

ADDIS ABABA UNIVERSITY
COLLEGE OF LAW AND GOVERNANCE



**THE CHALLENGES AND OPPORTUNITIES FOR IMPLEMENTATION
OF THE NEW CAPITAL MARKET PROCLAMATION IN ETHIOPIA**

**A THESIS SUBMITTED FOR THE PARTIAL FULFILLMENT OF LL.M
DEGREE IN BUSINESS LAW**

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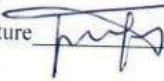
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TABLE OF CONTENTS

Contents	Pages
ACKNOWLEDGMENTS	i
TABLE OF CONTENTS	ii
LIST OF ACRONYMS	iv
ABSTRACT.....	v
CHAPTER ONE	1
1.1. Statement of Research Problem.....	4
1.2. Research Questions	6
1.3. Research Methodology	7
1.4. Significance of the study	7
1.5. Limitations of the Research	7
1.6. Ethical Considerations.....	8
1.7. Structure of the thesis	8
CHAPTER TWO	9
A FRAMEWORK FOR UNDERSTANDING AND REGULATING CAPITAL MARKETS	9
2.1. Introduction.....	9
2.2. The Concept of Capital and its Historical Development: An Elaboration	9
2.3. The differences between financial markets, capital markets, stock markets, and money markets	11
2.4. The Rationale for the Introduction of Capital Markets	13
2.4.1. The Rationale for Introducing Capital Markets in a Developing Economy	14
2.5. Capital Market and its Legal and Institutional Frameworks: An Elaboration	15
2.5.1. Legal Framework.....	15
2.5.2. Institutional Framework	16
2.5.3. Importance of Legal and Institutional Frameworks.....	17
2.6. Capital Market and its Legal and Institutional Frameworks in Selected Countries	18
2.6.1. United States.....	18
2.6.2. United Kingdom	19
2.6.3. China	19
2.6.4. India	20
2.7. Capital Market and Ethiopia's Legal and Institutional Frameworks.....	21
2.7.1. Legal Framework.....	21

2.7.2.	Institutional Framework	24
2.8.	Effective Capital Market and Internationally accepted Basic Principles	30
2.9.	Capital Market and the Challenges of its implementation	32
CHAPTER THREE		35
ANALYSIS OF THE PROSPECTS AND CHALLENGES OF THE NEW CAPITAL MARKET PROCLAMATION		35
3.1.	Introduction	35
3.2.	Historical Review	36
3.3.	Key Provisions of the Proclamation	38
3.4.	How the Ethiopian Capital Market Ecosystem is Regulated	39
3.4.1.	Ethiopian Capital Market Authority	39
3.4.2.	Self-Regulatory Organizations	40
3.4.3.	The Ethiopian Security Exchange	40
3.4.4.	Private Security Exchange Share Companies	41
3.4.5.	Security Depository and Clearing Company	42
3.4.6.	Government Securities	44
3.4.7.	Capital Market Service Providers Licensing	45
3.4.8.	Public Offering and Trading of Securities	46
3.4.9.	Collective Investment Schemes	46
3.4.10.	Prohibited Trading Practices	47
3.4.11.	Compensation Fund	48
3.4.12.	Criminal Liability and Administrative Measures	49
3.4.13.	Capital Market Tribunal	49
3.4.14.	Settlement of Disputes	50
3.5.	Gaps of Proclamation No. 1248/2021 vis-à-vis internationally accepted Basic Principles .	51
3.6.	Factors affecting the effective implementation of Proclamation	52
3.7.	The Institutional Structure under Proclamation no. No. 1248/2021 and its effectiveness .	53
3.8.	Challenges and Opportunities	54
3.8.1.	Challenges	54
3.8.1.1.	Infrastructural Challenges	55
3.8.1.2.	Legal and Regulatory Challenges	55
3.8.1.3.	Political and Economic Challenges	56
3.8.1.4.	Market Depth and Liquidity Challenges	57

3.8.2. Opportunities for Development	57
CHAPTER FOUR	59
CONCLUSION AND RECOMMENDATIONS	59
4.1. Conclusion	59
4.2. Recommendation	60

LIST OF ACRONYMS

Ethiopian Commodity Exchange (ECX)

The Ethiopian Capital Market Authority (ECMA)

Securities regulators, self-regulatory organizations (SROs)

Capital Market Authority (CMA)

Ethiopian Securities Exchange (ESE)

The CMA Clearing and Settlement Corporation (CCSC)

The Ethiopian Central Depository Agency (ECDA)

The National Bank of Ethiopia (NBE)

Small and medium-sized enterprises (SMEs)

Security Depository and Clearing Company (SDCC)

Ethiopian Securities Exchange Commission (ESEC)

ABSTRACT

The thesis examines the implementation of the Ethiopian capital market proclamation what it brings about the challenges and opportunities through the legal and institutional framework in Ethiopia. The study is based on the doctrinal approach by which used the primary and secondary data .The research is aimed to answer the question of problem which identified as "to what extent are the legal frameworks and enforcement mechanisms in Ethiopian capital market rules and practices efficient in comparison to well-developed international standards?" to answer this main question the following specific issues will be addressed: What are the core elements of international normative standards on capital market regulation and the challenges of implementing the framework at the domestic level? What are the key institutional building blocks of the Capital Market in Ethiopia? What are the challenges in implementing the new capital market Proclamation No. 1248/2021? The theses examines the Ethiopian legal and institutional frame work weakness and strength from the imperial to the present situation. It also analysis the capital market proclamation with regarding the key provisions in which the principal institutions are identified with their power and responsibility. And also analysis the law how to be implemented and protect the investors from unfair treatment, market manipulation, false information, insider trading and so on. In comparison with the international capital market principles, the capital market proclamation is evaluated. The paper also examines the opportunities and challenges of the implementation of the capital market proclamations. Finally the conclusions and the author recommendation are suggested based on the examination of the study.

CHAPTER ONE

INTRODUCTION

Local capital market development has been a long-standing policy concern. Many countries have adopted significant reforms to promote domestic capital market development over the last few decades.¹ Such reforms were frequently preceded by or included in broader reform agendas aimed at developing financial institutions and making them more linked with the global economy, including the abolition of banking and capital account restrictions and controls.² International organizations and standard setters such as the IMF, and the World Bank actively pushed capital market development.³ The belief was that the creation of local capital markets would boost economic growth by enhancing capital allocation efficiency and allowing for better risk sharing through stimulating financial development and financial integration.⁴ Furthermore, the growth of local bond markets was considered as vital for governments to finance significant fiscal deficits without resorting to financial repression or risky international borrowing, as well as to allow the sterilizing of large capital inflows.

Despite these potential benefits and good intentions, however, the performance of developing countries' capital markets has been varied. Despite well-intentioned and periodic government interventions, least developed countries have been able to build large and liquid local capital markets, while others have seen their markets stagnate or even implode.⁵ Furthermore, many of these markets have been vulnerable to erratic international capital flows, particularly in emerging market economies, prompting some to question the merits of financial deepening and financial globalization in general.⁶

In this regard, Ethiopia had a short-lived stock market that began in the late 1950s under the Imperial Regime and was formally established in 1965 after the enactment of the Commercial

¹ Asrat, T.. Prospects and challenges of developing Securities Market in Ethiopia, African Development Review,2003

² Azu, O.,Market liquidity and strategies for improving liquidity in the capital market.: Waifem regional course on operations and regulation of capital markets, Accra, Ghana,2003

³ Ibid

⁴ Dudley, W. and Hubbard, R., How capital markets enhance economic performance and facilitate job creation.Global markets institute, Goldman sacks,2004

⁵ Ibid

⁶ Ibid

Code Ethiopia in 1960.⁷ It was abolished shortly after the Imperial Regime was deposed in 1974 and replaced by military rule with a command economic policy.⁸ The country has undergone a number of economic policy and strategy adjustments since the change of the command economic system in 1991, emphasizing market-led economic development. Since the reform began, a lot of literatures have been created, most notably by consultants and the Addis Ababa Chamber of Commerce and Sectorial Association (*here in after AACCSA*) with the hopes of reestablishing a stock market in Ethiopia.⁹ The outcome of the literature developed by the latter aims at re-establishing a stock market in Ethiopia and claims that this will greatly aid the country's economic transition by promoting the development of new business ideas, creativity, and innovation and improving the efficiency of the market. The introduction of a stock market is also thought to improve the government's privatization of public enterprises by ensuring transparency in the process, expanding opportunities for individuals and private sector businesses to own large corporations, and assign market value to the public enterprises' shares.¹⁰

Many authors argued the need for regulatory reforms before starting stock markets. As such, they claim that the establishment of effective and efficient capital market requires a country to develop and strengthen its capital markets in general, such as updating the commercial code, financial reporting and auditing standards (which have already begun and are currently being implemented), and enacting laws requiring regulatory and stock exchange institutions.¹¹ In this regard, the Ethiopian government's recent reform measures attempt to address imbalances and ensure macro-financial stability. The reform program improves access to finance and the establishment of a capital market, where securities such as shares, bonds, and derivatives are purchased and sold, as part of the prerequisites for macroeconomic stability. As a result, the NBE, the country's central bank, was tasked with preparing the legal framework and came up

⁷ Mebrahtu Leake, *Is Ethiopia Ready to Commence Capital Market? Analysis of Potential Beddings, Constraints and the Dubious*, International Journal of African and Asian Studies - An Open Access International Journal Vol.3 2014

⁸ Ibid

⁹ Haileberhan Zena, *Analysis of the Need for Stock Market in Ethiopia* , International Journal of Economics and Finance; Vol. 13, No. 2; 2021

¹⁰ Ibid

¹¹ Ibid

with a draft capital markets proclamation, which was later approved and enacted by the Federal Parliament as Proclamation No. 1248/2021 during its regular session on June 10, 2021.¹²

The proposed proclamation is crucial for the country's economic progress and prosperity, according to Yayesh Tesfahuney, Chairperson of the Revenue, Budget, and Finance Affairs Standing Committee. She stated that when banks are in problems, the capital market is the only source of financing for the public and private sectors, and that it has been critical in linking untapped investors to desired investment possibilities and ensuring the success of the ten-year growth plan.¹³ According to a news release from the Prime Minister's Office, introducing a capital market in Ethiopia is critical for the country's economic progress and prosperity.¹⁴ Citizens can also use the capital market as an alternative savings strategy by investing in equities. According to the statement, a rise in local savings investments will lessen Ethiopia's reliance on foreign direct investment. It also said that the capital market plays an important role in macroeconomic stabilization by regulating the country's balance of payments.¹⁵ As a result, the government is taking steps to operationalize the Ethiopian Capital Market Authority by the end of 2024, and then the Ethiopian Securities Exchange in 2025, through public-private partnerships.¹⁶ Following the fall of the Derg regime in 1991, various attempts by both the government and private parties to re-establish a capital market were attempted, but all failed. However, the adoption of the new capital market proclamation by parliament appears to have taken a significant step ahead in these efforts, and the development of a capital market in Ethiopia appears to be closer than ever.

Economic development is essential for a country's long-term survival. Several hypotheses have been proposed in an attempt to establish what factors influence economic growth, and one of them claims that a country with a well-functioning capital market is more likely to have a

¹² The House of Peoples' Representatives, in its 14th regular session held in its 6th year, reviewed and approved the draft capital market establishment proclamation unanimously

¹³ Ibid

¹⁴ Available at <https://www.thereporterethiopia.com/article/parliament-tables-capital-market>. Last accessed at November 20, 2021

¹⁵ Ibid

developed economy.¹⁷ One rationale for this viewpoint is that a country with a well-functioning capital market has the necessary capital for significant projects, which, if properly allocated, has the potential to boost the country's development.¹⁸ Investors are more likely to invest when they have confidence in the market system and are certain, to a fair extent, that they will receive returns on their investments in the form of dividends or interest and that they will not be expropriated of their investments.¹⁹ In connection to this, establishing an efficient capital market is based on a complex web of regulatory laws and market institutions that provide investors with timely and accurate information about the value of a company's operations. Hence, in comparison to well-developed international norms, the study will examine the legislative regulations and enforcement procedures that control the Ethiopian capital market as per the new proclamation.²⁰ The findings of this thesis will aid in identifying flaws in the substantive regulations that govern the market, as well as making recommendations on how to improve the efficiency of the Ethiopian capital market.

1.1. Statement of Research Problem

Capital realization²¹ is one of the variables that contribute to economic growth; as a result, the availability and cost of capital is a major topic in discussions about developing-country growth prospects. A country's efficient capital market is critical since it is considered the backbone of modern economies' growth. Because of the sensitivity of capital market transactions, it is critical that they be properly regulated. This doesn't only guarantees that business runs smoothly in the market, but it has also the potential to attract new investors. While a spate of studies demonstrated that establishing a capital market would benefit the economy, some questioned if Ethiopia's burgeoning, but vulnerable private sector was up to the challenge. Although the administration appears to recognize the benefits of having a stock market, it is largely assumed

¹⁷ L. Burn and E. Greene, 'What are capital markets and what are they for?' 11 Capital Markets Law Journal 343,2016

¹⁸ R. Ngugu, D. Amanja and I, Maan, Capital market, financial deepening and economic growth in Kenya, Research Paper, Centre for the study of African Economies, Oxford University1-3 Centre for capital markets competitiveness, 'Strengthening US capital markets,2008

¹⁹ B. S. Black, The legal and institutional preconditions for strong securities markets ,2001

²⁰ The focus of this thesis is limited to assess the new proclamation's regulation of the Ethiopian capital market.

²¹ **Capital realization** is the process of converting an asset into cash. This can involve selling a tangible asset like real estate or a financial asset like stocks or bonds

that the stock market will not contribute to the country's short-term development.²² Rather, the government appears to focus on bolstering the Ethiopian Commodity Exchange (*here in after ECX*) in order to improve fair and transparent pricing of main agricultural products. Furthermore, some claim that the government's continual issuance of debt instruments (bonds) for state funding has resulted in a lack of interest on the government's behalf in other investment possibilities or capital market competition.²³ On the contrary, there is a risk that further delays in the legal framework, as well as the persistence of various difficulties in Ethiopia's under-regulated capital market, will erode credibility and entrench negative public perceptions of stock acquisition and exchange, putting stock markets in jeopardy during their early stages of development.²⁴ Among the key components of the legal regime that need be addressed are the necessity for a regulatory organ and securities enforcement, the sufficiency of the judicial system, accounting and auditing standards, corporate governance, takeover and merger regulation, and bankruptcy and insolvency law.²⁵

In order to maintain openness and predictability for investors, especially in the early stages of development, the legal, regulatory, and supervisory framework must be addressed. Establishing a legal framework for its issuance is an important first step in building stock market regulation to support the issuance and trading of stocks. A regulatory environment that promotes market development and permits the implementation of competent supervisory practices is also required. Market regulation should, in particular, ensure that secondary market trade is carried out in a transparent and efficient manner. As a result, a significant part of the legal and regulatory framework is required to ensure the provision of adequate information, such as the requirement of information disclosure and the prohibition of unlawful trading behaviors such as insider trading, fraud, and market manipulation.

