

**ADDIS ABABA UNIVERSITY**  
**COLLEGE OF BUSINESS AND ECONOMICS**



***Is Ethiopia Ready to Institute a Stock Exchange  
Market?***

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***Assessment on Establishing Stock Exchange Market in Ethiopia***

A Master's Thesis

In Partial Fulfillment of the Requirements for the Award of  
Executive Masters in Business Administration

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## DECLARATION BY CANDIDATE

I, the undersigned, hereby declare that this thesis entitled “**IS Ethiopia ready to Institute a Stock Exchange market: Assessment on Establishing Stock Exchange Market in Ethiopia**” is my own work and effort and that it has not been submitted anywhere for any award. Where other sources of information have been used, they have been acknowledged.

**Alemneh Abebe Kabtyemer** \_\_\_\_\_

**Name of the Candidate**

**Signature**

\_\_\_\_\_  
**Date**

# Is Ethiopia Ready to Institute a Stock Exchange Market?

*Assessment on Establishing Stock Exchange Market in Ethiopia*

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## ABSTRACT

Ethiopia has a growing economy which needs investment on a continuous basis for new ventures as well as for expansion and modernization of existing productive capacity. And, to sustain the annual GDP growth, the country needs new investments, in other words, it needs capital to invest. Capital markets provide one means to raise capital, as capital markets mobilize savings of investors. Therefore, capital markets are essential for the country's overall economic growth. Despite this, the country does not have an established stock exchange market although the need for capital market development has been continually discussed by various groups/stakeholders and academics.

This research project assesses Ethiopia's current condition with regard to establishing stock exchange market in terms of institutional, legal, regulatory, technical, economic, financial and other factors and found that the reluctance of the government, inadequate laws and regulations, insufficient technological infrastructure, and low level of public awareness and trust as important factors that need to be addressed to have an efficient stock exchange market in Ethiopia.

**Key Words: Stock Exchange Market, Ethiopia**

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## LIST OF ABBREVIATIONS

<b>CIA-</b>	Central Intelligence Agency
<b>ECX-</b>	Ethiopian Commodity Exchange
<b>FDI-</b>	Foreign Direct Investment
<b>GDP-</b>	Gross Domestic Product
<b>IMF-</b>	International Monetary Fund
<b>ICT-</b>	Information Communication Technology
<b>IOSCO-</b>	Internal Organization of Securities Commission
<b>MOT-</b>	Ministry of Trade
<b>MOFED-</b>	Ministry of Finance and Economic Development
<b>NBE-</b>	National Bank of Ethiopia
<b>OECD-</b>	Organization for Economic Cooperation and Development
<b>SRO-</b>	Self Regulatory Organization
<b>WB-</b>	The World Bank

# CHAPTER ONE

## INTRODUCTION

Ethiopia, the second most populous country in Africa, had passed through different economic and political changes, from the imperial feudal economy, to the Derg socialist system, and the current market economy. Although significant steps were taken since 1991 to liberalize the financial sector, it is still relatively small, closed and less developed even when compared to its neighboring countries (Reucker, 2011). The country has opened its doors to previously closed sectors of the economy to foreign investment, although financial services, telecommunication and power generation are still off limits. Following the liberalization of the economy many companies have been formed in different forms, the majority of whom being in the form of private limited companies, a lot others through selling of shares to the market.

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

According to Ruecker (2011), since the abolition of the Addis Ababa Share Dealing Group in 1974 by the military government ruling Ethiopia at the time, no stock market has been in place in Ethiopia. The need for stock exchange market development has, however, been continually discussed by various groups/stakeholders and academics. Accordingly, various studies have been carried out by these groups to initiate the establishment of capital market in the country. For example the study conducted by Ruecker (2011) and Tessema (2003), are among those in support of establishment. Treasury bills are the only active primary securities used in Ethiopia,

and secondary markets still do not exist at the moment. Long-term securities such as bonds are occasionally issued by the NBE to finance government expenditure and/or to absorb excess liquidity in the banking system.

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

In a study made by the African Union on the establishment of the Pan African stock exchange, stock exchanges are said to have a reputation for encouraging greater economic dynamism and producing higher levels of wealth by providing investors with the opportunity to share the risks and profits of enterprises. Thus they improve market mechanisms in order to raise and allocate scarce financial resources, mobilize local capital, attract foreign direct investment and allocate resources to projects likely to be beneficial to the economy.

The stock exchange is an alternative means for securing capital helping governments and private sectors to mobilize capital to finance a wide range of infrastructure thereby satisfying social needs as well as economic growth and jobs. Stock markets are perceived as a tool for the promotion of the financial sector and the development of private savings, thereby supporting the non-monetary funding of the economy and the fight against inflation.

## **STATEMENT OF THE PROBLEM**

Despite some of the acclaimed advantages of the stock exchange market for countries, Ethiopia is the only country of the world's 15 most populous countries which does not have a stock exchange (access Capital, 2012). Even in the past fifteen years several Sub-Saharan countries have established exchange markets and the number has been increasing by the passing of a year. According to Lemma W.Senbet and Isaac Otchre (2008), the rapid increase in the number of stock exchanges in the region is produced by the extensive financial reforms undertaken by

African countries, in the form of interest rate liberalization, removal of credit ceilings, restructuring and privatization of state-owned banks.

With the current Ethiopian condition, selling shares of companies will take long time and effort, even though the seller is in dire need of cash. And when dealers take part in the deal, it is usually observed some manipulation in the value of the share in the process. On the other hand, individual investors are unable to invest in feasible ventures as it is often difficult to get readily available markets from which they could go and buy. So, they may prefer to keep their money in their homes or save in accounts of banks for a nominal interest rate in consideration of the inflation rate prevalent in the country.

