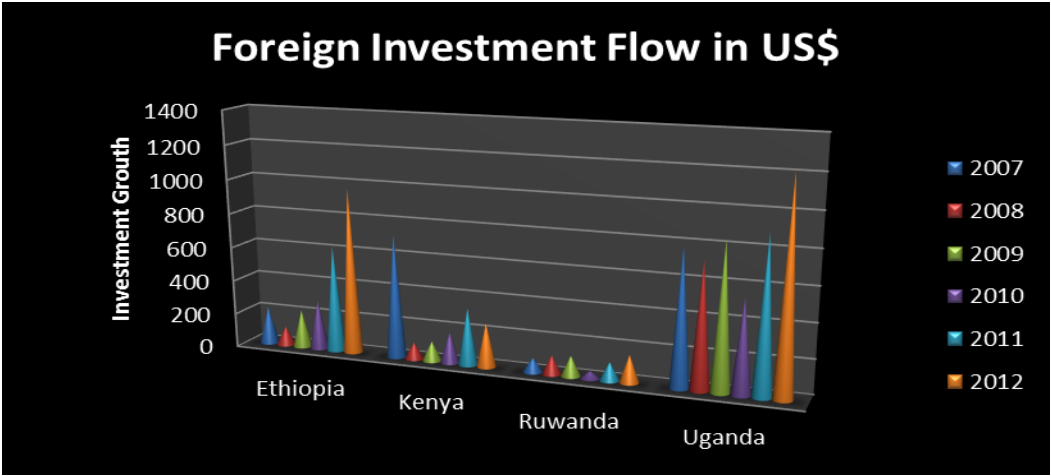
Trust plays a central role in the way in which financial services organization present themselves to customers, and this is particularly apparent in stock markets. Research by Sapienza and Zingales (2005) suggests that true insights into the root causes of a nation's financial strengths or weakness lies in trust. They noted that trust increases the probability of direct participation in the stock market. Trust captures investor optimism in that optimistic investors may be induced to participate in the stock market by their inflated expectation of returns. Trust is defined as the subjective belief about the likelihood that a potential trading partner will act honestly. Based on these idea the study assessed respondents view on the public trust effect on the establishment of stock exchanges in Ethiopia, their result were indicated at a mean score value of 3.6329 with a slight opposing ideas indicated at a standard deviation of 1.19636.

I. Macroeconomic effect on the establishment of Stock exchange

On the economic aspect of the country average number of respondents at mean score value of 2.7405 have stated that macroeconomic condition will affect stock market establishment. With respect to the level of domestic saving the rest respondents implied at a standard deviation value of 1.29271 have taken it as a less effect on the development of stock exchange market in the country.

Taking secondary sources of data on the macroeconomic condition of the country, Ethiopia is one of the fastest developing countries in the world with yearly average GDP growth of 10.8% between 2005 and 2013, where the country has been enjoying sustained economic growth in the past years (African Economic Outlook, 2014). Comparing the average yearly GDP growth of Rwanda, Kenya and Uganda for the same period of 8.2%, 4.8% and 6.7%, respectively (African Economic Outlook, 2014), Ethiopia's yearly economic growth is the highest in the Sub Sahara African countries. Below the figure indicated foreign investment flow of the country in compare with the Kenya, Rwanda and Uganda

Figure 4: foreign investment flow in us



Source: African Economic outlook, 2014

As indicated from the above figure Foreign investment flow of Uganda and Ethiopia is the highest specifically in 2012, this implied that, those countries population saving practices is so less that’s way instead of growing local investors the countries indicated the development of foreign investors.

CHAPTER FIVE

Conclusion and Recommendation

5.1. Conclusion

This paper has provided a comprehensive review of the role of the stock markets establishment and potential implication for the country in establishment from several perspectives. Based on this the study were done based on respondents view that were sampled from shareholders of private commercial banks as well as management bodies of each commercial banks based on head office. In addition as the study is argumentative in its nature it was also more depend on the argumentative scholars view, regulatory ground of the country, as well as potential implication of the establishment of stock market from demand and supply side as well as the prerequisite or factors that affect the establishment of the stock exchange in Ethiopia. Accordingly, the study was approached in four major parts, in the first part of the discussion the study analyzed respondents general background such as their educational background. In the second part of the study discussed potential implications of the establishment of stock exchange in Ethiopia from the demand side of stock market. The third part was presented potential implication of the country from the supply side and finally the study discussed prerequisites or major factors that affect the establishment of stock exchange in Ethiopia. Accordingly the study concluded the major finding of the study as follow:

- Hence, absence of stock market in Ethiopia may cause illiquidity of assets as holders of stocks may find it difficult to sell same at a fair market price. Specifically, as Ethiopian investors only have a small portion of their household income to invest, a fair priced stock trading is important in order to avoid systematic losses for the general public.
- The high collateral requirement of commercial banks affected innovative as well as entrepreneur development in the country. This is because, as the commercial banks governed under the general regulatory rule of NBE, they are remain idle in creating competitive rule and regulation, such as, supporting innovators and entrepreneur ideas by assessing their feasibilities. In this regard the study correlated that, the country need small business entrepreneur development, in contrary there is no competitive financial access that is prohibited by the regulatory rule of NBE, these activities kill the micro economic

development of the country, as Banks only provide loan for small investors which can provide the required collateral value. Therefore, the growing number of youth's unemployment and the existence of small number of successful entrepreneur as well as less innovative companies. Need an access of cogitative financial market and it can be conclude that, the establishment of stock exchange is needed at present time to solve the discussed challenge.