Local capital market growth is not without its difficulties, particularly in developing and emerging market countries, where small market sizes, weak institutions, and insecure macroeconomic policies frequently obstruct the creation of an enabling environment for local markets to thrive. Given the political obstacles and the time required to overcome them, one

²² Ali, Abdu Seid, *The Viability of Establishing Capital Market in Developing Countries: The Case of Ethiopia*, 2016

²³ Ibid

²⁴ Ibid

²⁵ Available at https://eeact.org/sites/default/files/publications/Araya%20and%20Tadewos_Towards%20the%20Development%20of%20Capital%20Market%20in%20Ethiopia Last accessed at November 20, 2021

must be realistic about the degree of local market development that can be achieved effectively in the short term without exposing investors to undue risks such as market illiquidity, securities fraud, and mispricing of securities.²⁶ Money markets can promote economic growth and welfare by improving risk sharing and the efficiency with which capital is allocated to the real economy. However, not all countries have well-developed capital markets, despite the potential benefits. Furthermore, government-led efforts to build local capital markets have met with varied results.

Despite the fact that Ethiopia's policy changes have had some good effects on capital market growth, there are still numerous issues and concerns to be solved in order to establish a functioning capital market in Ethiopia. Banking and financial institution reforms were designed to enhance capital market institutions so that financial resources might be mobilized for allocation to the private sector. Within the financial sector, competition is insufficient. The capital market's appeal to domestic and foreign investors is hampered by issues like illiquidity, infrequent trading, and lack of private company listings. The lack of government incentives to attract new companies and investors to the stock market has exacerbated the lack of absorption capacity and low demand for equity securities. Another difficulty is the capital market's infancy in terms of structure and legislation. This indicates that the capital market's instruments for resource mobilization are still limited, and in the early stages of development. Furthermore, the general weakness of the Ethiopian currency and rising inflation act as deterrents to long-term capital market investments. Based on these and other facts, this study will examine the new proclamation normative content and, on the advantages, and disadvantages of building local capital markets in Ethiopia, as well as the problems that such markets face.

1.2. Research Questions

The thesis' main theme/research question is "to what extent are the legal frameworks and enforcement mechanisms in Ethiopian capital market rules and practices efficient in comparison to well-developed international standards?" to answer this main question the following specific issues will be addressed:

- What are the core elements of international normative standards on capital market regulation and the challenges of implementing the framework at the domestic level?

²⁶ Ibid

- What are the key institutional building blocks of the Capital Market in Ethiopia?
- What are the challenges in implementing the new capital market Proclamation No. 1248/2021?

1.3. Research Methodology

So as to accomplish the objective, this study is designed as a research that is a blend of doctrinal. The doctrinal approach is introduced so as to examine the new legislative regulation in light of accepted core elements of international normative standards on capital market regulation. The study will, also, make use of data acquired from both primary and secondary sources. Accordingly, while the primary source of data is acquired from international agreements and domestic legislation that has a bearing on capital market regulation. The secondary sources of data are composed of reports, textbooks, treatises, commentaries on statutes, journal articles, dictionaries, encyclopedias, indexes, reviews etc.

1.4. Significance of the study

The outcome of this research will be significant in many ways. To begin with, research works in the field of capital market in Ethiopia are not holistic as they failed to incorporate issues raised under developing international norms. Moreover, pertinent legal issues concerning capital market has not been investigated. Thus, this research:

- Will fill gaps in existing literature in the field of capital market regulation in Ethiopia
- Will be informative to the public and government about the status of capital market governance in Ethiopia
- It may have a critical contribution to policy and lawmakers on capital market
- The outcome of the research could also be used by other researchers either as an input or an encouragement for further research in the field

1.5. Limitations of the Research

Ethiopia's capital market development is at infant stage in terms of structure and legislation. Due to this fact, we lack both primary and secondary data for analyzing the contribution of stock markets to the growth of the Ethiopian economy, because Ethiopia has yet to establish an active

stock market. As a result, content analysis is employed as a significant tool for drawing conclusions and suggestions from a systematic assessment of conceptual and empirical literature in the field of financial markets.

1.6. Ethical Considerations

The thesis will be directed with proper method valuing the reliability of academic study. All applicable ethical standards of Addis Ababa University will also be followed. Moreover, specific attention will be paid to the internationally established academic code of conducts in using published or unpublished literature and referencing. As a way of obtaining the informed consent of informants, the purpose of the study will be explained, and consent will be obtained from each participant, before beginning the interviews.

1.7. Structure of the thesis

The thesis will be organized in to four chapters. The first chapter is the proposal of the research. Chapter two will present Conceptual framework on Capital Market. The chapter will, among others, conduct discussion on points such as the concept of capital and historical development of capital market, the legal and institutional frameworks entrusted in regulating capital market at national and international level, basic accepted international standards for effective capital market, and finally the challenges for constructing effective capital market. Chapter three of the study, on its part, will go on to analyze the gaps of the new capital market proclamation (proclamation no. 1248/2021) in light of basic internationally accepted principles, the capacity of national institutions and other extra-legal determinants, which cut across the different set of political, social, economic and cultural dynamics that have an impact on its effective implementation. In so doing, it tries to discern its prospects and challenges. Finally, the final chapter will present conclusions and recommendations of the Study.

CHAPTER TWO

A FRAMEWORK FOR UNDERSTANDING AND REGULATING CAPITAL MARKETS

2.1. Introduction

Capital markets are financial markets where securities, such as stocks and bonds, are traded.²⁷ Securities are financial instruments that represent ownership in a company or a government. Capital markets allow businesses to raise capital to invest in growth and expansion, and they provide investors with opportunities to earn a return on their savings.²⁸ Capital markets are important for the economy because they help to allocate capital efficiently. By allowing businesses to raise capital from investors, capital markets help to promote economic growth. Capital markets also provide investors with a way to diversify their portfolios and reduce risk. However, capital markets can also be risky. Investors can lose money if the value of the securities they own decreases. Additionally, capital markets can be vulnerable to manipulation and fraud. For these reasons, it is important to have a framework for understanding and regulating capital markets. This framework should be designed to protect investors, promote fair and orderly trading, and ensure the efficient allocation of capital.²⁹

2.2. The Concept of Capital and its Historical Development: An Elaboration

The concept of capital is complex and multifaceted. It encompasses a wide range of resources, including physical assets, financial assets, and intangible assets. Capital can be used to produce goods and services, create jobs, and improve living standards. However, capital can also be used to exploit workers and the environment.³⁰ The historical development of the concept of capital is closely linked to the development of human society. In early societies, capital was primarily land and labor. People used their land to grow crops and raise animals, and they used their labor to

²⁷ Abdullah F. , Study Material. For Capital Market Examination-I of General Securities Qualifications Certificate: PART 2: Securities Operations. 2nd edition, No. 5,2018

²⁸ Ibid.

²⁹ Ibid.

³⁰ Aduda J., Masila J. and Nykundi E.. The Determinants of Stock Market Development: The Case for the Nairobi Stock Exchange. International Journal of Humanities and Social Science Vol. 2, No. 9,2012

produce goods and services. As societies became more complex, other forms of capital emerged, such as money and tools.³¹

The Industrial Revolution led to a dramatic increase in the importance of capital. New technologies required large amounts of investment in machinery and factories. This led to the development of new financial institutions, such as banks and stock exchanges, which helped to facilitate the flow of capital to businesses.³² In the 20th century, the concept of capital expanded to include intangible assets, such as intellectual property and brands. These assets can be just as valuable as physical assets, and they play an increasingly important role in the global economy. The historical development of the concept of capital has been closely linked to the development of capitalism. Capitalism is an economic system based on private ownership of capital and the use of that capital to produce goods and services for profit.³³ In a capitalist system, capital is essential for economic growth. Businesses need capital to invest in new technologies and equipment, to hire workers, and to produce goods and services. When businesses are successful, they generate profits, which can be reinvested in the business or distributed to shareholders. This process of reinvesting profits leads to further economic growth. However, the use of capital can also lead to inequality and poverty. In a capitalist system, the owners of capital tend to accumulate more wealth over time, while the workers who produce the goods and services that generate that wealth often see little or no improvement in their standard of living. This can lead to a widening gap between the rich and the poor.³⁴

The concept of capital has been criticized by some economists and philosophers. They argue that capital is inherently exploitative and that it leads to inequality and poverty. However, others argue that capital is essential for economic growth and that it can be used to create jobs and improve living standards. The debate over the role of capital is likely to continue for many years to come. However, there is no doubt that capital is a fundamental concept in economics and that it has played a major role in the development of the modern world.³⁵ It is important to strike a balance between the need for capital and the need to ensure that its benefits are shared

³¹ Ibid.

³² Ibid

³³ Anokye M., *Macroeconomic Factors and Stock Market Movement: Evidence from Ghana*, School of Management, University of Leicester, UK.,2008

³⁴ Ibid

³⁵ Ibid.

equitably.³⁶ This is a complex and challenging task. On the one hand, capital is essential for economic growth and for the production of goods and services.³⁷ Without capital, businesses would not be able to invest in new technologies and equipment, hire workers, or produce goods and services. This would lead to a decline in economic output and a decrease in living standards for everyone. On the other hand, the use of capital can also lead to inequality and poverty. If capital is concentrated in the hands of a few wealthy individuals, then the benefits of economic growth will not be shared equitably. This can lead to a widening gap between the rich and the poor, which can create social and political instability.³⁸

There are a number of ways to strike a balance between the need for capital and the need to ensure that its benefits are shared equitably. One approach is to invest in public goods, such as education and healthcare. This can help to create a more skilled workforce and improve the productivity of the economy. It can also help to reduce inequality by giving everyone a fair chance to succeed. Another approach is to regulate the financial sector and to tax capital gains more heavily. This can help to prevent the concentration of capital in the hands of a few wealthy individuals and to ensure that the benefits of economic growth are shared more widely. Finally, it is important to support policies that promote social mobility and economic equality. This includes policies that provide affordable housing, access to quality education, and job training opportunities for all.³⁹

2.3. The differences between financial markets, capital markets, stock markets, and money markets

Financial Markets

Financial markets are extensive networks of marketplaces where buyers and sellers exchange financial assets, including securities, commodities, currencies, and derivatives. These markets facilitate liquidity for investors by allowing them to trade their assets promptly and at prices that reflect the true worth of the underlying assets. By enabling the transfer of funds between investors and the conversion of savings into investments, financial markets encompass a wide

³⁶ A.S. Kannan and Letenah Ejigu,. Establishing Secondary Market in Ethiopia: Benefits and Costs Study. Indian Journal of Commerce and Management Studies. Vol. IV, Issue 1,2013

³⁷ Ibid.

³⁸ Ibid.

³⁹ Ibid.

range of markets, including stock markets, bond markets, commodity markets, capital markets, and currency markets.⁴⁰

Capital Markets

Capital markets function as financial systems that enable private and public institutions to trade equity and debt instruments, allowing companies to raise long-term funds by selling securities like stocks and bonds. These markets consist of primary markets, where new securities are directly sold to investors, and secondary markets, where existing securities are traded among investors. Essentially, capital markets facilitate the transfer of capital from investors to entities seeking funds.⁴¹

Stock Markets

Stock markets represent a network of exchanges or Over-the-Counter (OTC) markets where shares of publicly traded companies are issued and traded. These exchanges facilitate open and transparent stock trading between buyers and sellers. Serving as a critical source of capital for companies, stock markets provide a platform for companies to raise funds to fuel their growth and expansion. Likewise, investors can profit from stock trading by buying shares at a lower price and selling them at a higher price or by collecting dividends.⁴²

Money Markets

Money markets focus on investing in short-term debt instruments. They enable the trading of short-term financial assets such as treasury bills, commercial paper, and certificates of deposit. Money markets provide liquidity to businesses and governments by offering a platform for short-term borrowing and lending.⁴³

Similarities

⁴⁰ Karekwaivenani, G. 'A History of the Rhodesian Stock Exchange: The Formative Years, 2003

⁴¹ CARSON J., 'Self- Regulation in Securities Markets', Working Paper for World Bank Financial Sector Policy Group, 2010

⁴² Kim, J. 'Corporate Financial Structure of South Korea After Asian Financial Crisis: The Chaebol Experience'. Journal of Economic Structures, 2017.

⁴³ PwC, Africa Capital Markets Watch ,2021. Available at: <https://www.pwc.co.za/en/publications/africa-capital-markets-watch.html> (accessed September 2022).

Although there are distinct differences between financial markets, capital markets, stock markets, and money markets, they share certain commonalities. These markets are interconnected and focus on activities related to trading, investing, and managing money. While money markets primarily deal with short-term debt investments, financial markets encompass the buying and selling of financial instruments, stock markets focus on trading stocks and other equities, and capital markets facilitate the trading of long-term debt or equity-backed securities. Together, these four markets play a crucial role in the global economy by enhancing liquidity and promoting financial stability.⁴⁴

2.4. The Rationale for the Introduction of Capital Markets

Capital markets are financial markets where long-term debt and equity securities are traded.⁴⁵ They play a vital role in the economy by providing a mechanism for businesses to raise capital and for investors to allocate their savings.⁴⁶ There are a number of rationales for the introduction of capital markets. One rationale is that they can help to promote economic growth. Businesses need capital to invest in new technologies and equipment, to hire workers, and to produce goods and services.⁴⁷ Capital markets provide a way for businesses to raise this capital from a wide range of investors. Another rationale for capital markets is that they can help to improve efficiency in the allocation of capital.⁴⁸ Capital markets allow investors to compare different investment opportunities and to invest in the opportunities that they believe are most promising. This helps to ensure that capital is allocated to the most productive uses.⁴⁹

Capital markets can also help to reduce risk. By diversifying their investments, investors can reduce the risk of losing all of their money.⁵⁰ Capital markets provide a wide range of investment opportunities, so investors can choose investments that match their risk tolerance and investment objectives. Finally, capital markets can help to promote financial inclusion.⁵¹ By providing a way

⁴⁴ Ibid.