One of the reasons for the government's reluctance to establish a stock exchange market could be the lack of regulation. Other institutional and economic factors which determine the establishment of stock exchanges in Ethiopia are also absent or are inappropriately organized. In recent times, Ethiopia has seen growth in the number of share companies under formation through initial public offerings. Although some share companies have managed to mobilize huge amounts of capital from the public, there were disappointments as some of the promoters have failed to meet their promises. There were also cases where some companies have failed to be formed in addition to inappropriate actions of company organizers. Hence from the point of view of regulation, facilitation of the trade and the positive impact of stock exchange markets, a question could be raised whether or not establishing a stock exchange market could do away with the problems that have occurred and likely to occur in the future.

The degree to which physical, technological and legal infrastructures are developed; the need for regulation and capital by companies; the level of initiation by the government and/or the private sector; existence of public trust and awareness in share investment; the level of private sector development and others are considered by many as some of the important factors that determine the establishment of stock exchange markets in countries. Whether or not the main reason why Ethiopia does not still have a stock exchange market is due to the underdevelopment or absence of these determining factors is not clear. Therefore, this paper will assess Ethiopia's current economic, social, technological, political and legal conditions in relation to the necessary pre-

requisites for establishing stock exchange markets. Besides, not much has been written thus far which assesses the readiness of Ethiopia to establish a stock exchange market. Hence, this paper will try to give it considerable focus and fill potential knowledge gap that could exist in this regard.

## **RESEARCH QUESTIONS**

This research will try to address the following questions:

1. What are the benefits of establishing stock exchange to Ethiopia?
2. What are the prerequisites to establish stock exchanges?
3. Which of these prerequisites are in place and which require due attention?

## **OBJECTIVE OF THE STUDY**

The general objective of the study is to assess Ethiopia's current condition with regard to establishing stock exchange market.

Specific objective of the study include:

- To identify the benefits of stock exchange markets to Ethiopia
- To identify the institutional, legal, regulatory, technical, economic and financial prerequisites for establishing stock exchange markets
- To assess the identified prerequisites against the Ethiopian current environment

## **SIGNIFICANCE OF THE STUDY**

This study will contribute to the efforts of policy makers for establishment of stock exchange market by giving highlights on the country's situation for stock exchange. Moreover, it will serve as supplement for subsequent studies in the field. In addition, the fact that the study focused on the current practice of stock exchange in Ethiopia,.

## **THE RESEARCH SCOPE & LIMITATION**

This study is limited to the assessment of the conditions which are required for establishing a stock exchange market are available or not.

The limitation in the research is with regard to the availability and adequacy of relevant information on share companies and their profiles. Although I was planning to get the views of some government offices with regard to issues relevant to the study, the willingness and cooperation to provide pertinent information was very low. Besides, since the country does not have current experience in stock markets, some important information may not be available.

# CHAPTER TWO

## LITERATURE REVIEW

This chapter reviews the theoretical and empirical evidences of stock exchange markets and the roles these markets play in countries, companies and individual investors. Besides, various literatures on the factors that affect the stock market development in Africa, specific African countries and the situation in Ethiopia are reviewed.

### 2.1 THEORETICAL REVIEW

#### 2.1.1 DEFINITIONS

Businessdictionary.com ([www.businessdictionary.com](http://www.businessdictionary.com)) defines stock market as an organized and regulated financial markets where securities (bonds, notes, shares) are bought and sold at prices governed by the forces of demand and supply. Stock exchanges basically serve as primary markets where corporations, governments, municipalities, and other incorporated bodies can raise capital by channeling savings of the investors into productive ventures; and secondary markets where investors can sell their securities to other investors for cash, thus reducing the risk of investment and maintaining liquidity in the system. Stock exchanges impose stringent rules, listing requirements, and statutory requirements that are binding on all listed and trading parties.

Likewise, Investopedia.com, defines a stock market as a market in which shares of publicly held companies are issued and traded either through exchanges or over-the-counter markets. Also known as the equity market, the stock market is one of the most vital components of a free-market economy, as it provides companies with access to capital in exchange for giving investors a slice of ownership in the company.

The stock market lets investors participate in the financial achievements of the companies whose shares they hold. When companies are profitable, stock market investors make money through the dividends the companies pay out and by selling appreciated stocks at a profit called a capital gain. The downside is that investors can lose money if the companies whose stocks they hold lose money, the stocks' prices goes down and the investor sells the stocks at a loss.(Investopedia.com)

### **2.1.2 THE ROLE OF STOCK EXCHANGE MARKETS**

There are various literatures written on stock exchange markets and the roles they play in benefiting individual investors, companies and countries.

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

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

increases, firms gain increased assurance that they will be able to exit from long term investments. They therefore become more willing to make the permanent investments critical to development.

Securities markets also give people (especially the poor) a chance to buy shares of listed companies and become part-owners of profitable enterprises. The people sharing the profits of businesses in turn help to reduce large income inequalities. (Etienne and Vincent, 2008) Wider distribution of corporate profits develops a general sense of ownership and an assumption of responsibility on the part of the citizen. People will be united by their common defense of their business interests, where ethnic and religious differences would gradually dissipate. (Tessema, 2003) Furthermore, self and external regulation of the stock exchange help to ensure that the market is working efficiently, fairly and transparently. Stock exchanges raise requirements for corporations which seek to be listed in a stock exchange market. These requirements relate to the submission of financial information regarding companies whose securities are sold on the stock exchange. Such requirements exercise a control on a company management; keep its malpractice in check; and improve corporate governance. (Etienne and Vincent, 2008)

In a market economy, issues of securities help raise capital for projects whose outputs are in the highest demand by society, and those enterprises which are most capable of raising productivity. Thus, efficient enterprise management is rewarded by access to investment funds. (Tessema, 2003) Without securities markets, companies must rely on internal resources (retained earnings) for investment funds, on bank financing or on government grants or subsidies. New and growing enterprises often have little in the way of retained earnings.