- Shareholders usually face problems in getting buyers for their shares at a fair price and in-time. This inability will make shares illiquid, which will therefore affect the public's perception towards buying of shares. If individual investors are affected, then companies will have difficulty in raising capital through issuance of shares to the public. A well regulated stock exchange market will provide ready market whereby investors could easily buy and sell their shares, thereby rendering liquidity to stocks of companies, hence helping both investors and companies in their financing needs
- The finding implied that in Ethiopia introducing stock market, among other things, allows the “de-concentration of ownership, improve accounting and auditing standards, provide effective tools for monetary and fiscal policy and help privatization efforts”. In addition the finding also implied that, the establishment of stock market in Ethiopia could contribute to economic growth, since it encourages investment by helping traders buy and sell stocks quickly and efficiently. Hence, absence of stock market in Ethiopia may cause illiquidity of assets as holders of stocks may find it difficult to sell same at a fair market price.
- Currently there is high rate of shareholding companies' establishment. There are more than 60,000 shareholders in Ethiopia where there is no market for share trading and re-trading implying that there is high share illiquidity. If this illiquidity persists, the existing shareholders tend to frustrate and new shareholders will be discouraged to get into share company business which in effect hinders the growth of investment and private sector involvement in the Economy. This is one of the implications of high demand of stock market establishment is needed in the country.
- Regarding debt securities, the only issuer is the Government of Ethiopia. The government is issuing short term (treasury bills) and long term debt securities to finance mega projects (bonds). There are not corporate bonds currently issued in the market. Even in

the absence of the corporate bonds, there is a huge supply of government bonds to finance mega projects (e.g. the Great Renaissance Dam). Similarly majority of the respondents at a mean value of 3.7152 also assures that, the activities such as Treasury bill, and selling bonding for several mega projects in the country are the implication of the potential of suppliers of if stock market stabled in the country.

- Regarding corporate governance, the overall standard in Ethiopia is low. The legal and constitutional instruments do not provide an adequate regulative framework, investor and creditor protection laws are inadequate, and the absence of an organized capital market is a remarkable deficit and contributes to a lack in transparency. However, recent developments prove an emerging commitment to corporate governance standards and a corporate governance code is expected to be introduced in the near future.
- Despite the acclaimed benefits, establishing a stock market in Ethiopia may not be a smooth process as some of the pre-requisites are not currently in place in the country.
 - The commitment of government in pursuing the establishment of stock exchange markets is not visible. Besides, government's strategies and policies are not clear enough with respect to capital markets.
 - The legal infrastructure and regulation framework is not comprehensive and the laws pertaining to share companies are not up to date. There are no regulatory frameworks and institutions to take care of the regulation and supervision activities.
 - Corporate governance is not fully developed and the governing laws on corporate governance are not up-to-date. However, the recent activities of revising the commercial code of Ethiopia is on progress, so does the National Bank of Ethiopia's draft directive on corporate governance.
 - Even though the country has agreed to adopt international financial reporting standards in the country it is on its infancy stage.
 - Technological infrastructure of the country is in its development stage, which needs to be further improved to facilitate smooth transaction settlement and flow of information.

- In terms of such macroeconomic factors, like economic growth, inflation rate, foreign direct investment, the country's position is good when compared to other Sub Sahara African countries.
- The financial sector which is expected to compliment the development of stock exchange market is growing in terms of number of Banks and Branches

5.2. Recommendation

- The strength and performance of the financial system is an indicator of the strength and performance of the nation's economy. Financial markets, being an element of the financial system play a pivotal role in expediting the nation's economic growth through mobilization of domestic resources and attracting foreign direct investment. Existence of the financial markets encourages the private sector involvement in the economy which is usually described as the engine of the national economic growth. Besides, financial markets help to mobilize local savings, enhance competition among financial institutions, increases remittances, lead to improve corporate governance, reward sound economic policies, provide for sources of project financing on short and long term bases, allow deconcentration of ownership, improve accounting and auditing standard and help privatization efforts. Because of these tangible benefits, it is possible to recommend that financial markets need to be established in Ethiopia to further speed up the growth of the Ethiopian economy.
- A well-functioning financial system requires strong institutions and a sound legal framework. Among others consumer and property rights protection, contract enforcement laws and corporate governance can be considered as the key elements for creating deep and vibrant financial markets and creating an enabling business environment. Establishing financial markets is not an easy task for the Ethiopian government. It is affected by several environmental factors emanating from different sources. For instance, the legal regime is the bedrock of robust securities markets. In Ethiopia, there is no institutional, legal and policy framework for any secondary financial market activity in the country. Regarding security issues, Ethiopia fares better compared to regional countries, implying conducive security situation to establish financial markets. Ethiopia has taken important steps to combat corruption such as ratifying convention Against