⁴⁵ Beckaert G., Harvey C.R. and Lundblad C. Does financial liberalization spur growth? *Journal of Financial Economics*, 77,2005.

⁴⁶ Ibid.

⁴⁷ Demirguc-Kunt A. and R. Levine, Bank-based and market-based financial systems: Cross-country comparisons. World Bank Policy Research Working Paper No. 214,1999

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ Beckaert G., Harvey C.R. and Lundblad C. Does financial liberalization spur growth? *Journal of Financial Economics*, 77,2005

⁵¹ Ibid.

for businesses to raise capital and for investors to invest their savings, capital markets can help to create a more equitable society. Here are some specific benefits of capital markets:

Economic growth: Capital markets can help to promote economic growth by providing businesses with access to capital to invest in new technologies, equipment, and workers. This can lead to increased productivity and output, which can boost economic growth.

Efficiency: Capital markets can help to improve efficiency in the allocation of capital by allowing investors to compare different investment opportunities and to invest in the opportunities that they believe are most promising. This helps to ensure that capital is allocated to the most productive uses.

Risk reduction: By diversifying their investments, investors can reduce the risk of losing all of their money. Capital markets provide a wide range of investment opportunities, so investors can choose investments that match their risk tolerance and investment objectives.

Financial inclusion: Capital markets can help to promote financial inclusion by providing a way for businesses to raise capital and for investors to invest their savings. This can help to create a more equitable society.⁵²

2.4.1. The Rationale for Introducing Capital Markets in a Developing Economy

Capital markets are especially important in developing economies.⁵³ Developing economies often have limited access to traditional sources of finance, such as bank loans. Capital markets can provide a way for businesses in developing economies to raise capital to invest in growth. Capital markets can also help to attract foreign investment to developing economies. Foreign investors are often willing to invest in developing economies with well-developed capital markets. This can help to boost economic growth and development. Capital markets play a vital role in the economy by providing a mechanism for businesses to raise capital and for investors to allocate their savings. Capital markets can help to promote economic growth, improve efficiency in the allocation of capital, reduce risk, and promote financial inclusion.⁵⁴

⁵² Ibid.

⁵³ Asrat T., *Prospects and Challenges for Developing Securities Markets in Ethiopia: An Analytical Review*. Blackwell Publishing Ltd, 2003

⁵⁴ Ibid

In developing economies, capital markets are especially important. They can provide a way for businesses to raise capital to invest in growth and attract foreign investment. In addition to the benefits listed above, capital markets can also help to:

- Promote innovation: Capital markets can help businesses to raise capital to invest in new products and services. This can lead to increased innovation and economic growth.
- Create jobs: When businesses invest in new products and services, they create jobs. This can help to reduce unemployment and improve living standards.
- Provide liquidity: Capital markets provide liquidity to businesses and investors. This means that businesses and investors can easily buy and sell securities. This can help to reduce risk and make the economy more efficient.⁵⁵

Overall, capital markets are a valuable tool for promoting economic growth and development. They can help businesses to raise capital, investors to allocate their savings, and the economy to become more efficient and inclusive.

2.5. Capital Market and its Legal and Institutional Frameworks: An Elaboration

Capital markets play a vital role in the economy by providing a mechanism for businesses to raise capital and for investors to allocate their savings. However, capital markets cannot function efficiently and orderly without strong legal and institutional frameworks.

2.5.1. Legal Framework

The legal framework for capital markets typically includes laws that:

- Define the different types of securities that can be traded: This includes laws that define equity securities, such as shares of stock, and debt securities, such as bonds.
- Regulate the issuance and trading of securities: This includes laws that require companies to disclose certain information to investors before they can issue securities, and laws that regulate the trading of securities on exchanges.
- Protect investors from fraud and other abuses: This includes laws that prohibit insider trading and other forms of market manipulation.

⁵⁵ Ibid.

- Establish a regulatory framework for market participants: This includes laws that establish the authority of securities regulators and that set out the rules that market participants must follow.⁵⁶

The legal framework for capital markets can vary from country to country. However, there are some common elements that are found in most jurisdictions. For example, most countries have laws that require companies to disclose certain information to investors before they can issue securities.⁵⁷ This information is typically made available in a prospectus, which is a document that provides investors with information about the company, its business, and its financial condition.

2.5.2. Institutional Framework

The institutional framework for capital markets includes the organizations that support the trading of securities. These organizations include:

- **Securities exchanges:** Securities exchanges are platforms where buyers and sellers of securities can meet to trade. Securities exchanges play a vital role in providing liquidity to markets. This means that buyers and sellers of securities can easily buy and sell securities at competitive prices.
- **Clearinghouses:** Clearinghouses are organizations that help to settle trades between buyers and sellers of securities. This means that they ensure that trades are completed and that securities are delivered to buyers and sellers.
- **Depositories:** Depositories are organizations that hold securities in safekeeping on behalf of investors. This means that investors do not have to worry about physically storing their securities.⁵⁸

In addition to these organizations, there are also a number of other organizations that play a role in the institutional framework for capital markets. These organizations include securities regulators, self-regulatory organizations (SROs), and credit rating agencies.⁵⁹

⁵⁶ Benn S., *Creating Securities Markets in Developing Countries: A New Approach for the Age of Automated Trading*. International Finance, 2001, pp, 257-278.

⁵⁷ Ibid.

⁵⁸ Ibid.

⁵⁹ Ibid.

2.5.3. Importance of Legal and Institutional Frameworks

The legal and institutional frameworks for capital markets are important for a number of reasons.⁶⁰ First, they help to protect investors from fraud and other abuses.⁶¹ This is because the laws and regulations that make up these frameworks establish rules that market participants must follow. For example, laws that require companies to disclose certain information to investors help to ensure that investors have the information they need to make informed investment decisions.⁶² Second, the legal and institutional frameworks for capital markets help to ensure the fair and orderly operation of markets. This is because these frameworks establish rules that govern the trading of securities. For example, rules that prohibit insider trading help to ensure that all investors have equal access to information about securities.⁶³

Third, the legal and institutional frameworks for capital markets help to promote the efficient allocation of capital. This is because these frameworks create a framework for businesses to raise capital from investors and for investors to invest their money in businesses.⁶⁴ For example, laws that require companies to disclose certain information to investors help to ensure that investors can make informed investment decisions about which businesses to invest in. The legal and institutional frameworks for capital markets are essential for the efficient and orderly operation of markets. These frameworks help to protect investors, ensure fair and orderly markets, and promote the efficient allocation of capital.

In addition to the legal and institutional frameworks mentioned above, there are a number of other factors that are important for the development of strong capital markets. These factors include:

- **Financial literacy:** Investors need to be financially literate in order to make informed investment decisions. This means that they need to understand the risks and rewards of different investment options.

⁶⁰ Anokye M., Macroeconomic Factors and Stock Market Movement: Evidence from Ghana, School of Management, University of Leicester, UK,2008

⁶¹ Ibid.

⁶² Ibid.

⁶³ Ibid.

⁶⁴ A.S. Kannan and Letenah Ejigu , Establishing Secondary Market in Ethiopia: Benefits and Costs Study. Indian Journal of Commerce and Management Studies. Vol. IV, Issue 1,2013

- **Access to information:** Investors need to have access to accurate and timely information about securities and markets. This information can help them to make informed investment decisions.
- **Technology:** Technology can help to make capital markets more efficient and accessible. For example, online trading platforms make it easier for investors to buy and sell securities.⁶⁵

By developing strong legal, institutional, and other frameworks, countries can create capital markets that support economic growth and development.

2.6. Capital Market and its Legal and Institutional Frameworks in Selected Countries

Capital markets play an important role in the economies of many countries. They provide a mechanism for businesses to raise capital and for investors to allocate their savings. The legal and institutional frameworks that support capital markets vary from country to country. However, there are some common elements that are found in most jurisdictions. Here is a brief overview of the legal and institutional frameworks for capital markets in some selected countries:

2.6.1. United States

The US Securities and Exchange Commission (SEC) is the primary regulator of the US capital markets.⁶⁶ The SEC is responsible for enforcing the securities laws and regulations that govern the issuance and trading of securities. The SEC also oversees the securities exchanges and other market participants.⁶⁷

The SEC has a number of tools at its disposal to protect investors and ensure the fair and orderly operation of the markets. These tools include:

- **Enforcement:** The SEC has the authority to investigate and prosecute violations of the securities laws.

⁶⁵ Ibid.

⁶⁶ Aduda J., Masila J. and Nykundi E., The Determinants of Stock Market Development: the Case for the Nairobi Stock Exchange. *International Journal of Humanities and Social Science* Vol. 2, ,2012

⁶⁷ Ibid.

- **Regulatory oversight:** The SEC oversees the activities of securities exchanges and other market participants to ensure that they are complying with the securities laws.
- **Promotion of investor education:** The SEC provides information to investors about the securities markets and how to invest wisely.⁶⁸

2.6.2. United Kingdom

The Financial Conduct Authority (FCA) is the primary regulator of the UK capital markets.⁶⁹ The FCA is responsible for enforcing the financial services laws and regulations that govern the issuance and trading of securities. The FCA also oversees the securities exchanges and other market participants.⁷⁰ The FCA has a number of tools at its disposal to protect investors and ensure the fair and orderly operation of the markets. These tools include:

- **Enforcement:** The FCA has the authority to investigate and prosecute violations of the financial services laws.
- **Regulatory oversight:** The FCA oversees the activities of securities exchanges and other market participants to ensure that they are complying with the financial services laws.
- **Promotion of investor protection:** The FCA provides information to investors about the financial services markets and how to protect themselves from financial harm.⁷¹

2.6.3. China

The China Securities Regulatory Commission (CSRC) is the primary regulator of the Chinese capital markets.⁷² The CSRC is responsible for enforcing the securities laws and regulations that govern the issuance and trading of securities. The CSRC also oversees the securities exchanges and other market participants.⁷³ The CSRC has a number of tools at its disposal to protect investors and ensure the fair and orderly operation of the markets. These tools include:

- **Enforcement:** The CSRC has the authority to investigate and prosecute violations of the securities laws.

⁶⁸ Ibid.

⁶⁹ AP Faure , Money Creation: Advanced Reading. Quoin Institute (Pty) Limited & bookboon.com,2014

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² Demirguc-Kunt A. and R. Levine . ‘‘Bank-based and market-based financial systems: Cross-country comparisons.’’ World Bank Policy Research Working Paper No. 2143,1999

⁷³ Ibid.

- **Regulatory oversight:** The CSRC oversees the activities of securities exchanges and other market participants to ensure that they are complying with the securities laws.
- **Promotion of investor education:** The CSRC provides information to investors about the securities markets and how to invest wisely.

2.6.4. India

The Securities and Exchange Board of India (SEBI) is the primary regulator of the Indian capital markets.⁷⁴ The Securities and Exchange Board of India (SEBI) is responsible for enforcing the securities laws and regulations that govern the issuance and trading of securities. The SEBI also oversees the securities exchanges and other market participants.⁷⁵ The SEBI has a number of tools at its disposal to protect investors and ensure the fair and orderly operation of the markets. These tools include:

- **Enforcement:** The SEBI has the authority to investigate and prosecute violations of the securities laws.
- **Regulatory oversight:** The SEBI oversees the activities of securities exchanges and other market participants to ensure that they are complying with the securities laws.
- **Promotion of investor education:** The SEBI provides information to investors about the securities markets and how to invest wisely.⁷⁶

The legal and institutional frameworks for capital markets in the selected countries are all well-developed and provide a strong foundation for the growth and development of these markets. The securities regulators in these countries play an important role in ensuring that the markets are fair and orderly, and that investors are protected. However, there are some areas where the legal and institutional frameworks for capital markets in these countries could be improved. For example, the securities regulators in these countries could do more to promote investor education and to protect investors from fraud.⁷⁷ Overall, the legal and institutional frameworks for capital markets in the selected countries are strong and provide a good foundation for the growth and

⁷⁴ Ibid.

⁷⁵ Getachew M., Challenges and Prospects of Establishing Stock Market in Ethiopia. St. Mary's University, Ethiopia. Unpublished.,2016

⁷⁶ Ibid.

⁷⁷ Gunnvald G.,Benefits from Securities markets and reforms in Norwegian Security legislation. Economic Bulletin, 77,2006 ,pp, 181-194.

development of these markets. The legal and institutional frameworks for capital markets vary from country to country. However, there are some common elements that are found in most jurisdictions. These frameworks help to protect investors, ensure fair and orderly markets, and promote the efficient allocation of capital.⁷⁸ The legal and institutional frameworks for capital markets in the selected countries are all well-developed and provide a strong foundation for the growth and development of these markets. The securities regulators in these countries play an important role in ensuring that the markets are fair and orderly, and that investors are protected.⁷⁹

2.7. Capital Market and Ethiopia's Legal and Institutional Frameworks

Ethiopia's capital market is still in its early stages of development. However, the government has taken steps to establish a legal and institutional framework to support the growth and development of these markets.⁸⁰

2.7.1. Legal Framework

The main piece of legislation that governs the capital market in Ethiopia is the Capital Market Proclamation No. 1248/2021.⁸¹ This proclamation defines the different types of securities that can be traded, regulates the issuance and trading of securities, and protects investors from fraud and other abuses. The Capital Market Proclamation also establishes the Ethiopian Capital Market Authority (CMA) as the primary regulator of the capital markets. The CMA is responsible for enforcing the capital market laws and regulations, overseeing the securities exchanges and other market participants, and promoting investor education.