Securities markets break the oligopoly that would be enjoyed by the banks in the absence of securities markets. Securities markets provide impetus for the establishment of financial prices based on scarcity values rather than on administrative fiat. Such market-determined financial prices and investment options, in turn, attract more savings, creating a virtual circle of innovation and mobilization that contributes to the overall efficiency of the financial system. (Tessema, 2003)

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

### **2.1.3 FACTORS THAT AFFECT THE EFFICIENCY OF STOCK EXCHANGE**

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

#### **i. Government**

It relates to the degree of stability, peace and internal security of a country and how well the government is functioning and is in control. It also relates to the rule of law and how sufficiently strong and independent is the legal institution to protect property rights and encourage private ownership. (Fredholm and Taghavi-Amel, 2006). According to Yartey (2007) good quality institutions such as law and order, democratic accountability, bureaucratic quality as important determinants of stock market development because they reduce political risk and enhance the viability of external finance. Bekaert (1995) provides evidence that higher levels of political risk are related to higher degrees of market segmentation and consequently low level of stock market development. Erb et al (1996) show that expected returns are related to the magnitude of political risk. They find that in both developing and developed countries, the lower the level of political risk, the lower is required returns. (Yartey and Adjasi, 2007)

According to Ndikumana (2001), governments can enhance financial development by promoting a strong, independent and effective legal system, where the judiciary can play an important role in enforcing the constitutional protection of individual and property rights and by arbitrating commercial disputes.

## **ii. Legal infrastructure**

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

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

## **iii. Regulation**

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

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

#### **iv. Accounting and Auditing Standards**

Accounting and auditing standards provide users of financial statements with information that is consistent, uniform, relevant and presenting the true and fair view of the financial dealings of the business.

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

#### **v. Macroeconomic Stability**

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

environments and sufficiently high income levels—GDP per capita, domestic savings, and domestic investments—are important determinants of stock market development.

**vi. Technological infrastructure**

Information and communication technology (ICT) has become a powerful tool for development extending its role from improving education and health system to widening business opportunities. For actors in the capital market, ICT is vital to communicate and exchange information swiftly; hence, make capital markets more efficient by including all information in stock prices. (Teklehaimanot, 2014)

Automation helps to speed up operations and activities of exchanges and reduces cost associated with manual systems. In addition, automation makes it easier to extend trading days and hours due to less cumbersome procedures. Automated trading also eliminates the need for trade intermediation since investors can log onto systems to monitor markets and also trade on markets, thus bypassing the use of brokers. (Yartey and Adjasi, 2007)□□□□□□

**vii. Number of Companies**

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

**viii. Institutional Investors**

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

#### **ix. Financial sector Development**

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

#### **x. Public awareness of stock markets**

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

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

#### **xi. Public Trust**

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

#### **xii. The Technological Infrastructure**

According to Stein B.(2001), modern telecommunications infrastructure is important for taking full advantage of the latest trading and settlement technology; in particular, to eliminate distance costs and facilitate the widest possible network of market participants.

#### **xiii. Economic Growth**

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

#### **xiv. Inflation**

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

#### **xv. Foreign Direct Investment (FDI)**

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

#### **xvi. Savings**

Higher rate of domestic savings in the economy accelerates the stock market activity (Kalim, 2009). Garcia and Liu (1999) found in their empirical study a strong statistical positive

relationship between stock market development and savings. They also argued that larger savings boost higher amount of capital flows through stock markets.

#### **xvii. Corporate Governance**

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

## **2.2. EMPIRICAL REVIEW**

### **2.2.1 OVERVIEW OF THE GLOBAL STOCK EXCHANGE MARKET**

According to the world development indicator of the World Bank, the United States of America has the biggest stock market measured in terms of their market capitalization, followed by China, Japan and UK. The only representation Africa has in the top twenty stock market performers is South Africa, which is in seventeenth place. (Table 1)

The size of the world Stock exchange market was estimated at about US\$53.1 trillion as the end of 2012. (The World Bank, 2014). The United States has more than thirty stock exchanges, of which the NYSE (New York Stock Exchange) is the largest with market capitalization of USD 14.2 trillion. Major European stock exchanges include, the London Stock Exchange in the United Kingdom, Deutsche Börse in Germany and the Euronext Paris in France. In Asia, the Mumbai, Singapore, Tokyo, Hong Kong and Shanghai stock exchanges are notable mentions. In Latin America, the BOVESPA (A Bolsa do Brazil) in Brasil and Mexican Stock Exchange in Mexico are well known markets. In Africa, with the exception of the Johannesburg Stock exchange, the rest are very small by world standards. (World-Stock-Exchanges.net, 2012).

**Table 1 Top 20 countries in terms of stock exchange activities**

Country	Market capitalization	% of GDP	Market liquidity	No. of
	(\$ millions)		Value of shares traded % of GDP	Listed domestic companies
	2012	2012	2012	2012
United States	18,668,333	114.9	131.6	4,102
China	3,697,376	44.9	70.8	2,494
Japan	3,680,982	62	60.7	3,470
United Kingdom	3,019,467	122.7	101.1	2,179
Canada	2,016,117	110.7	66.3	3,876
France	1,823,339	69.8	43.1	862
Germany	1,486,315	43.4	35.8	665
Australia	1,286,438	83.9	68.6	1,959
India	1,263,335	68	33.5	5,191
Brazil	1,229,850	54.7	37.1	353
Korea, Rep.	1,180,473	96.5	123.8	1,767
Hong Kong	1,108,127	421.9	468.1	1,459
Switzerland	1,079,022	171	101.6	238
Spain	995,095	75.2	81.4	3,167
Russia	874,659	43.4	36.3	276
Netherlands	651,004	84.5	57.3	105
South Africa	612,308	160.1	81.5	348
Sweden	560,526	107	71.8	332
Mexico	525,057	44.3	10	131
Italy	480,453	23.9	37.7	279

**Source: World Development Indicators 2014. The World Bank**

### **2.2.2. STOCK EXCHANGES IN AFRICA**

A number of studies have been made regarding the performance of African stock exchange markets. Some of the reviewed studies relate to those which were made on country specific basis while others have considered regional or continental approach to the study.