Corruption and the African Union Convention on the Prevention and Combating of Corruption, and recently arrested and prosecuted key government officials as part of the corruption eradication campaign but still Ethiopia is known for popular corruption. Pertaining to the adequacy of the judiciary system, the 1960 commercial code is outdated and there is no system of civil courts where securities cases can be prosecuted by a dedicated governmental authority. Therefore, through adequate judiciary system and regulatory power, the government can reduce uncertainty, control unethical practices and enhance investors' confidence in the financial markets. The missing laws, such as The Securities Laws can be enacted and used.

- With regards to adopting state of the art technology, the use of World Wide Web and licensed technology are very limited compared to regional standards. A lot has to be done to aware and support companies to use licensed technologies and World Wide Web as a competition tool. The government's commitment towards privatization of state owned enterprises is encouraging. However, the privatization scheme is not contributing to the formation of new share companies as the enterprises are transferred to highest bidders - individuals and companies- but not for the general public in the form of shares. Therefore, the government need to consider transferring state owned enterprises to the Public on share basis.
- In order to ensure the liquidity of assets in Ethiopia, it is vital to introduce stock market because of the limited investor and issuer base. However, a stock market does not automatically provide any of the indicated benefits. This is because it relies on an array of institutions for its benefits to be realized. For instance, institutions, such as a free press, an efficient and independent judicial system, corporate lawyers and accountants, professional underwriters and a group of mature institutional investors are difficult to establish at an early stage of economic development.

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Annex

ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

SCHOOL OF GRADUATE STUDIES PROGRAM IN MSC

Introduction

This questionnaire is intended to gather primary data on the establishment of stock market in Ethiopia. The purpose of the study is to fulfill a thesis requirement for the Master of Degree in accounting and Finance at Addis Ababa University. Your genuine responses for the questions are very important for the success of completing this study. All information collected through the questionnaire will be used only for the purpose of the study and will be kept confidential. And thus, I would like to thank you in advance for your kindly cooperation.

N.B No needs to write your name

Put (√) inside the box or table for an alternative you think is right.

Part I: Background Information

1. Gender Male Female
2. Corporate position, Shareholder Manager
3. Age 21 - 25 26 – 30 years 31 – 35 years > 46
4. Educational Background of parents

Junior High school Diploma B/A MA other _____

5. Sources of finance for company

Retained Earnings Bank Loans Selling shares to the public if any other _____

Part Two issues related to Infant formula

In this part the survey questioner provide questions that affect stock establishment in Ethiopia, Therefore, based on the questions indicate your level of agreement or disagreement by *putting tick (√) mark with the corresponding score value.*

S.N.	Statement	Score Values				
		Disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Agree (5)
	<i>Demand side (investor base) issues</i>	1	2	3	4	5
1	The increasing number of share companies and shareholders in Ethiopia, implied there is a wide-ranging prevalence of share illiquidity and implication of high demand of Stock exchange market					
2	The high demand of Bank loan is an implication of the need of optional or competitive financial market.					
3	The mismatch between the low interest rate for saving and high interest rate for loan is the implication of lack of Stock market computation on the country.					
4	To cop up with challenges of inflation savers need to invest on an opportunity investment like stock market.					
5	The government’s commitment to privatize public enterprises has certainly increased the private sector investment in the economy, which is an indicator of potential demand for financial markets					
6	The increasing entrepreneurial practice of the country and their need of money is an implication of the market need competitive secondary market					
7	The ground need to reduce dominancy of small owners of share companies is an implication of the need to establish stock market in the country					

8	The overall growing of the Economy requires more financial sources, and a financial market that can fulfill such potential gap					
	<i>Supply side (issuer base)</i>					
1	Issuing short term (Treasury bill) implied potential supply of stock market need.					
2	The highest rate of illiquidity of Ethiopia companies is an implication of the existence of potential supplier's stock market.					
3	Government activities in privatization of public companies is potential implication of Stock market					
	Factors that affect Stock exchange market establishment in Ethiopia					
1	security challenge					
2	Corruption and lack of good governance					
3	inadequacy of the Judicial System					
4	Low level of corporate governance					
5	Lack of technology					
6	Low awareness level of the society about stock exchange markets					
7	Lack of (inadequate) regulation and laws					
8	Lack of public trust					
9	Macro-economic situation of the country					