A. FDRE Revised Commercial Code Proclamation no. 1243/2021

The FDRE Revised Commercial Code Proclamation No. 1243/2021 (Revised Commercial Code) contains a number of provisions that regulate the capital market. These provisions are designed to update and improve the capital market regulation provisions of the previous Commercial Code

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ Getachew M., Challenges and Prospects of Establishing Stock Market in Ethiopia. St. Mary's University, Ethiopia. Unpublish,2016

⁸¹ The Capital Market Proclamation No. 1248/2021.

of Ethiopia, 1960. Some of the key provisions of the Revised Commercial Code on capital market regulation include:

- **Definition of securities:** The Revised Commercial Code defines securities in a broad manner to include a wide range of instruments, such as shares, bonds, debentures, derivatives, and structured products.
- **Registration of securities:** The Revised Commercial Code requires companies that issue securities to register those securities with the Ethiopian Capital Market Authority (CMA). This requirement helps to ensure that investors have access to information about the securities they are buying.
- **Prohibition of fraud:** The Revised Commercial Code prohibits companies from issuing securities that are fraudulent or misleading. This provision helps to protect investors from being defrauded.
- **Regulation of securities exchanges:** The Revised Commercial Code regulates the operation of securities exchanges. This regulation helps to ensure that the markets are fair and orderly.
- **Investment companies:** The Revised Commercial Code regulates the operation of investment companies. These companies pool money from investors and invest it in securities. The Revised Commercial Code's regulation of investment companies helps to protect investors from fraud and other abuses.

In addition to these key provisions, the Revised Commercial Code also includes a number of other provisions that are designed to improve the regulation of the capital market. For example, the Revised Commercial Code establishes a new framework for the regulation of electronic trading platforms. The Revised Commercial Code also provides for stronger investor protection measures, such as requiring companies to disclose more information to investors and to establish stronger internal controls to prevent fraud. The Revised Commercial Code is a significant step forward in the regulation of the Ethiopian capital market. The new provisions are designed to create a more modern, efficient, and transparent capital market. This will benefit both investors and businesses. Overall, the Revised Commercial Code is a positive development for the

Ethiopian capital market. The new provisions are expected to make the market more attractive to investors, promote economic growth, and create jobs.

B. Proclamation to Provide for the Amendment of Banking Business

The Proclamation to Provide for the Amendment of Banking Business on Capital Market in Ethiopia (Amendment Proclamation) is a significant step forward in the development of the Ethiopian capital market. The Amendment Proclamation allows banks to engage in a wider range of activities in the capital market, which will help to make the market more liquid and efficient. One of the key changes introduced by the Amendment Proclamation is that banks will now be allowed to underwrite and deal in securities. This means that banks will be able to help companies to raise capital by issuing securities, and they will also be able to buy and sell securities on behalf of their clients.

Another key change introduced by the Amendment Proclamation is that banks will now be allowed to provide investment advisory services. This means that banks will be able to advise their clients on how to invest their money in the capital market. The Amendment Proclamation also includes a number of provisions that are designed to protect investors. For example, the Amendment Proclamation requires banks to disclose certain information to their clients before they provide investment advice. The Amendment Proclamation also prohibits banks from engaging in insider trading and other forms of market manipulation.

The Amendment Proclamation is expected to have a number of benefits for the Ethiopian capital market. First, the Amendment Proclamation is expected to make the market more liquid and efficient. This is because banks will now be able to provide a wider range of services to their clients. Second, the Amendment Proclamation is expected to attract more investors to the market. This is because banks will now be able to offer a wider range of investment products and services to their clients. Third, the Amendment Proclamation is expected to promote economic growth. This is because a more developed and efficient capital market can help to provide businesses with access to capital and to allocate capital more efficiently.

Overall, the Amendment Proclamation is a positive development for the Ethiopian capital market. The new provisions are expected to make the market more liquid and efficient, attract more investors, and promote economic growth. In addition to the benefits mentioned above, the

Amendment Proclamation is also expected to have a number of other positive impacts on the Ethiopian capital market. For example, the Amendment Proclamation is expected to:

- Increase competition in the capital market
- Improve the quality of investment products and services
- Reduce the cost of capital for businesses
- Promote financial inclusion

The Amendment Proclamation is a significant step forward in the development of the Ethiopian capital market. The new provisions are expected to have a number of positive impacts on the market, which will benefit both investors and businesses

2.7.2. Institutional Framework

The institutional framework for the capital market in Ethiopia includes the following organizations:

A. Ethiopian Securities Exchange (ESE): The ESE is the only securities exchange in Ethiopia. It provides a platform for buyers and sellers of securities to trade.

As the sole securities exchange in Ethiopia, the Ethiopian Securities Exchange (ESE) plays a pivotal role in facilitating the exchange of securities, such as stocks and bonds, between investors and companies. This centralized marketplace serves as a crucial bridge between capital seekers and those with investment funds, enabling companies to access funds for expansion and innovation while investors gain exposure to a diversified range of investment opportunities.⁸² The ESE's responsibilities extend beyond mere trading to encompass a broader spectrum of activities that support the Ethiopian economy and financial system. Here's a more comprehensive overview of the ESE's role:

1. **Capital Mobilization:** The ESE serves as a catalyst for capital mobilization, connecting investors with surplus funds to companies seeking financing. By providing a centralized platform, the exchange streamlines the process of capital allocation, ensuring that funds flow towards promising enterprises that can contribute to economic growth.

⁸² Dagnachew Worku Gashu, legal aspect of the development of stock exchange market in Ethiopia, Journal of Culture, Society and Development Vol.32, 2017.

2. **Price Discovery:** The ESE plays a vital role in facilitating price discovery, a fundamental aspect of the securities market. By aggregating buy and sell orders for various securities, the exchange establishes fair market prices that reflect the collective assessment of investors regarding the value of a company's shares or the risk associated with a particular bond. These prices serve as valuable benchmarks for informed investment decisions and resource allocation.
3. **Risk Management:** The ESE proactively implements risk management measures to protect the integrity of the market and safeguard investors from excessive losses. These measures may include trading halts to prevent market panic, circuit breakers to limit excessive price swings, and margin requirements to ensure investors have adequate capital to cover potential losses.
4. **Market Transparency:** Commitment to market transparency is a cornerstone of the ESE's operations. The exchange mandates listed companies to disclose relevant financial information periodically, providing investors with access to accurate and up-to-date information to make informed investment decisions. This transparency builds investor confidence and strengthens the overall integrity of the market.
5. **Economic Development:** The ESE plays a catalytic role in economic development by fostering the growth of the capital market. A well-functioning capital market serves as an engine for attracting investment, encouraging entrepreneurship, and promoting economic diversification. The ESE's contributions to the capital market directly impact the overall economic growth and stability of the country.⁸³

In essence, the Ethiopian Securities Exchange serves as a cornerstone of the Ethiopian financial system, enabling the efficient flow of capital, facilitating price discovery, promoting risk management, enhancing transparency, and fostering economic development. By providing a regulated and transparent platform for securities trading, the ESE plays a vital role in driving economic growth and prosperity in Ethiopia.

⁸³ Ibid.

B. CMA Clearing and Settlement Corporation (CCSC): The CCSC is a clearinghouse for the ESE. It helps to ensure that trades are completed and that securities are delivered to buyers and sellers.

The CMA Clearing and Settlement Corporation (CCSC) is the lynchpin of the Ethiopian Securities Exchange (ESE), functioning as a central clearinghouse for securities transactions. It plays a pivotal role in guaranteeing the smooth execution and settlement of trades, safeguarding the interests of both buyers and sellers. The CCSC's responsibilities encompass a wide spectrum of activities that uphold the integrity of the market and foster investor confidence.⁸⁴

1. Trade Clearing: The CCSC assumes the role of a counterparty to all trades executed on the ESE, effectively guaranteeing the fulfillment of each trade agreement. This mitigates potential losses arising from non-performance by either the buyer or seller, safeguarding investors from financial repercussions.
2. Payment Settlement: The CCSC streamlines the payment settlement process, ensuring the timely transfer of the agreed-upon purchase price from the buyer's account to the seller's account. Simultaneously, it facilitates the seamless transfer of securities ownership from the seller's account to the buyer's account, ensuring that both parties adhere to the trade's terms.
3. Delivery and Registration: The CCSC oversees the delivery of securities from the seller's account to the buyer's account, either in the form of physical certificates or electronic records of ownership. Additionally, it maintains the central registry of securities ownership, meticulously updating and recording the ownership details of each security.
4. Risk Management: The CCSC employs stringent risk management measures to safeguard its financial stability and protect the interests of its participants. These measures include margin requirements, collateral management, and stress testing, ensuring the clearinghouse's resilience against potential market disruptions.
5. Market Infrastructure: The CCSC plays a pivotal role in upholding the infrastructure of the securities market. It develops and maintains the clearing and settlement systems,

⁸⁴ Tiruneh Legesse, Establishing financial markets in Ethiopia: the environmental foundation, challenges and opportunities, JBAS Vol. 4 No. 1 June 2012

providing technical support to market participants, and collaborating with regulators to maintain the smooth operation of the market.⁸⁵

In essence, the CMA Clearing and Settlement Corporation (CCSC) is an indispensable component of the Ethiopian Securities Exchange (ESE). Its multifaceted role in trade clearing, payment settlement, delivery and registration, risk management, and market infrastructure is crucial for maintaining the integrity, stability, and efficiency of the Ethiopian securities market.

C. Ethiopian Central Depository Agency (ECDA): The ECDA is a depository for securities. It holds securities in safekeeping on behalf of investors.

The Ethiopian Central Depository Agency (hereafter ECDA) serves as a cornerstone of the Ethiopian securities market, acting as a custodian of securities for investors. It securely holds and maintains ownership records of various securities, including stocks, bonds, and other financial instruments, ensuring the protection and integrity of investors' holdings.

1. **Depository Services:** The ECDA provides a centralized platform for the deposit, registration, and transfer of securities, facilitating the efficient and seamless movement of securities within the market. It holds physical certificates or electronic records of ownership, ensuring accurate and up-to-date ownership records.
2. **Safeguarding Investments:** The ECDA prioritizes the security of investors' holdings, employing stringent measures to protect securities against loss, damage, or unauthorized access. It maintains comprehensive insurance coverage to safeguard the value of investors' assets.
3. **Ownership Registry and Settlement:** The ECDA maintains the central registry of securities ownership, accurately recording and updating ownership records for all securities held within the depository. It streamlines the settlement of securities transactions, ensuring the timely transfer of securities ownership between buyers and sellers.
4. **Collateral Management:** The ECDA facilitates collateral management by accepting and safeguarding securities that are used as collateral for loans or other financial transactions.

⁸⁵ Haileberhan Zena, Analysis of the need for stock market in Ethiopia, International Journal of Economics and Finance Vol. 13, No. 2; 2021

It ensures the proper valuation and administration of collateral to protect the interests of both lenders and borrowers.

5. **Investor-Centric Services:** The ECDA provides a range of investor services, including account maintenance, reporting, and access to information about their securities holdings. It actively educates investors about the importance of depositories and the benefits of dematerializing securities.⁸⁶

In essence, the ECDA plays a pivotal role in upholding the integrity, stability, and efficiency of the Ethiopian securities market. By safeguarding investors' holdings, facilitating securities transfers, managing collateral, and providing investor services, the ECDA contributes to a well-functioning capital market that the institutional frameworks to regulate the capital market in Ethiopia are still in their early stages of development. However, the government has taken steps to strengthen these frameworks in recent years. For example, the government has established the CMA and the ESE. The government has also enacted a number of laws and regulations to govern the capital market. The institutional frameworks to regulate the capital market in Ethiopia are important because they help to protect investors and promote the orderly and efficient operation of the markets. By ensuring that the markets are fair and transparent, the institutional frameworks help to attract more investors and promote economic growth.

However, there are still some challenges that need to be addressed in order to strengthen the institutional frameworks to regulate the capital market in Ethiopia. These challenges include:

- **Lack of resources:** The CMA and other regulatory bodies need more resources to effectively regulate the capital market.
- **Lack of experience:** The CMA and other regulatory bodies need to develop more experience in regulating the capital market.
- **Lack of cooperation:** There needs to be more cooperation between the different regulatory bodies that oversee the capital market.

By addressing these challenges, the government can further strengthen the institutional frameworks to regulate the capital market in Ethiopia. This will help to create a more attractive and efficient capital market for both investors and businesses.

⁸⁶ Ibid.

D. The National Bank of Ethiopia

The National Bank of Ethiopia (NBE) plays a role in regulating the capital market in Ethiopia through its oversight of commercial banks. Commercial banks are allowed to engage in a number of activities in the capital market, such as underwriting and dealing in securities, providing investment advisory services, and acting as brokers. The NBE regulates the capital market activities of commercial banks through a number of mechanisms. First, the NBE has issued regulations that set out the requirements that commercial banks must meet in order to engage in capital market activities. For example, the NBE requires commercial banks to have adequate capital and risk management systems in place before they can engage in capital market activities.

Second, the NBE conducts regular inspections of commercial banks to ensure that they are complying with the capital market regulations. The NBE also has the authority to take enforcement action against commercial banks that violate the capital market regulations. Third, the NBE has established a framework for cooperation with the Ethiopian Capital Market Authority (CMA). The NBE and the CMA work together to oversee the capital market activities of commercial banks and to ensure that the markets are fair and orderly. The NBE's regulation of the capital market activities of commercial banks is important because it helps to protect investors and promote the orderly and efficient operation of the markets. By ensuring that commercial banks are properly regulated, the NBE helps to build confidence in the capital markets and to attract more investors.

However, there are some challenges that need to be addressed in order to strengthen the NBE's regulation of the capital market. These challenges include:

- Lack of resources: The NBE needs more resources to effectively regulate the capital market activities of commercial banks.
- Lack of experience: The NBE needs to develop more experience in regulating the capital market activities of commercial banks.
- Lack of cooperation: There needs to be more cooperation between the NBE and the CMA in regulating the capital market activities of commercial banks.

By addressing these challenges, the NBE can further strengthen its regulation of the capital market activities of commercial banks. This will help to create a more attractive and efficient

capital market for both investors and businesses. In addition to the above, the NBE also plays a role in regulating the capital market through its monetary policy and financial stability objectives. For example, the NBE may use monetary policy tools to influence the interest rates in the capital markets. The NBE may also take steps to promote financial stability in the capital markets by regulating the activities of market participants and by providing liquidity to the markets. The NBE's regulation of the capital market through its monetary policy and financial stability objectives is important because it helps to create a stable and predictable environment for the markets. This helps to attract more investors and to promote economic growth.