Although the continent has shown remarkable economic growth since the last decade or so with continental annual average economic growth in excess of 5% for the past 7 years, it is still the least developed continent which had combined GDP in 2012 was US\$2.2 trillion. This compares with the combined World GDP of US\$ 72.9 trillion and that of China US\$8.2 trillion in 2012(World Bank, 2014). The continent is still in lingering poverty, unemployment and overall economic underdevelopment. To sustain the current level of economic growth and encourage both domestic and foreign investment in the continent, Africa needs to rapidly expand, develop and modernise its financial markets. Evidence from recent empirical economic studies suggests that deeper, broader, and better functioning financial markets can stimulate economic growth (Ndikumana, 2001).

Africa has experienced fast development of equity markets over the past two decades. In 1980, Africa had only 8 active markets, (Ndikumana, 2001). But in 2014, the number had risen to more than twenty (Lemma, 2008). the market capitalization of these markets has also expanded considerably. Relative to GDB, stock market capitalizations of some of the countries range from 160% in south Africa, 94.7% in Zimbabwe to 6.4% in Tanzania. (Table 2) In terms of the number of domestic listed companies South Africa, Egypt and Nigeria take the first three positions with 348, 234 and 192 respectively. Other worthy mentions include Mauritius (84), Morocco (76) and Zimbabwe (76). (Table 2)

**Table 2 Top African Countries' Stock Exchange Markets**

Country	Market capitalization (\$ millions)	Market capitalization (% of GDP)	Listed domestic companies number
South Africa	612,308	160.1	348
Egypt	58,008	22.1	234
Nigeria	56,389	12.2	192
Morocco	52,634	54.8	76
Kenya	14,791	36.7	57
Zimbabwe	11,816	94.7	76
Tunisia	8,887	19.6	59
Cote d'Ivoire	7,829	31.7	37
Uganda	7,294	36.4	10
Mauritius	7,093	62	87
Botswana	4,588	31.6	24
Ghana	3,465	8.3	34
Zambia	3,004	14.6	20
Tanzania	1,803	6.4	17
Namibia	1,305	9.7	7
Malawi	754	17.8	14

**Source: World Development Indicators 2014, The World Bank**

African stock markets are highly illiquid, with very low trading and turnover ratios. The low liquidity implying limited opportunities for the transformation of illiquid assets into liquid assets, which constrain economic activity. (Ndikumana, 2001). African stock markets are also highly

volatile with weak economic base, high country-specific risk and weak external position (Ndikumana, 2001).

Despite these situations, some of the African Stock markets are highly profitable. According to a report by Ventures Africa (2014), Egyptian, Kenyan and Nigerian stock exchange markets are rated as the most profitable ones with Yield-to-Maturity(YTD) of 49.56%, 39.32% and 35.45% respectively. The same report indicated that the YTDs of US DOW Jones averaged 6.4%, NASDAQ 13.9%, German DAX 29% and UK FTSE 8.61%.

According to Levine (1997), over the past two decades, stock market liquidity has been a catalyst for long-run growth in developing countries. He argues that without a liquid stock market, many profitable long-term investments would not be undertaken because savers would be reluctant to tie up their investments for long periods of time. In contrast, a liquid equity market allows savers to sell their shares easily, thereby permitting firms to raise equity capital on favorable terms. By facilitating longer-term, more profitable investments, a liquid market improves the allocation of capital and enhances prospects for long-term economic growth.

Levine (1997) stated, countries with relatively liquid stock grew much faster than countries with illiquid markets, after adjusting for differences in other factors that influence growth, such as education levels, inflation rates, and openness to trade. His studies also indicate that, in promoting economic growth, a liquid stock market complements a strong banking system, suggesting that banks and stock markets provide different bundles of financial services to the economy.

In recognition of the importance of stock markets in economic development, several African countries launched stock exchanges during the past two decades. At present more than 50% of the 54 African countries operate stock exchanges. Rapid expansion of stock exchanges in the continent contributed to economic development in various ways. These are, among others, facilitating the privatization process, diversifying the financial services, facilitating long term capital mobilization, provision of alternative investment opportunities, attracting foreign capital inflows and serving as a signal of overall macroeconomic performance. (Kumo, 2008)

## **WHAT AFFECTS THE STOCK MARKET DEVELOPMENT IN AFRICA**

According to Kumo (2008), most African stocks exchanges are still at early stage of development and face several constraints facing such challenges like political instability in some economies, high volatility in economic growth, macroeconomic uncertainty, liquidity constraints, limited domestic investor base, underdeveloped trading and settlement structures, and limited market information. (Kumo, 2008)

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

Murinde (2006) further indicates that the performance, in terms of return and cost of capital, level of listing of companies, liquidity and efficiency of the markets show that almost all of the capital markets in Africa, except the Johannesburg Stock Exchange, and with some respects the Cairo Stock Exchanges, have marked weaknesses. Moreover, most of these markets do not attract international investors despite the fact that stock markets in Africa and other emerging markets seem to have higher returns than developed stock markets. Therefore these are the major impediments to sustained development of capital markets in Africa. Nonetheless, to enhance their performance, most African countries have revitalized their capital markets in terms of key institutional reforms, namely revitalization of the regulatory framework, modernization of trading systems, and relaxation of restrictions on foreign investors.

A study made on *Stock Market Development in Sub Saharan Africa*, Charles Amo Yarety et al (2007), has indicated that sound macroeconomic environment, well developed banking sector,

transparent and accountable institutions, and shareholder protection are some of the challenges stock markets in the Sub Saharan African countries are facing for their efficient functioning. Same study has also suggested factors that help develop stock markets in Africa. These range from the need to increase automation, demutualization of exchanges, regional integration of exchanges, promotion of institutional investors, regulatory and supervisory improvements, involvement of foreigner investors, and educational programs.

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

This literature also reviews and presents some of the studies made in specific countries in Africa with regard to the factors that affect the efficiency and development of the stock exchange markets:

### ***i. Ghana***

In his research entitled, 'Factors affecting the development of emerging capital market of Ghana', Osei (1998) has analyzed the Ghanaian Stock Exchange institutional characteristics in terms of the legal and regulatory frameworks, information disclosure requirements, transparency of transactions, accounting and auditing standards, transaction costs, delivery and settlement of transactions, barriers to entry and exit, taxation of investment income, market structure and public knowledge and awareness that ensure protection and security of investors. The study also finds out that the delivery and settlement are performed satisfactorily by brokers, while introducing a centralized clearing system would improve the clearing and settlement procedures.

## ***ii. Tanzania***

A research by Massele et al (2013), studied the challenges the Darassalam Stock exchange market is facing. The study has pointed out lack of desirable characteristics of the stock market in terms of liquidity, availability of information that leads to market efficiency, high price sensitivity to new information, small price sensitivity, narrow price spread as factors having impacted the market. He also indicated lack of public awareness and knowledge about stock market, few market participants, lack of ICT and technology support for trading sessions and settlement of transactions, macro-economic instability from the point of view of inflation, currency depreciation, unemployment, population increase and poverty as some of the challenges. Lack of competent experts in the financial sector was also emphasized like stock analysts, financial analysts, lawyers, licensed brokers and professional financial advisors.

## ***iii. Rwanda***

In a study conducted on Establishing Stock Exchange in Emerging economies, Musonera (2008) has explored some of the challenges of the Rwandan Stock Exchange. These are: low domestic saving, complex tax regime, absence of financial intermediaries, lack of adequate accounting and auditing expertise, family owned companies, lack of information, underdeveloped market infrastructure and problems in capacity development.

## ***iv. Uganda***

The research conducted by Bohnstedt et al on Capital Markets development in Uganda has analyzed the potentials and challenges of the Ugandan Stock exchange market and identified those factors that need to be improved to enable an efficient market in Uganda. An enabling environment which provides macroeconomic stability, prudential financial sector regulation, active government support, an improved tax regime and tax incentives, installing clearing and settlement system and strengthening the accounting profession were identified as important measures.

## **v. Kenya**

Josiah et al (2012) have studied the determinants of stock market development in the case of Nairobi Stock Exchange by using secondary data from 2005-2009. The results of their study show that institutional quality represented by law and order and bureaucratic quality, democratic accountability and corruption indices as important determinants of stock market development because they enhance the viability of external finance. On the other hand, the regression analysis between stock market development and macroeconomic stability- in terms of inflation and private capital flows show no significant relationship.

In summary, lack of sound macroeconomic environment, absence of well developed banking sector and financial intermediaries, lack of competent professionals, low level of domestic saving and underdeveloped market infrastructures are some of the most significant challenges encountered in underdeveloped countries in Africa.

### **2.2.3 STOCK EXCHANGE IN ETHIOPIA**

Ethiopia used to have stock exchange market in the mid 1960s before it was abandoned by the Derg regime in 1974. According to Mohammed (2010), Ethiopia's brief history of stock exchange shows that there were share and bond dealings under the sponsorship of the National Bank of Ethiopia (NBE) starting in March 1965. Later, the Addis Ababa Share Dealing Group was set up to trade in shares and government bonds. The group started functioning with share dealings of 15 listed companies and four government bonds, and the number of listed companies reached 17 by 1966.

After the change of the socialist government in 1991, attempts were made to re-establish stock exchange market in Ethiopia by interested parties like the Addis Ababa Chamber of Commerce and Sectoral Associations. According to Ruecker (2011), in 1995, the National Bank of Ethiopia undertook a study on the Feasibility of Establishing of Securities Exchange Market in Ethiopia and also prepared a draft securities and exchange proclamation which are awaiting government endorsement.

Different seminars and studies were undertaken by different scholars which emphasized on the necessity of having capital market in Ethiopia. In 1995, a group of entrepreneurs organized as the Ethiopian Share Dealing Group under the Addis Ababa Chamber of Commerce and Sectoral Associations initiated a share dealing group similar to the former Addis Ababa Share Dealing Group of 1974. The group initiated the development of a Stock Exchange rules and regulations as well as bylaws of a share dealing group, and commissioned Ernst & Young to develop an international standard rules and regulations manual.(Ruecker 2011)

In 2008, the NBE launched a capital market infrastructural development study by international consultants under the Financial Sector Capacity Building Project. The study included capital market infrastructure development in Ethiopia. This initiative was financed by the World Bank (WB) based on the potential interest of the government of Ethiopia. According to the WB Ethiopia Office and the Project Unit at NBE, the study is under review by the concerned government body.(Ruecker, 2011)

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

### ***Opportunities and challenges of Share markets for Ethiopia***

According to Solomon (2011), Ethiopia currently faces the following problems and the creation of securities market is justified by its potential to solve these problems.

- Bank loans are usually given on short term basis and most private companies suffer from high leverage, less access to finance as banks usually require huge collaterals due to high NPLs of banks. The securities market can fill the gap by allowing direct formation of equity and debt capital.

- The country has limited share of foreign capital investment which forces the utilization of domestic resources to finance investments. The securities market can facilitate the mobilization of domestic resources to meet the need.
- Both the government and a large number of private companies have already issued securities to the public and these have lacked market for secondary trading. The issuance, transferability, liquidity and proprietary value of all these securities has, however, become severely weak due to absence of securities market.
- Excess liquidity and reserve of banks are kept idle which could have been invested in securities markets. The securities market can help the banks and the NBE to mop up and manage their idle fund during this situation.
- The country's financial market is limited being dominated by banks, MFIs and insurance (and equib). It lacks investment banks, mutual funds, private pension companies, and venture capital companies that can pool and share risk and offer alternative channels for saving and investment as institutional savers and investors which remained to be informal and piecemeal.
- Most of the business organizations in the country suffer from narrow ownership base and inability or lack of motivation to go public. The majority of the business organizations have also suffered from non-separation of ownership and management as a result of their narrow ownership base and inability or lack of motivation to go public. Creation of the market can curb the problem by encouraging the business organizations to go public and stimulating competition.
- The flow of information and corporate management, accounting and control is severely limited. Most business firms do not keep operational reports and formal books of accounts. Creation of the securities market can change the situation by stimulating competition and increasing the need for enhancement of corporate governance by at least those which want to raise finance through it.