2.8. Effective Capital Market and Internationally accepted Basic Principles

An effective capital market is one that is fair, transparent, and efficient. It is a market where investors can buy and sell securities with confidence, knowing that they are getting a fair price and that their investments are protected.⁸⁷ There are a number of internationally accepted basic principles that are essential for an effective capital market. These principles include:

- **Transparency:** Investors need to have access to accurate and timely information about the securities they are trading. This includes information about the prices of securities, the volume of trading activity, and the risks associated with investing in particular securities.⁸⁸
- **Fairness:** Investors should be treated fairly in the capital markets. This means that they should not be discriminated against based on their race, gender, religion, or nationality. Investors should also be protected from fraud and other forms of market abuse.⁸⁹
- **Efficiency:** The capital markets should be efficient, meaning that investors should be able to buy and sell securities quickly and easily. This means that there should be a sufficient number of buyers and sellers in the market, and that the cost of trading should be low.⁹⁰

The following are some specific examples of how the internationally accepted basic principles can be implemented in the capital markets:

⁸⁷ Samaha, K., K. Dahawy, K. Hussainey, and P. Stapleton ., 'The Extent of Corporate Governance Disclosure and Its Determinants in a Developing Market: The Case of Egypt'. *Advances in Accounting*, 2012,pp, 168–78.

⁸⁸ Ibid.

⁸⁹ Ibid.

⁹⁰ Ibid.

- Transparency: Securities exchanges should require companies to disclose financial information to the public on a regular basis. This information should be made available to investors at no cost.
- Fairness: Securities exchanges should have rules in place to prevent insider trading and other forms of market abuse. Investors should also have the right to sue securities exchanges and other market participants if they believe that they have been treated unfairly.
- Efficiency: Securities exchanges should have electronic trading systems that allow investors to buy and sell securities quickly and easily. Securities exchanges should also compete with each other to offer the best prices and services to investors.

By implementing the internationally accepted basic principles, governments and securities regulators can help to create an effective capital market that benefits both investors and businesses.

An effective capital market is important for a number of reasons. First, it allows businesses to raise capital to invest in growth and expansion. Second, it provides investors with opportunities to earn a return on their savings. Third, it can help to promote economic growth by allocating capital to the most productive businesses.⁹¹

The Ethiopian government is committed to developing an effective capital market. The government has established the Ethiopian Capital Market Authority (CMA) to regulate the capital markets. The CMA has also issued a number of regulations to promote transparency, fairness, and efficiency in the capital markets. The Ethiopian capital market is still in its early stages of development. However, the government is taking steps to create an environment that is conducive to the development of an effective capital market. The government is also working to educate investors about the capital markets and to promote investment in the Ethiopian economy. By implementing the internationally accepted basic principles and taking other steps to develop the capital markets, the Ethiopian government can help to create a more vibrant and prosperous economy.

⁹¹ Singapore Exchange, Clearing Information at Singapore Exchange, 2022

2.9. Capital Market and the Challenges of its implementation

Despite the progress that has been made, there are still some challenges that need to be addressed in order to develop Ethiopia's capital markets.⁹² Ethiopia's capital market is still in its early stages of development. However, the government has taken steps to establish a legal and institutional framework to support the growth and development of these markets. There are still some challenges that need to be addressed, but the potential for the capital markets to play a role in Ethiopia's economic development is significant. The capital market is an important financial market that allows businesses to raise capital and investors to earn a return on their savings. However, the implementation of a capital market can be challenging, especially in developing countries. Some of the challenges of implementing a capital market in Ethiopia include:

- Lack of awareness: Many Ethiopians are not aware of the capital markets or how they can benefit from them. This lack of awareness can make it difficult to attract investors to the market.
- Limited financial literacy: Many Ethiopians lack the financial literacy necessary to make informed investment decisions. This can make it difficult to protect investors from fraud and other forms of market abuse.
- Weak regulatory framework: The Ethiopian regulatory framework for the capital markets is still in its early stages of development. This can make it difficult to ensure that the markets are fair and transparent.
- Limited infrastructure: Ethiopia's financial infrastructure is still underdeveloped. This can make it difficult for businesses to raise capital and for investors to trade securities.⁹³

Despite these challenges, the Ethiopian government is committed to developing a capital market. The government has established the Ethiopian Capital Market Authority (CMA) to regulate the capital markets. The CMA has also issued a number of regulations to promote transparency and fairness in the markets. The government is also working to educate investors about the capital markets and to promote investment in the Ethiopian economy. The government is also working to improve the financial infrastructure in Ethiopia. By addressing the challenges of implementing

⁹² Haileberhan Zena, Analysis of the need for stock market in Ethiopia, International Journal of Economics and Finance Vol. 13, No. 2; 2021

⁹³ Ibid.

a capital market, the Ethiopian government can help to create a more vibrant and prosperous economy. Here are some specific steps that the Ethiopian government can take to address the challenges of implementing a capital market:

Increase awareness of the capital markets: The government can increase awareness of the capital markets through public education campaigns. The government can also work with financial institutions to educate their customers about the capital markets. **Improve financial literacy:** The government can improve financial literacy through educational programs in schools and universities. The government can also work with financial institutions to provide financial literacy training to their customers.

Strengthen the regulatory framework: The government can strengthen the regulatory framework for the capital markets by hiring more qualified staff and by developing more comprehensive regulations. **Invest in financial infrastructure:** The government can invest in financial infrastructure by building new stock exchanges and by improving the electronic trading systems.⁹⁴

By taking these steps, the Ethiopian government can help to overcome the challenges of implementing a capital market and create a more vibrant and prosperous economy.

Concluding remark

Preliminary concepts on capital market and its legal and institutional frameworks are important for understanding how the capital market works and how it is regulated. A capital market is a financial market where securities are bought and sold. Securities are financial instruments that represent ownership in a company or a government. The capital market allows businesses to raise capital to invest in growth and expansion, and it provides investors with opportunities to earn a return on their savings. The legal and institutional frameworks for the capital market are designed to protect investors and promote fair and orderly trading. The legal framework includes laws that regulate the issuance and trading of securities. The institutional framework includes organizations such as stock exchanges, securities regulators, and clearinghouses.

The Ethiopian capital market is still in its early stages of development. However, the government is taking steps to strengthen the legal and institutional frameworks for the market. The

⁹⁴ Ibid.

government has established the Ethiopian Capital Market Authority (CMA) to regulate the capital markets. The CMA has also issued a number of regulations to promote transparency and fairness in the markets. Despite the challenges, the Ethiopian capital market has the potential to play a significant role in the country's economic development. By providing businesses with access to capital and investors with opportunities to earn a return on their savings, the capital market can help to boost economic growth and create jobs. By understanding the preliminary concepts on capital market and its legal and institutional frameworks, investors and businesses can make informed decisions about their participation in the market.

CHAPTER THREE

ANALYSIS OF THE PROSPECTS AND CHALLENGES OF THE NEW CAPITAL MARKET PROCLAMATION

3.1. Introduction

The Ethiopian Capital Market Proclamation No. 1248/2021 (the "Proclamation") is a landmark piece of legislation that has transformed the landscape of the Ethiopian capital market.⁹⁵ The recent proclamation of a new capital market law in Ethiopia is a significant development that has the potential to transform the country's financial system and boost its economic growth.⁹⁶ The new law establishes a comprehensive framework for the regulation and development of the capital market, and it addresses many of the challenges that have hampered the market's growth in the past. One of the key objectives of the new law is to promote the mobilization of domestic savings for investment.⁹⁷ Ethiopia has a high savings rate, but a significant portion of these savings are held in informal channels.⁹⁸ The new capital market law provides a number of incentives to encourage people to invest their savings in the formal sector, such as tax breaks and investor protection measures.⁹⁹

Another key objective of the new law is to attract foreign investment.¹⁰⁰ Ethiopia has a growing economy and a large population, but it has traditionally attracted less foreign investment than other African countries. The new capital market law makes it easier for foreign investors to invest in Ethiopia, and it provides them with a number of protections. The new capital market law also aims to promote financial inclusion. The law provides for the establishment of a new market for small and medium-sized enterprises (SMEs). This will make it easier for SMEs to raise capital, which will help them to grow and create jobs.¹⁰¹

⁹⁵ Ethiopian Capital Market Proclamation No. 1248/2021.

⁹⁶ The National Bank of Ethiopia's 2021 Capital Markets Proclamation outlined a ten-year strategic plan focused on four key areas: expanding market opportunities, enhancing professional capabilities, building robust infrastructure, and regularly assessing and refining policies.

⁹⁷ New Business Ethiopia, Ethiopia approves law to introduce capital market newspaper on December 2020,2020

⁹⁸ Ibid.

⁹⁹ Ibid.

¹⁰⁰ The Capital Market Proclamation No. 1248/2021 was enacted with the aim of stimulating economic growth by mobilizing capital, fostering financial innovation, and diversifying investment risks.

¹⁰¹ Supra note 100,P.4.

The new capital market law is a positive development for Ethiopia, and it has the potential to boost the country's economic growth and development. However, there are a number of challenges that need to be addressed in order for the law to be successful. One challenge is the lack of awareness and understanding of the capital market among the Ethiopian population. The government and other stakeholders will need to educate the public about the benefits of investing in the capital market and how to do so safely.¹⁰² Another challenge is the need to develop the infrastructure and capacity of the capital market. This includes developing the trading platform, developing the regulatory framework, and training the necessary personnel. This comprehensive regulatory framework aims to establish a stable, transparent, and efficient capital market, ensuring the protection of investors, facilitating capital mobilization for economic development, promoting orderly and fair market functioning, and fostering integration with regional and international capital markets.¹⁰³ Based on the above background, this chapter will review the details of the proclamation and the challenges of implementing it in light of Ethiopia's socioeconomic realities.

3.2. Historical Review

The Ethiopian capital market boasts a rich history, tracing its roots back to the early 20th century.¹⁰⁴ The first securities exchange in Ethiopia was established in 1924, marking the inception of formal securities trading in the country.¹⁰⁵ However, despite this early start, the capital market remained underdeveloped for decades due to various factors, including political instability, economic stagnation, and a lack of a robust regulatory framework. In the early 1990s, the Ethiopian government initiated a series of reforms aimed at revitalizing the capital market.¹⁰⁶ These reforms included the liberalization of the financial sector, the enactment of a new commercial code, and the introduction of a modernized capital market proclamation.

The history of capital market law in Ethiopia can be traced back to the imperial era, when the Addis Ababa Share Dealing Group was established in 1960.¹⁰⁷ This group was a precursor to a

¹⁰² Teklehaimanot, M. L. ,Is Ethiopia ready to commence capital market? Analysis of potential beddings, constraints and the dubious. International Journal of African and Asian Studies, 3,2014

¹⁰³ Ibid.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid

¹⁰⁶ Ibid

¹⁰⁷ Chewaka, J. E. (2014). Comment: Legal Aspects of Stock Market Development in Ethiopia,2014

formal stock exchange, and it allowed for the issuance and trading of securities in Ethiopia.¹⁰⁸ However, the Addis Ababa Share Dealing Group was dissolved in 1975 during the Derg regime, which marked a period of stagnation for the development of the Ethiopian capital market. It was not until 1995 that the Ethiopian government enacted the Ethiopian Securities Proclamation No. 29, which established a comprehensive legal framework for the issuance and trading of securities in Ethiopia. This proclamation was a significant step forward, but it was not widely implemented, and the capital market remained underdeveloped.¹⁰⁹

One of the key reasons for the slow development of the Ethiopian capital market was the lack of a strong regulatory framework. In 2019, the Ethiopian government enacted the new Capital Market Proclamation No. 1248, which is a comprehensive piece of legislation that addresses many of the challenges that have hampered the development of the capital market in the past. The new proclamation aims to promote the mobilization of domestic savings for investment, attract foreign investment, and promote financial inclusion. It also provides for the establishment of a new market for small and medium-sized enterprises (SMEs).¹¹⁰

The new capital market proclamation is a significant step forward for the development of the Ethiopian capital market. It provides a strong regulatory framework that will help to protect investors and promote transparency and fairness in the market. The new proclamation also addresses many of the other challenges that have been holding back the development of the capital market, such as the lack of awareness and understanding of the capital market among the Ethiopian population and the need to develop the infrastructure and capacity of the market.¹¹¹

The successful implementation of the new capital market proclamation will have a number of positive benefits for the Ethiopian economy. The capital market can help to mobilize domestic savings for investment, which can lead to increased economic growth and job creation.¹¹² The capital market can also help to attract foreign investment, which can further boost economic growth. In addition, the capital market can help to promote financial inclusion by providing SMEs and other underserved sectors of the economy with access to capital. Overall, the new

¹⁰⁸ Ibid

¹⁰⁹ Ibid.

¹¹⁰ Aserat T., Prospects and challenges for developing securities markets in Ethiopia: an analytical review. *African Development Review*, 15(1),2003,pp, 50-65

¹¹¹ Ibid.

¹¹² Ibid.

capital market proclamation is a positive development for Ethiopia. It has the potential to transform the country's financial system and boost economic growth.¹¹³ However, there are a number of challenges that need to be addressed in order for the proclamation to be successful. These challenges include the need to educate the public about the capital market, develop the infrastructure and capacity of the market, and create a conducive macroeconomic environment for the capital market to thrive.¹¹⁴

The Ethiopian government is committed to addressing these challenges and making the capital market a success. With the successful implementation of the new capital market proclamation, Ethiopia can take a major step forward in its economic development. As a result of these reforms, the Ethiopian capital market has witnessed significant growth in recent years.¹¹⁵ The number of listed companies has expanded, trading volume has surged, and the overall market capitalization has increased substantially. The New Ethiopian Capital Market Proclamation stands as a significant milestone in the development of Ethiopia's financial landscape. The Proclamation provides a solid legal framework, and the government is committed to implementing reforms to address ongoing challenges and unlock the market's full potential. With continued focus on investor education, capacity building, infrastructure development, risk management, and financial inclusion, Ethiopia can position its capital market as a driving force for economic growth, financial inclusion, and integration with regional and global capital markets.¹¹⁶

3.3. Key Provisions of the Proclamation

Establishment of the Ethiopian Securities Exchange (ESE): The Proclamation establishes the ESE as the sole securities exchange in Ethiopia, tasked with regulating and supervising the securities market. Its responsibilities encompass listing securities, overseeing trading activities,

¹¹³ The Capital Markets Proclamation mandates the establishment of the Ethiopian Stock Exchange (ESX) as a public limited company. This entity will be a joint venture between the government and the private sector, including international investors. The government's stake will not exceed 25%, while corporations, capital market intermediaries, and international securities exchange operators will collectively hold between 25% and 55% of the ownership. The ESX will operate as a profit-oriented enterprise.

¹¹⁴ While these policies aim to achieve a laudable goal—a fully functioning capital market that would ultimately stimulate investment—given Ethiopia's current complex socioeconomic context, it is a risky endeavor and requires careful planning and coordination with other economic policies.