- Individuals and businesses have limited source of income and investment options. The securities market can assist the country to curb the problem by serving as alternative investment channel. Solving the problem will also be in line with the poverty reduction goal of the country.
- Although the country has privatized several state owned enterprises, the privatization has been made through direct sales to individual buyers. Creation of the market is necessary to facilitate future privatization.

However, lessons learnt from many countries as a late comer and the current economic and social development in Ethiopia will prove the betterment of opportunities than the effect of threats. In dealing with these issues, the study made by Reucker (2011) has identified both opportunities and threats of stock market development in Ethiopia. As per the study, the opportunities include:

- The agenda of poverty eradication turned into a national growth and transformation plan
- Macro-economic development is positive
- Economic growth and human development is increasing consistently
- Capital market provides services to the economy that are crucial for long-term economic development.
- Although some analysts view stock markets in developing countries as “casinos” that have little positive impact on economic growth, recent evidence suggests that stock markets can give a big boost to economic development.
- Ongoing and future privatizations stipulate additional capital needs
- Efficient stock pricing through competition and market

- Capital market promotes Private Sector Development, which is seen to be crucial for the economic development of the next five years
- De-concentration of ownership could be seen as a democratic measure by the Government of Ethiopia
- Accession to World Trade Organization
- Capital market increases liquidity by supporting the placement of government bonds
- Capital market mobilizes local savings
- Capital market could increase remittances as an additional capital to FDI
- Capital market leads to transparency

On the other hand, the same study has identified the following matters as threats to the development of stock exchange market in the country:

- High level of poverty
- Future (volatile) macroeconomic and political environments can affect market liquidity
- Legal, regulatory, accounting, tax, and supervisory systems influence stock market liquidity
- Lack of awareness and willingness among Ethiopian policymakers
- Ethiopian banks have an oligopoly position in the financial system which needs to be broken by a securities market
- Ethiopian banks are highly reliant on loan income
- Poor savings culture

- No access for foreign investors and financial institutions, and therefore less flow and international awareness
- African stock markets are generally small, illiquid, with infrastructural bottlenecks and weak regulatory institutions
- Lack of liberalization of the financial sector
- Low implementation capacity on the part of the government
- Some of the potential market participants see the private sector as weak, disorganized, short-term oriented, emotional and non-systematic
- Capital market enhances bank competition

Further on the issue of opportunities, Tessema (2003) indicated that many prospects (opportunities) for developing securities markets exist in Ethiopia. The prospects mentioned include: Ethiopia has considerable unexploited resources and is considered as one of the largest potential markets in Africa; Ethiopia's process of transition from a centrally planned to a market-oriented economic system and the process of economic liberalization underway is encouraging; the privatization efforts going on would help with the supply problems, particularly if a public offering of shares is used as the method of privatization; the existence of many profitable companies, which can potentially benefit from floating shares to the public; the existence of institutions like the country's pension fund, insurance companies, credit unions, etc., with large sums of money. If allowed to invest, they would boost the demand for securities; the gradual improvements of the incentive packages in the successive investment proclamations help attract new investors including Ethiopians with foreign passports.

Moreover, Teklay (2011) stated prospects as including the current scenario in share buying is a testimony of the existence of demand and supply sufficient to begin the long journey: the government has consistently maintained that the macroeconomic situation is reasonably stable

and there are already some legal pronouncements, which can be reinforced a little more for a start.

Challenges are also highlighted by different writers. Professor Asrat Tessema (2003) identifies different challenges in the establishment of stock exchange including: low level of public awareness about securities markets; lack of public confidence in share investment; lack of institutional capacity to facilitate securities trading; the underdeveloped state of the bond (debt) market; low level of private sector development and a low level of market orientation in the economy; problems with the supply and demand for securities at least initially and absence of input by the business community in the formulation of economic policy by the government. In addition to this, Teklay (2011) states that the current state of affairs does not make the country ready for a full-fledged stock market.

Solomon (2011) identified some of the likely challenges in establishing stock market in Ethiopia as: companies being too young to be judged for their profitability; companies' reluctance to go public and restrict their ownership; owner managers; financial inexperience; lack of accounting/auditing professional expertise; investment regime which support individual ownership than portfolio investment; non existence of investment banks; low income and saving capacity of individuals; non-conducive political and macro-economic environment; NBE's lack of supervisory knowhow and discouraging tax regime.

Reucker (2011) made market potential assessment for successful establishment of stock exchange market in Ethiopia, The study evaluated the country's situation from different angles; such as, government commitment, macroeconomic conditions, corruption and transparency, the business environment, foreign investment, legal and regulatory infrastructure, accounting and auditing practices and market conditions.

The study examined the internal and external environments and puts the threats in the establishment of stock markets in Ethiopia. These are, high level of poverty, volatile macroeconomic and political environments; legal, regulatory, accounting, tax, and supervisory systems influence stock market liquidity; lack of awareness and willingness among Ethiopian

policymakers; oligopoly position of Ethiopian banks in the financial system, Ethiopian banks are highly reliant on loan income, poor savings culture, no access for foreign investors and financial institutions, and therefore less flow and international awareness, African stock markets are generally small, illiquid, with infrastructural bottlenecks and weak regulatory institutions, lack of liberalization of the financial sector, low implementation capacity on the part of the government serious demand in knowledge, training and education, some of the potential market participants see the private sector as weak, disorganized, short-term oriented, emotional and non-systematic.

Teklehaimanot (2014), after studying the potential beddings and constraints in the establishment of stock exchange markets in Ethiopia, has indicated economic growth, privatization scale-up, increasing capital inflow, negative real interest rate, inclination to incorporated enterprises, the establishment of Ethiopian Commodity Exchange (ECX) and energy expansion as some of the motivating matters for the establishment of stock exchanges in Ethiopia. While on the constraints side he mentioned government's reluctance; the underdeveloped infrastructure, like the legal and regulatory frameworks, media, ICT; immature financial sector, uninformed and small base investors and shortage of professionals.

Despite the challenges there are scholars and other interested parties who evaluated the potential for stock exchange market in Ethiopia, have recommended the establishment of stock exchange. The recommendation by Teklay (2011), Ruecker (2011) and Tsegaye (2012), are few of them. African Development Bank (2010) stated that it is the right time for Ethiopia to invest on the necessary infrastructures that will enable it to introduce stock market. This will enable the country to mobilize capital and encourages saving. Teklay, (2011) on his part stated that even though the preconditions are not fulfilled fully, it is time to start work to establish a stock exchange and we can start operation at a minimum level. But the government has to be involved fully and has to control, follow and supervise the process.

To conclude, from review of literatures, for an efficiently operating stock exchange market to exist in a country, the factors that need to get the necessary attention are government commitment, policies and laws; availability of market participants; the legal and regulatory framework that protects the rights and interests of interests of shareholders; macroeconomic

conditions such as GDP growth, FDI, inflation rate, devaluation of currency, the level of domestic savings; awareness and trust of the public towards stock markets; financial literacy, the development of accounting and auditing standards and infrastructural development should get due regard.

# CHAPTER THREE

## METHODOLOGY

The research is a descriptive research which focus on assessing the potential factors that impact the development of stock markets in Ethiopia. The potential factors are gathered by reviewing various researches which are made to evaluate/assess what impacts the efficiency of stock exchange markets in Sub Sahara African countries and other developing countries. Some quantitative data like GDP, inflation rate and domestic saving rate are also used to evaluate and make comparison with the data of other countries.

In order to achieve the objectives of this paper and address the research questions which are: what advantages does stock exchange bring to Ethiopian economy and what are the prerequisites to establish stock exchange market in Ethiopia, self administered questionnaire and semi-structured interview were used to collect information from different stakeholders about the current share-dealing in companies, shareholders and the general situation of the country. Besides, secondary data were used from different literatures, reports, journals and websites.

### 3.1 DATA SOURCE AND COLLECTION TOOLS

The data employed in this study are both primary and secondary sources on GDP growth, Foreign Direct investment, domestic saving rates, rates of inflation, number of share companies, potential investor base, institutional framework like the legal and regulatory matters, accounting and auditing standards, government policies and strategies, and other relevant factors that potentially affect the stock market development in a country.

Secondary data are obtained mainly from the following sources:

- Reports of the World Bank development indicators, CIA fact book, National Bank of Ethiopia reports and various government institutions like MOT, MOFED, IMF database

- Various journals and literatures

Primary data are collected through questionnaire and semi-structured interviews. The sources will include:

- Share company managers
- Promoters of share companies
- Shareholders of companies

### **3.2 POPULATION AND SAMPLES**

The research is made on share companies incorporated in Ethiopia and the shareholders of these companies. Data is collected on a purposive sampling technique, where samples are taken from persons who are believed to possess the requisite knowledge and expertise on the subject matter. Besides selection of sample considers the time and budget limitation. Moreover, the share companies for the research are those that are incorporated from 1991 onwards it is believed that these companies and their shareholders have the current and contemporary information on share dealing activities in the country.

Although it is difficult to determine the total population size, as data could not be obtained from all incorporated companies regarding their number of shareholders, however, 120 shareholders and 30 managers and promoters of share companies were selected for the questionnaire. From these 102 shareholder and 24 managers have returned their filled questionnaires.

# **CHAPTER FOUR**

## **DATA PRESENTATION AND ANALYSIS**

This chapter presents data collected through survey questionnaire and interview, and the analysis based on the data collected. The responses are presented and analyzed to address the questions raised in the study and meet objectives of the study- Is Ethiopia Ready to Institute Stock Exchange Market? Specific research questions addressed by the collected and presented data are:

- a. what are the benefits of establishing stock exchange to the Ethiopian Economy?
- b. what are the prerequisites to establish stock exchange?
- c. which of these prerequisites are in place and which require due attention?

### **RESULTS OF THE SURVEY**

#### **Response Rate**

A total of 150 questionnaires were distributed to share company managers (30) and shareholders of companies (120). From the total distributed questionnaire, 24 of the share company managers and 102 shareholders' of companies, a total of 126(84%) have responded with their valuable comments and feedbacks.

**Table 3: General information of the respondents (shareholders of companies)**

	DESCRIPTION	Frequency	%
SEX	Male	84	82%
	Female	18	18%
Age	Less than 25 years old	-	-
	26-30 years old	16	16%
	31-40 years old	35	34%
	More than 40 years old	51	50%
Educational Background	High school graduate	-	-
	Diploma level	20	20%
	Bachelors Degree	48	47%
	Masters or higher	34	33%

Response was obtained from 102 shareholders of companies. In terms of sex of shareholders, 82% (84) are male, while 18% (18) are female. Age wise, 50% of the respondents are more than 40 years old, 34% between 31-40 years old and 16% between 26 and 30 years old. There are no respondents who are less than 25 years old. In terms of educational background, 33% hold masters or higher qualification, 47% Bachelors degree, while 20% have diplomas. From the educational background it can be said that the respondents have sufficient knowledge on stock exchange and the responses they provide to be valid.

**Table 4: Shareholding period of the shareholders**

Shareholding period	Frequency	% from total respondents
Less than 1 year	-	-
1-3 years	19	19%
3-5 years	35	34%
More than 5 years	48	47%

The shareholding history of the respondents who are shareholders in companies indicates that 47% of the shareholders have held shares for more than five years, 34% of the shareholders for between three to five years and 19% of the shareholders held their shares between one and three years.

**Table 5: Age of the share companies surveyed**

Age of company	Frequency	% from total respondents
Before 1-3 years	3	13%
Before 4-6 years	10	42%
Before 6-15 years	6	25%
More than 15 years	5	21%

In terms of the size of the companies, 8% of the companies have less than 10 shareholders, 21% of the companies have 10-100 shareholders, 25% of the companies have 101-500 shareholders, while 46% have more than 500 shareholders. In terms of sectoral classification the companies, 21% are engaged in the financial sector like banks and insurances, 8% in real estate, 13% in agriculture, 4% in trade, 33% in manufacturing and 21% in others sectors like education, and transport. From the respondents, 62% of the companies have one or more institutional investors like private companies, associations and other legal personalities as shareholders in their companies.