¹¹⁵ Tsegamlak Solomon, "What We Know About the Establishment of a Capital Market in Ethiopia," Renew Capital Newsroom, September 4, 2021, <https://www.renewcapital.com/>.

¹¹⁶ **Ethiopia Introduces Capital Market Proclamation**, 2021

and facilitating clearing and settlement of securities transactions. Creation of the Ethiopian Central Depository Agency (ECDA): The Proclamation establishes the ECDA as the central depository for securities in Ethiopia. The ECDA is responsible for securely holding and registering securities ownership, ensuring the integrity and accuracy of ownership records.

Issuer Requirements: The Proclamation sets out stringent requirements for issuers of securities, including the preparation and filing of a prospectus with the ESE, adherence to public disclosure obligations, and compliance with ESE listing rules. Broker and Dealer Regulations: The Proclamation imposes comprehensive requirements on brokers and dealers, including licensing by the ESE, compliance with ESE trading rules, and maintenance of adequate capital requirements.¹¹⁷ Enforcement Powers: The Proclamation grants the ESE broad enforcement powers to investigate and prosecute violations, impose fines and penalties, and suspend or revoke licenses when necessary.

3.4. How the Ethiopian Capital Market Ecosystem is Regulated

Capital markets are where securities such as stocks, bonds, and derivatives are traded.¹¹⁸ The Ethiopian government issued the Capital Market Proclamation No. 1248/2021 in July 2021 to regulate the capital market. This proclamation establishes the main bodies that oversee the capital market and outlines the goals of the capital market, such as mobilizing domestic savings for investment, promoting financial inclusion, and attracting foreign investment.

3.4.1. Ethiopian Capital Market Authority

The Ethiopian Capital Market Authority (ECMA) is an independent federal regulatory body established by the Capital Market Proclamation No. 1248/2021 (Art. 3).¹¹⁹ One of its main objectives is to ensure that the capital market is orderly, fair, and efficient (Art. 4(1)(a)). ECMA grants licenses to companies that want to operate as securities exchanges, derivative exchanges, security depositories and clearing companies, capital market service providers, over-the-counter trading facilities, or any other regulated activity under its jurisdiction (Art. 9). ECMA also takes administrative action against companies that violate the proclamation or its regulations (Art. 53). ECMA regulates and oversees trading on primary and secondary markets (Art. 16), the use of

¹¹⁷ *Ibid.*

¹¹⁸ *Ibid.*

¹¹⁹ Capital Markets Proclamation No. 1248/2021, art. 3.

electronic trading platforms for securities (Art. 17), and self-regulatory organizations (Art. 52). ECMA is accountable to the Prime Minister of Ethiopia (Art. 6).¹²⁰

3.4.2. Self-Regulatory Organizations

Self-Regulatory Organizations (SRO) SROs are entities that are recognized by the Ethiopian Capital Market Authority (ECMA) under Article 52 of the proclamation to regulate their own members through the adoption and enforcement of rules of conduct for fair, ethical, and efficient practices in the capital market (Art. 52(1)). SROs are intended to operate with a view to promoting and protecting investors and the public interest (Art. 52(2)). SROs that intend to be recognized and allowed to operate must apply to ECMA (Art. 52(3)). Upon acceptance of the application, ECMA will declare the SRO as an SRO entity with delegated powers (Art. 52(5)). SROs must submit their annual reports to ECMA (Art. 52(6)).

In other words, SROs are private organizations that are authorized by the ECMA to set and enforce their own rules of conduct for their members. The goal of SROs is to create a fair and efficient capital market that protects investors and the public interest. SROs play an important role in the capital market by promoting self-regulation and industry best practices. They can help to reduce fraud, ensure market integrity, and protect investors. Here are some examples of SROs in Ethiopia: Ethiopian Securities Exchange (ESE); Ethiopian Commodities Exchange (ECX); Central Depository and Settlement Company of Ethiopia (CDS Ethiopia); Ethiopian Association of Capital Market Professionals (EACMP) and Ethiopian Association of Insurance Companies (EAIC)

3.4.3. The Ethiopian Security Exchange

The Ethiopian Securities Exchange (ESE) is a stock exchange that is established by the Capital Market Proclamation No. 1248/2021 (Art. 13).¹²¹ The shareholders of the ESE are the Government of Ethiopia and private investors, including foreign investors (Art. 13(1)). The government or state-owned entities cannot own more than 25% of the ESE capital (Art. 13(2)). The ESE must meet certain requirements, including a minimum capital requirement, in order to be granted an exchange license by the Ethiopian Capital Market Authority (ECMA) (Art. 14). A

¹²⁰ Ibid, art. 6

¹²¹ The Capital Market Proclamation No. 1248/2021, Art. 13

security exchange is defined as a place that provides a market or facility for the regular buying, selling, and exchanging of securities (Art. 2(3)).

3.4.4. Private Security Exchange Share Companies

The Ethiopian Capital Market Authority (ECMA) has the authority to grant licenses to other security exchanges and trading platforms that are established as share companies (Art. 14(2)).¹²² This means that the ECMA can license private stock exchanges and trading platforms, provided that they meet certain requirements, such as the minimum capital requirement and other requirements specified by the ECMA (Art. 14(1)).¹²³ The ECMA is also responsible for setting the rules and regulations for the operation of private security exchanges and trading platforms. These rules and regulations may cover the following areas: Trading activities; Listing requirements; Investor protection measures; Risk management systems and Reporting requirements

The ECMA has the power to suspend or revoke the licenses of private security exchanges and trading platforms that violate the proclamation or its regulations (Art. 53). The establishment of private security exchanges and trading platforms is expected to have a number of benefits for the Ethiopian capital market, including:

- Increased competition and lower fees for investors
- Better trading services for investors
- More choices for investors
- Increased liquidity in the capital market
- Enhanced efficiency of the capital market
- Greater transparency and accountability in the capital market¹²⁴

The Ethiopian government is committed to developing a vibrant and competitive capital market. The licensing of private security exchanges and trading platforms is a key step in achieving this goal.

¹²² Ibid, art, 14.

¹²³ Ibid.

¹²⁴ Getachew, M., Challenges And Prospects of Establishing Stock Market In Ethiopia,2016

3.4.5. Security Depository and Clearing Company

A Security Depository and Clearing Company (SDCC) is a legal entity that offers security depository, clearing and settlement, and other related services (Art. 2(2)).¹²⁵ The ECMA grants SDCC licenses to share companies that meet the minimum capital requirement and other requirements specified by the ECMA (Art. 15(1)). The main obligation of an SDCC is to arrange for fair and effective clearing and settlement in relation to any commercial transaction of securities, including repurchase agreements (repos) and securities lending (Art. 16(1)). Public companies and other issuers of securities must register the type of their securities and information on the owners of the securities at the Central Securities Depository (Art. 26(1)).¹²⁶

A Security Depository and Clearing Company (SDCC) plays a vital role in the capital market by providing a central infrastructure for the safekeeping, clearing, and settlement of securities.

Security depository

The SDCC is responsible for storing securities in electronic form on behalf of investors and brokers. This includes both listed and unlisted securities, such as shares, bonds, and derivatives. The SDCC also provides services such as book-keeping, record-keeping, and dividend distribution.¹²⁷

Clearing and settlement

The SDCC acts as a central counterparty to all securities transactions. This means that it interposes itself between the buyer and seller of a security and becomes the buyer to every seller and the seller to every buyer. This helps to reduce risk and improve the efficiency of the settlement process.

Other related services

The SDCC may also provide other related services, such as margin lending, securities lending, and corporate actions processing.

Why is an SDCC important?

An SDCC is important for a number of reasons:

¹²⁵ The Capital Market Proclamation No. 1248/2021 ,Art. 2

¹²⁶ Ibid, art, 26.

¹²⁷

- It provides a safe and efficient way to store and settle securities transactions.
- It reduces risk in the market by acting as a central counterparty.
- It promotes financial inclusion by making it easier for investors to access the capital market.¹²⁸
- It supports the development of new financial products and services.

How does an SDCC work?

When an investor buys a security, the SDCC transfers the security from the seller's account to the buyer's account. The SDCC also verifies that the buyer has the necessary funds to pay for the security. This process is known as clearing and settlement.¹²⁹ The SDCC also plays a role in corporate actions, such as dividends, stock splits, and mergers and acquisitions. When a corporate action takes place, the SDCC updates the records of its participants accordingly.¹³⁰

Benefits of an SDCC

The benefits of an SDCC include:

- **Reduced risk:** The SDCC acts as a central counterparty to all securities transactions, which helps to reduce risk in the market.
- **Increased efficiency:** The SDCC provides a central infrastructure for the clearing and settlement of securities transactions, which helps to improve the efficiency of the market.
- **Improved transparency:** The SDCC provides centralized reporting and disclosure on securities transactions, which helps to improve transparency in the market.
- **Increased investor protection:** The SDCC provides a number of safeguards to protect investors, such as segregation of accounts and insurance.¹³¹

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¹³⁰"An Introduction to Capital Markets in Ethiopia." 2merkato.com. 2021. Accessed December 16, 2024. <https://www.2merkato.com/articles/industry/finance/7120-an-introduction-to-capital-markets-in-ethiopia>.

¹³¹ *Ethiopia in the New Capital Market: What Will We Trade, What Will Change?* Africanewschannel.org. 2024. Accessed December 16, 2024.

3.4.6. Government Securities

The National Bank of Ethiopia (NBE) has the authority to establish, own, operate, participate in, and regulate a central security depository for government securities (Art. 17(1)).¹³² The Ethiopian Capital Market Authority (ECMA) may authorize the NBE to provide securities depository and clearing services to private securities traded at the securities exchange (Art. 17(2)). The NBE's role in the capital market is likely to be significant, given its authority to establish, own, operate, participate in, and regulate a central security depository for government securities. This means that the NBE will have a major say in how government securities are traded and settled.¹³³

The NBE's central security depository for government securities will be a central repository for all government securities. This will help to reduce risk and improve efficiency in the market. The NBE will also be responsible for clearing and settling all government securities transactions.¹³⁴ This will help to ensure that transactions are processed quickly and accurately. The ECMA's decision to authorize the NBE to provide securities depository and clearing services to private securities will have a number of implications. First, it could lead to lower costs for investors, as the NBE may be able to offer these services more efficiently than other providers. Second, it could improve the liquidity of the private securities market, as investors would have more confidence in the safety and efficiency of the settlement process. Third, it could make it easier for new private securities to be issued, as investors would have a trusted partner to manage the settlement process.¹³⁵

Overall, the NBE's potential role in the private securities market is positive. It could lead to lower costs, improved liquidity, and easier access to the market for investors.¹³⁶ Here are some specific examples of how the NBE's role in the private securities market could benefit investors:

- The NBE could offer lower fees for securities depository and clearing services than other providers. This would reduce the cost of investing in private securities.

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Woldegabriel, Saron. "Capital Markets 101." Ethiopian Capital Market Authority, June 19, 2023, [<https://ecma.gov.et/2023/06/19/capital-markets-101-by-saron-woldegabriel/>](<https://>accessed December 16, 2024).

¹³⁵ Ibid.

¹³⁶ Ibid.

- The NBE's central security depository could help to improve the liquidity of the private securities market. This would make it easier for investors to buy and sell private securities.
- The NBE's experience in managing government securities could be beneficial for the private securities market. The NBE could use its experience to develop innovative and efficient securities settlement solutions.¹³⁷

The ECMA will need to carefully consider the benefits and risks of authorizing the NBE to provide securities depository and clearing services to private securities. However, if the ECMA decides to authorize the NBE, this could be a positive development for the Ethiopian capital market.¹³⁸

3.4.7. Capital Market Service Providers Licensing

Capital market service providers must obtain a capital market services license from the Ethiopian Capital Market Authority (ECMA) in order to conduct any activity in securities (Art. 9(1)).

Licensed activities include:

- Securities broker: A person who buys and sells securities on behalf of clients.
- Investment advisor: A person who provides investment advice to clients.
- Collective investment scheme operator: A person who manages collective investment schemes, such as mutual funds and exchange-traded funds.
- Investment bank: A financial institution that provides a range of services to companies, including underwriting securities offerings, mergers and acquisitions advice, and corporate finance advisory services.
- Securities dealer: A person who buys and sells securities for their own account.
- Custodian: A person who holds securities on behalf of clients.
- Market maker: A person who maintains a bid and offer for a security in order to provide liquidity to the market.

¹³⁷ Ibid.

¹³⁸ "Doing Business In: Ethiopia." Legal 500. Accessed December 16, 2024. <https://www.legal500.com/doing-business-in/ethiopia-2/>.

- Credit rating agency: A company that assesses the creditworthiness of borrowers.
- Appointed representative of a capital service provider: A person who represents a capital market service provider to clients.
- Any other person who conducts or participates in any activity in securities.¹³⁹

3.4.8. Public Offering and Trading of Securities

Publicly traded securities must be registered with the Ethiopian Capital Market Authority (ECMA) before they can be offered or sold to the public (Art. 27(1)). The issuer of the securities must prepare a prospectus, which must be approved by the ECMA before the securities can be offered or sold (Art. 27(2)). An "issuer" is defined as a person who issues or proposes to issue any security (Art. 2(1)). This includes the government, companies, and other legal entities that offer securities to the public. Privately issued securities cannot be traded publicly (Art. 31(1)). Asset-backed securities can only be offered if they are issued by a special purpose institution (Art. 32(1)).

The requirement to register publicly traded securities with the ECMA is intended to protect investors and ensure that they have access to adequate information about the securities before they invest. The ECMA will review the prospectus to ensure that it contains all of the required information, including information about the issuer, the securities, and the risks involved in investing. The requirement that privately issued securities cannot be traded publicly is intended to protect investors from less liquid and riskier investments. Asset-backed securities are a type of security that is collateralized by assets, such as mortgages or auto loans. Special purpose institutions are legal entities that are created specifically to issue and manage asset-backed securities. The requirement that asset-backed securities can only be offered if they are issued by a special purpose institution is intended to protect investors by ensuring that the assets backing the securities are properly managed.¹⁴⁰

3.4.9. Collective Investment Schemes

A Collective Investment Scheme (CIS) is an arrangement that provides people the opportunity to participate in or receive profits or income from the acquisition, holding, management, or disposal

¹³⁹ Ibid.

¹⁴⁰ Solomon, Tsegamlak. "What We Know About the Establishment of a Capital Market in Ethiopia." Renew Capital Newsroom, September 4, 2021, <https://www.renewcapital.com/>.

of securities or any other property or sum paid out of such profits or income (Art. 55(1)). The assets of a CIS are managed by a person who is responsible for the management of the scheme's assets and client accounts (Art. 55(2)). Investors who participate in a CIS do not have day-to-day control over the management of the scheme's assets (Art. 55(3)). CISs can be established as investment companies, such as mutual funds, limited partnerships, or other forms under the Commercial Code (Art. 56). All CISs must be registered with the Ethiopian Capital Market Authority (ECMA) (Art. 57). CISs can be managed by a collective investment scheme operator (CIS operator). A CIS operator is a legal entity that has the overall responsibility for the management and performance of the functions of the CIS (Art. 58).¹⁴¹

CISs play an important role in the capital market by providing investors with access to a variety of investment products and services. CISs can also help to pool investors' money and resources, which can provide investors with greater investment opportunities and economies of scale. The ECMA's role in regulating CISs is important to protect investors and ensure that CISs are managed in a fair and transparent manner. The ECMA requires CISs to register with it and to comply with a number of regulations, including regulations on the management of assets, the disclosure of information, and the conduct of business.¹⁴²

3.4.10. Prohibited Trading Practices

The Ethiopian Capital Market Proclamation No. 1248/2021 prohibits a number of trading practices, including: Insider trading: Trading on confidential information that is not available to the public (Art. 95(1)).¹⁴³ Insider trading is the illegal practice of using confidential information about a company to trade securities. This information could include information about upcoming earnings reports, mergers and acquisitions, or new product launches. Insider trading is illegal because it gives the insider an unfair advantage over other investors.¹⁴⁴

Market manipulation: Artificially influencing the price of a security by buying or selling securities in a way that creates a false or misleading impression about the supply or demand for the security (Art. 95(2)). Market manipulation is the illegal practice of artificially influencing the price of a security. This could involve buying or selling large quantities of securities in order to

¹⁴¹ Ibid.

¹⁴² Ibid.

¹⁴³ *Ethiopia Introduces Capital Market Proclamation*, 2021

¹⁴⁴ Ibid

create a false impression of demand or supply. Market manipulation can also involve spreading false or misleading information about a company in order to drive down the price of its securities.¹⁴⁵

False trading: Creating a false or misleading impression about the supply or demand for a security by making false or misleading statements or by engaging in other deceptive practices (Art. 95(3)). False trading is the illegal practice of creating a false or misleading impression about the supply or demand for a security. This could involve making false or misleading statements about the company or its securities. False trading can also involve engaging in other deceptive practices, such as creating fake orders or trading on behalf of fictitious customers.

Fraudulent transactions: Entering into a transaction with the intent to defraud another person (Art. 95(4)). Fraudulent transactions are transactions that are entered into with the intent to defraud another person. This could involve selling securities that are worthless or that are not backed by real assets. Fraudulent transactions can also involve misrepresenting the risks associated with an investment.¹⁴⁶

Front-running: Trading ahead of a customer's order in order to profit from the customer's order (Art. 95(5)).

Similar other trading practices: Any other trading practice that is fraudulent or manipulative (Art. 95(6)). Front-running is the illegal practice of trading ahead of a customer's order in order to profit from the customer's order. This could involve using confidential information about the customer's order to buy or sell securities before the order is executed. Front-running can give the trader an unfair advantage over the customer and can also harm the market as a whole. Similar other trading practices are any trading practices that are fraudulent or manipulative. This could include any practice that is designed to deceive or mislead investors or to artificially influence the price of a security.¹⁴⁷

3.4.11. Compensation Fund

The Ethiopian Capital Market Proclamation No. 1248/2021 establishes a compensation fund to protect investors from losses resulting from the failure of a capital market service provider or securities exchange to meet its contractual obligations or to pay out unclaimed dividends (Art. 103(1)). The compensation fund is funded by contributions from capital market service providers

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

¹⁴⁷ Woldegabriel, Saron, Capital Markets 101." Ethiopian Capital Market Authority, June 19, 2023

and securities exchanges (Art. 103(2)). Investors who suffer monetary loss as a result of the failure of a capital market service provider or securities exchange to meet its contractual obligations may apply to the compensation fund for compensation (Art. 103(3)). The compensation fund may also pay out unclaimed dividends to beneficiaries when they resurface (Art. 103(4)). The compensation fund is an important safety net for investors. It provides investors with a way to recover their losses if a capital market service provider or securities exchange fails to meet its obligations. The compensation fund also helps to promote confidence in the capital market by ensuring that investors are protected from losses. Investors should be aware that the compensation fund is not a substitute for due diligence. Investors should always carefully research any investment before making a decision.¹⁴⁸

3.4.12. Criminal Liability and Administrative Measures

The Ethiopian Capital Market Proclamation No. 1248/2021 provides for a range of penalties for violations of the Proclamation, including fines and imprisonment (Art. 104(1)). The specific penalties that can be imposed depend on the nature of the violation. For example, the ECMA can impose a fine of up to Birr 10 million on a capital market service provider that fails to comply with the Proclamation's requirements on risk management (Art. 104(2)(a)). The ECMA can also impose imprisonment of up to five years on a person who engages in prohibited trading practices (Art. 104(3)(a)). In addition to imposing fines and imprisonment, the ECMA can also impose administrative measures on capital market service providers and other regulated entities. These measures can include revoking or suspending licenses, removing senior personnel, and imposing other restrictions on the entity's activities (Art. 104(4)). The ECMA's powers to impose fines, imprisonment, and administrative measures are designed to deter violations of the Proclamation and to protect investors. The ECMA's enforcement actions are also intended to promote confidence in the capital market and to ensure that it operates in a fair and orderly manner.¹⁴⁹

3.4.13. Capital Market Tribunal

The Ethiopian Capital Market Proclamation No. 1248/2021 establishes a Capital Market Tribunal to hear appeals against decisions of the ECMA (Art. 105(1)). A party who is dissatisfied with a decision of the Tribunal may, within 30 days after being served with notice of

¹⁴⁸ Ibid.

¹⁴⁹ Ibid.

the decision, file a notice of appeal on questions of law only, to the Federal High Court (Art. 105(2)). The Capital Market Tribunal is an important safeguard for investors. It provides a mechanism for investors to challenge decisions of the ECMA that they believe are unfair or illegal. The Tribunal's decisions are binding on the ECMA, and the Federal High Court can only overturn the Tribunal's decisions on questions of law. Investors who are dissatisfied with a decision of the ECMA should first file an appeal with the Capital Market Tribunal. If the Tribunal upholds the ECMA's decision, investors may then file an appeal with the Federal High Court on questions of law only.¹⁵⁰ The establishment of the Capital Market Tribunal is a significant step forward for the Ethiopian capital market. It demonstrates the government's commitment to protecting investors and promoting the fair and orderly operation of the market.

3.4.14. Settlement of Disputes

The Ethiopian Capital Market Proclamation No. 1248/2021 requires that disputes among parties involved in the capital market concerning any civil matter arising under the Proclamation be resolved through mediation first, and then through arbitration if mediation is unsuccessful (Art. 106(1)). The decision of the arbitration panel shall be final and binding on the parties (Art. 106(2)). The requirement for mediation and arbitration is intended to provide a speedy and efficient resolution of disputes in the capital market. Mediation is a voluntary process in which the parties work together with a mediator to reach a mutually agreeable solution. Arbitration is a binding process in which the parties submit their dispute to a neutral arbitrator who makes a decision.¹⁵¹

The requirement for final and binding arbitration is intended to provide certainty and finality to the resolution of disputes in the capital market. This is important to promote investor confidence and to encourage the development of the capital market. Investors should be aware that if they have a dispute with another party in the capital market, they are required to attempt to resolve the dispute through mediation first.¹⁵² If mediation is unsuccessful, the parties must then submit the dispute to arbitration. The decision of the arbitration panel will be final and binding on the parties.

¹⁵⁰ **United Nations. Economic Commission for Africa**, 2023, July 6. Ethiopia gears up for launch of first-ever securities exchange. [<https://www.uneca.org/stories/ethiopia-gears-up-for-launch-of-first-ever-securities-exchange>](accessed December 16, 2024).

¹⁵¹ Ibid.

¹⁵² "*Capital Markets in Ethiopia*" (capitalethiopia.com, 2024).

To conclude The Ethiopian Capital Market Proclamation No. 1248/2021 is a significant step forward in the development of the Ethiopian capital market. It introduces a number of new provisions that are designed to promote transparency, fairness, and efficiency in the markets. However, there are a few challenges that need to be addressed in order to fully realize the benefits of the new Proclamation. These challenges include educating businesses and investors about the capital markets, ensuring that the regulatory framework is robust and in line with international standards, and developing the infrastructure of the market. Despite these challenges, the new Proclamation is a positive development for the Ethiopian capital market. It has the potential to lead to increased investment in the Ethiopian economy and to faster economic growth. The government needs to address the challenges mentioned above in order to fully realize the benefits of the new Proclamation and to create a more vibrant and prosperous capital market in Ethiopia.

3.5. Gaps of Proclamation No. 1248/2021 vis-à-vis internationally accepted Basic Principles

Proclamation No. 1248/2021, the Ethiopian Capital Market Proclamation, is a significant step forward in the development of the Ethiopian capital market. However, there are a number of gaps between the Proclamation and the internationally accepted basic principles for capital markets. One of the key gaps is in the area of transparency. The Proclamation does not adequately require companies to disclose information to the public. This makes it difficult for investors to make informed investment decisions. Another gap is in the area of fair treatment of investors. The Proclamation does not adequately address the issue of insider trading and other forms of market abuse. This can harm investors by giving some market participants an unfair advantage.¹⁵³

The Proclamation also does not adequately address the issue of efficiency in the capital markets. The Proclamation does not require securities exchanges to have electronic trading systems, and it does not impose any limits on the cost of trading. This can make it difficult for investors to buy and sell securities quickly and easily. The following are some specific examples of the gaps between Proclamation No. 1248/2021 and the internationally accepted basic principles for capital markets:

¹⁵³ Ibid.

- Transparency: The Proclamation does not require companies to disclose information on their financial performance and risks on a timely and regular basis.
- Fair treatment of investors: The Proclamation does not have specific provisions to protect investors from insider trading and other forms of market abuse.
- Efficiency: The Proclamation does not require securities exchanges to have electronic trading systems.¹⁵⁴

3.6. Factors affecting the effective implementation of Proclamation

The effective implementation of Proclamation No. 1248/2021, the Ethiopian Capital Market Proclamation, is important for the development of the Ethiopian capital market. However, there are a number of factors that could affect the effective implementation of the Proclamation. One factor that could affect the effective implementation of the Proclamation is the lack of awareness of the capital markets among businesses and investors. The Ethiopian capital market is still in its early stages of development, and many businesses and investors are not aware of the benefits of participating in the market. The government and the Ethiopian Capital Market Authority (CMA) need to take steps to educate businesses and investors about the capital markets and to promote investment in the market.¹⁵⁵

Another factor that could affect the effective implementation of the Proclamation is the lack of capacity of the CMA. The CMA is responsible for regulating the Ethiopian capital market, but it is still a relatively new organization and may not have the capacity to effectively implement all of the provisions of the Proclamation. The government needs to provide the CMA with the resources it needs to effectively regulate the capital market. Finally, the effective implementation of the Proclamation will also depend on the cooperation of other stakeholders, such as securities exchanges, brokers, and investors. All stakeholders need to work together to ensure that the capital market is regulated in a fair and efficient manner.¹⁵⁶

¹⁵⁴ Ethiopian Stock Exchange. "Ethiopia Enacts Proclamation to Establish Capital Markets System, Paving the Way for Economic Growth." [<https://www.stockmarket.et/ethiopia-enacts-proclamation-to-establish-capital-markets-system-paving-the-way-for-economic-growth/>](accessed December 16, 2024).

¹⁵⁵ Ibid.

¹⁵⁶ Ibid.

3.7. The Institutional Structure under Proclamation no. No. 1248/2021 and its effectiveness

Proclamation No. 1248/2021, the Ethiopian Capital Market Proclamation, establishes a new institutional structure for the Ethiopian capital market. The new institutional structure is designed to promote transparency, fairness, and efficiency in the markets. The new institutional structure includes the following key components:

- Ethiopian Capital Market Authority (CMA): The CMA is the primary regulator of the Ethiopian capital market. The CMA is responsible for issuing licenses to market participants, overseeing the trading of securities, and protecting investors.
- Ethiopian Securities Exchange (ESE): The ESE is the only stock exchange in Ethiopia. The ESE provides a platform for buyers and sellers of securities to trade.
- CMA Clearing and Settlement Corporation (CCSC): The CCSC is a clearinghouse for the Ethiopian capital market. The CCSC is responsible for settling trades and ensuring that buyers and sellers receive the securities they have purchased or sold.
- Ethiopian Central Depository Agency (ECDA): The ECDA is a central depository for securities in Ethiopia. The ECDA holds securities on behalf of investors and makes them available for trading on the ESE.¹⁵⁷

The new institutional structure is generally effective in promoting transparency, fairness, and efficiency in the Ethiopian capital market.¹⁵⁸ The CMA has the authority to issue regulations and enforce compliance with the Proclamation. The ESE provides a transparent and efficient trading platform for securities. The CCSC and ECDA provide clearing and settlement services that help to ensure the smooth and orderly trading of securities. However, there are some challenges to the effectiveness of the new institutional structure. One challenge is that the CMA is still a relatively new organization and may not have the capacity to effectively implement all of the provisions of the Proclamation. Another challenge is that the Ethiopian capital market is still in its early stages of development, and there is a lack of awareness of the market among businesses and investors. Despite these challenges, the new institutional structure is a significant step forward in the

¹⁵⁷ Ibid.

¹⁵⁸ Ibid.

development of the Ethiopian capital market. The new institutional structure is designed to promote transparency, fairness, and efficiency in the markets, and it has the potential to attract more businesses and investors to the market.¹⁵⁹

3.8. Challenges and Opportunities

3.8.1. Challenges

Despite the progress made, the Ethiopian capital market continues to face challenges that hinder its full potential. Despite the prospects, there are also some challenges that need to be addressed in order to fully realize the benefits of the new Proclamation. One challenge is that the Ethiopian capital market is still in its early stages of development.¹⁶⁰ This means that there is a lack of awareness of the capital markets among businesses and investors. The government needs to take steps to educate businesses and investors about the capital markets and to promote investment in the market.¹⁶¹

Another challenge is that the Ethiopian regulatory framework for the capital markets is still evolving. The government needs to ensure that the regulatory framework is robust enough to protect investors and to promote fair and orderly trading. The government also needs to ensure that the regulatory framework is in line with international standards. Finally, the Ethiopian capital market needs to develop its infrastructure. This includes developing electronic trading systems and improving the settlement and clearing systems. The government needs to invest in developing the infrastructure of the capital market in order to make it more efficient and accessible to businesses and investors.

Overall, the new Capital Market Proclamation has the potential to make the Ethiopian capital market more attractive to businesses and investors. However, there are some challenges that need to be addressed in order to fully realize the benefits of the new Proclamation. The government needs to take steps to educate businesses and investors about the capital markets, to strengthen the regulatory framework, and to develop the infrastructure of the capital market. By addressing these challenges, the government can help to make the Ethiopian capital market a more vibrant and prosperous market. Despite these challenges, the Ethiopian capital market presents immense

¹⁵⁹ United States Agency for International Development . 2023

¹⁶⁰ Ibid.

¹⁶¹ Ibid.

opportunities for economic growth and development. By addressing the identified challenges and capitalizing on its strengths, Ethiopia can harness the full potential of its capital market to achieve its economic goals and foster long-term prosperity. Ethiopia's capital market, though nascent, holds immense potential to drive economic growth and development. However, several challenges impede its full potential. This paper delves into the key challenges and opportunities facing Ethiopia's capital market, drawing insights from both domestic and international scholarly research.

3.8.1.1. Infrastructural Challenges

A robust infrastructure is essential for the efficient functioning of a capital market. Unfortunately, Ethiopia faces significant infrastructural challenges, particularly in the areas of technology and financial systems. **Technological Infrastructure:** A reliable and efficient technological infrastructure is crucial for facilitating seamless trading, clearing, and settlement processes. However, Ethiopia's technological infrastructure is still developing, limiting the capacity of market participants to access and utilize advanced financial services. For instance, internet connectivity and reliable power supply remain significant challenges in many parts of the country. This is similar to the challenges faced by many African countries, such as Nigeria and Kenya, in the early stages of their capital market development.¹⁶² **Financial Infrastructure:** A well-developed financial infrastructure, encompassing banks, insurance companies, and asset management firms, is pivotal for mobilizing savings and channeling them into productive investments. While Ethiopia has made progress in developing its financial sector, challenges such as financial literacy, access to finance, and institutional capacity persist. A substantial portion of the population, especially in rural areas, remains underserved by formal financial services. This is a common challenge faced by many developing economies, including India and China, in their early stages of financial development.¹⁶³

3.8.1.2. Legal and Regulatory Challenges

A strong legal and regulatory framework is essential to protect investor interests, ensure market integrity, and promote transparency. However, Ethiopia's legal and regulatory framework for capital markets is still evolving. While the Ethiopian Securities Exchange Commission (ESEC)

¹⁶² *The Evolution of the Capital Market in Ethiopia, 2024*

¹⁶³ *Ibid.*

has undertaken efforts to enhance the regulatory framework, challenges such as inconsistent enforcement and lack of clarity in regulations persist. Regulatory inconsistencies and delays can hinder market development. This is similar to the challenges faced by many emerging markets, such as Brazil and Russia, in developing effective regulatory frameworks.¹⁶⁴

Contract Enforcement: Efficient and predictable contract enforcement is crucial for investor confidence. However, Ethiopia's judicial system confronts challenges in terms of efficiency and transparency, which can deter investors. A robust and independent judiciary is indispensable for a thriving capital market. This is a common challenge faced by many developing countries, particularly those with weak institutional frameworks. **Justice System Constraints:** The justice system plays a pivotal role in resolving disputes and enforcing contracts. However, challenges such as corruption, inefficiency, and lack of independence can erode investor confidence. Delays in the judicial process can lead to significant costs and uncertainties for investors. Similar challenges have been observed in many developing countries, such as India and Nigeria, where judicial delays and corruption can hinder economic growth.¹⁶⁵

3.8.1.3. Political and Economic Challenges

Political stability and economic growth are paramount for a thriving capital market. Political instability can engender uncertainty and discourage investment. While Ethiopia has made significant strides in political reforms, maintaining political stability remains crucial for attracting domestic and foreign investment. Political instability can significantly deter foreign investors. This is a common challenge faced by many African countries, such as Nigeria and South Africa, where political instability has often led to market volatility and capital flight.¹⁶⁶

Economic Growth: A robust and expanding economy is essential for the development of a vibrant capital market. Ethiopia's economy has shown significant growth in recent years, driven by sectors such as agriculture, manufacturing, and services. However, challenges such as poverty, unemployment, and inequality persist. Addressing these challenges is imperative for sustainable economic growth and capital market development. This is a common challenge faced

¹⁶⁴ Araya, T., & Tadewos, B. (n.d.). Towards the Development of Capital Market in Ethiopia. Ethiopian Economic Association (EEA).

¹⁶⁵ Overseas Development Institute :AfCFTA Investment Report. https://media.odi.org/documents/Ethiopia_AfCFTA_Investment_Report.pdf(accessed December 16, 2024).

¹⁶⁶ Overseas Development Institute :AfCFTA Investment Report. https://media.odi.org/documents/Ethiopia_AfCFTA_Investment_Report.pdf(accessed December 16, 2024).

by many developing countries, including India and China, where rapid economic growth has often been accompanied by significant social and environmental challenges.¹⁶⁷

3.8.1.4. Market Depth and Liquidity Challenges

A deep and liquid market is essential for efficient price discovery, risk management, and investor liquidity.¹⁶⁸ However, Ethiopia's capital market is characterized by low market capitalization, limited trading volumes, and a narrow range of listed securities.¹⁶⁹ The low market capitalization of the Ethiopian Stock Exchange limits its ability to attract investors and raise capital. Low trading volumes can lead to price volatility and hinder efficient price discovery. This is a common challenge faced by many emerging markets, particularly those with a limited number of listed companies.¹⁷⁰

3.8.2. Opportunities for Development

Despite the challenges, Ethiopia's capital market offers significant opportunities for growth and development. *Economic Growth:* Ethiopia's strong economic growth potential, driven by sectors such as agriculture, manufacturing, and services, can create new investment avenues. *Demographic Dividend:* Ethiopia's large and young population can fuel economic growth and create a growing investor base. *Government Support:* The Ethiopian government's commitment to economic reforms and infrastructure development can create a conducive environment for capital market development. *Regional Integration:* Ethiopia's participation in regional economic integration initiatives, such as the African Continental Free Trade Area (AfCFTA), can expand market opportunities and attract foreign investment.

The new Proclamation has the potential to attract more businesses to the capital market and to increase the number of investors. The Proclamation makes it easier for businesses to raise capital by simplifying the process of listing on the stock exchange. The Proclamation also makes it easier for investors to participate in the capital market by establishing new investment products and services. The new Proclamation is also expected to promote fair and orderly trading in the capital markets. The Proclamation includes new provisions to protect investors from fraud and other forms of market abuse. The Proclamation also includes new provisions to promote

¹⁶⁷ Ibid.

¹⁶⁸ Ibid.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

transparency in the markets. Overall, the new Proclamation has the potential to make the Ethiopian capital market more attractive to businesses and investors. This could lead to increased investment in the Ethiopian economy and to faster economic growth.

Conclusion

To fully unlock the immense potential of Ethiopia's capital market and propel the nation towards sustainable economic growth and development, a comprehensive and multifaceted approach is imperative. Addressing the multifaceted challenges outlined above is crucial. Strengthening the nation's infrastructure, both technological and financial, is paramount. A robust technological infrastructure, encompassing reliable internet connectivity and advanced trading platforms, is essential to facilitate efficient and transparent market operations. Additionally, a well-developed financial infrastructure, including a strong banking sector, insurance companies, and asset management firms, is vital to mobilize savings and channel them into productive investments.

A robust legal and regulatory framework is another cornerstone for a thriving capital market. Enacting clear, consistent, and investor-friendly regulations, coupled with effective enforcement mechanisms, is crucial to safeguard investor interests and promote market integrity. A strong and independent judiciary is also essential to ensure timely dispute resolution and enforce contracts. Political stability and sound economic policies are prerequisites for attracting both domestic and foreign investment. A stable political environment, coupled with prudent economic policies, can foster investor confidence and encourage long-term investment.

Moreover, fostering a deep and liquid market is essential for efficient price discovery, risk management, and investor liquidity. This can be achieved by encouraging a diverse range of issuers to list their securities on the exchange, attracting a broad investor base, and promoting market-making activities. By addressing these challenges and capitalizing on the opportunities, Ethiopia can establish a vibrant capital market that contributes to economic growth, job creation, and poverty reduction.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATIONS

4.1. Conclusion

A well-developed financial system is essential for economic growth. A deep and liquid capital market can support the financial system and help to transmit monetary policy, which can in turn help to promote financial stability and economic growth. However, the benefits and challenges of capital markets depend on the overall state of the financial system and the level of economic development in a country. Without proper regulation, some of the benefits of capital markets can become costs. The new capital market regulation in Ethiopia, Proclamation No. 1248/2021, has the potential to significantly improve the country's capital markets. The Proclamation introduces a number of new provisions that are designed to promote transparency, fairness, and efficiency in the markets. However, there are some challenges that need to be addressed in order to fully realize the benefits of the new regulation. One challenge is that the Ethiopian capital market is still in its early stages of development. This means that there is a lack of awareness of the capital markets among businesses and investors. The government needs to take steps to educate businesses and investors about the capital markets and to promote investment in the market.

Another challenge is that the Ethiopian regulatory framework for the capital markets is still evolving. The government needs to ensure that the regulatory framework is robust enough to protect investors and to promote fair and orderly trading. The government also needs to ensure that the regulatory framework is in line with international standards. Finally, the Ethiopian capital market needs to develop its infrastructure. This includes developing electronic trading systems and improving the settlement and clearing systems. The government needs to invest in developing the infrastructure of the capital market in order to make it more efficient and accessible to businesses and investors.

The new capital market regulation in Ethiopia is a significant step forward for the country's economy. The regulation has the potential to attract more businesses and investors to the capital markets, which could lead to increased investment in the Ethiopian economy and to faster economic growth. The government's commitment to developing the capital market is also encouraging. The government has taken a number of steps to address the challenges facing the

capital market, such as strengthening the regulatory framework and developing the infrastructure of the market. If the government continues to take these steps, the capital market in Ethiopia has the potential to become a major driver of economic growth.

4.2. Recommendation

Despite these challenges, the new capital market regulation in Ethiopia has the potential to make the country's capital markets more attractive to businesses and investors. The government can help to realize this potential by taking the following steps:

- Educate businesses and investors about the capital markets: The government and the Ethiopian Capital Market Authority (CMA) can increase awareness of the capital markets through public education campaigns and by working with financial institutions to educate their customers about the capital markets.
- Strengthen the capacity of the CMA: The government can provide the CMA with the resources it needs to effectively implement the Proclamation, such as by increasing its budget and hiring more qualified staff.
- Promote cooperation among stakeholders: The government can promote cooperation among stakeholders by establishing a forum where stakeholders can discuss and resolve issues related to the implementation of the Proclamation.
- Develop the infrastructure of the capital market: The government can invest in developing the infrastructure of the capital market, such as by developing electronic trading systems and improving the settlement and clearing systems.
- Align the regulatory framework with international standards: The government can work with international organizations to ensure that the Ethiopian capital market regulatory framework is aligned with international standards.

In addition to these steps, the government can also consider the following:

- Provide tax incentives for businesses that list on the stock exchange: This would make it more attractive for businesses to raise capital through the capital markets.
- Develop a comprehensive financial literacy program: This would help to educate investors about the risks and rewards of investing in the capital markets.

- Promote the development of investment products and services that are suitable for the Ethiopian market: This would make it easier for investors to participate in the capital markets.

The capital market has the potential to catalyze the growth and development of micro, small, and medium-sized enterprises (MSMEs), but it is essential to address certain key aspects to ensure that MSMEs are able to leverage this platform effectively. Capacity building and support initiatives are crucial to equip MSMEs with the necessary knowledge, skills, and resources to navigate the complexities of the capital market. This can be achieved through comprehensive training programs, mentorship opportunities, investment readiness incubation, and access to financial expertise. By empowering MSMEs and enhancing their capabilities, they can be enabled to compete effectively alongside larger entities.

Robust legal frameworks and regulations are essential to ensure fair practices, protect investor interests, and promote transparency within the market. Legal structures should emphasize accountability, discourage fraudulent activities, safeguard investor interests, maintain market integrity, and provide a level playing field for all participants. By strengthening the foundations of the capital market, instilling transparent reporting standards, and effective enforcement mechanisms, trust and confidence among investors can be fostered, encouraging their active engagement and contribution to market growth. Integration of environmental, social, and governance (ESG) considerations into the capital market is becoming increasingly important as investors seek to align their investments with their values. Ethiopia can align its capital market development with sustainability principles by encouraging companies to adopt responsible business practices and rewarding them with increased investor interest. By integrating ESG considerations into its capital market, Ethiopia can attract socially responsible investors and contribute to long-term sustainable development.

Addressing inherent trust issues through financial literacy and public awareness is paramount to ensure that MSMEs are able to fully benefit from the capital market. The perception of an exclusive market for MSMEs can perpetuate disparities and hinder their growth potential. Instead, fostering an integrated and inclusive ecosystem that bridges the gap between MSMEs and larger entities is essential. Successful capital markets have emphasized public awareness campaigns and financial literacy programs. This can be achieved through promoting

collaboration, knowledge-sharing, and information dissemination through educational initiatives. By creating a dynamic market with well-informed players, all stakeholders will benefit, wealth concentration will be mitigated, and the full potential of MSMEs will be realized.

In conclusion, the success of the capital market in Ethiopia and the broader global south hinges on our collective efforts to confront capacity building, legal structures, and trust issues. While recognizing the importance of supporting MSMEs, it is imperative to strive for an inclusive capital market that empowers MSMEs, addresses disparities, and ensures shared prosperity. By adopting a holistic and integrated approach, the true potential of the capital market can be unlocked, contributing to the socio-economic development of Ethiopia and the global south as a whole.

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