When requested about how they acquired their shares 44% of the respondents have indicated that they have acquired their shares through initial public offering, 31% through buying from existing shareholders and 25% through gift. Thus, the majority of the respondents have acquired their shares through initial public offers of their companies.

**Table 6: Method of share acquisition**

Method of acquisition	Frequency	% from total respondents
Initial public offering	45	44%
Bought from existing shareholder	32	31%
Gift	25	25%
Other	-	-

If during acquisition of their shares the shareholders have encounter any kind of challenge, 33% of the respondents have indicated that they had faced challenges, while 67% of the respondents said they did not face any challenge at all. And in terms of the time it took for the shareholders to finalize the share buying and registration activities, the responses given are as follows:

**Table 7: Time period to finalize the share acquisition process**

No of days	No of respondents	% from total respondents
Less than 15 days	20	20%
15-30 days	28	27%
30-60 days	32	31%
More than 60 days	22	22%

As seen from the table, 20% of the respondents said that it took them less than 15 days to finalize the share acquisition process, 27% of them from 15 to 30 days, 31% from 30 to 60 days while 22% took them more than two months to finalize the process and get their share certificates. This implies that the share buying process takes unnecessary time and therefore is not efficient.

Meanwhile, from the companies perspective, one of the challenge to raising capital from the public is the time it will take to finalize selling of their shares in the initial public offering. Thus in this connection, the length of time it took for the share companies to sell out their shares to the public is as shown below:

**Table 8: the time it took to establish the share companies**

No of days	No of respondents	% from total respondents
Less than 6 months	6	25%
6-12 months	7	29%
12-24 months	6	25%
More than 24 months	5	21%

From the foregoing table, 25% (6) of the surveyed companies were formed within 6 months of share companies' initial public offering, 29% (7) companies within 6-12 months, 25% (6) companies within 12-24 months and 21% (5) companies took over two years to finalize their formation. From the data it can be seen that only 54% of the companies were able to finalize the share selling and formation of the companies within a year time. This shows that time is being wasted by companies to finalize formation of the companies and starting their business.

**Table 9: Shareholders' level of awareness about stock markets**

Level of awareness	No of respondents	% from total respondents
Expert level	-	-
Adequate knowledge	46	45%
Basic awareness	55	54%
No awareness	1	1%

From surveyed shareholders, 45% have indicated that they have adequate knowledge about stock exchanges, while 54% have indicated that they have basic awareness about it. Meaning 99% of the surveyed shareholders have indicated that they have at least basic knowledge about what stock exchanges are and the benefits they have.

The other challenge companies face in raising capital from the sale of shares is whether or not the companies have employees having the necessary skills, experience on fund management activities. In this regard, 63% of the respondents have indicated that they have the necessary expertise in their company, while 37% have indicated that they do not have one.

The response indicates there is sufficient level of awareness and knowledge regarding the benefit and basics of stock exchange markets.

### **Challenges to sell shares**

For the question on if shareholders have ever sold their shares, the response indicate that only 17% of the respondents have said that they did, while 83% have indicated that they do not have experience in selling of their shares. And from those who have experience in selling their shares, 12 (71%) of them had faced some challenge in selling their shares. The types of challenges they mentioned are difficulty in finding buyers (58%), difficulty in finding the right price (33%), and one has complained of the high commission of facilitators like brokers.

**Table 10: shareholders response concerning the challenge they face to sell their shares**

	No of respondents	% from total respondents
Difficulty to find a buyer	7	58%
Difficulty to find fair price	4	33%
Higher commission by facilitators	1	8%
Others	-	-

Similarly, for the issue that shareholders are facing in liquidating their shareholding in their companies, company managers' response indicate the following:

**Table 11: Problems in share selling by shareholders**

	No of respondents	% from total respondents
Difficulty in finding buyers	5	56%
Difficulty in getting fair price for their shares	3	33%
Regulatory hindrances	-	-
Problems in share registration process	1	11%
Other	-	-

Hence the problem of finding a ready market to sell their shares is indicated by most as the main challenge in share dealing in companies, followed by being able to find a fair price for their shares. Besides, regarding the means through which shares can be liquidated, 39% of the respondents have stated that they will refer to their share company to sell out their shares, while 28% will try to find buyers by themselves through their business contacts, and 22% resort to use the services of share dealers.

**Table 12: Means of selling shares**

Means of selling shares	No of respondents	% from total respondents
Through the share company	7	39%
Through Dealers or brokers	4	22%
Through Informal communications with the business community	5	28%
Other	2	11%

Concerning use of share capital as an alternate means of raising capital, 22% of the respondents, which are mainly financial institutions, use share issuances to raise funds for their capital needs. On the other hand most resort to taking loans from banks (56% of the respondents). While 22% state that they will take from internal source (their retained earnings).

**Table 13: Sources of finance for companies**

Retained Earnings	6	22%
Bank Loans	15	56%
Selling shares to the public	6	22%
Other	-	-

Despite the fact that most opt to go to banks when they need capital, 80% of the respondents have stated that they face difficulty in getting loans from banks. The challenges the managers have indicated are banks' high collateral requirement is mentioned as the main set back (50%), followed by liquidity problem of banks (25%), delay in processing of their loans (17%), and the other reason mentioned was regulatory requirements (8%).

**Table 14: Challenges of taking bank loans**

	No of respondents	% from total respondents
High Collateral requirement	6	50%
High debt/equity leverage	-	-
Liquidity problems of banks	3	25%
Delay in processing loans	2	17%
Others	1	8%

Regarding the use of excess funds by companies, 44% of the managers have indicated that whenever they have excess liquidity the better opportunity to use their money is by depositing in to banks and earn interest, 33% by investing in fixed assets, whereas only 22% would want to buy shares in companies.

## The advantages of Stock exchange markets

Concerning what advantages could stock exchanges provide to shareholders, companies and the country's economy, the responses are summarized in the following page.

**Table 15: the advantages of stock exchange markets**

<i>Potential advantages</i>	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
It builds public trust/confidence to invest in share companies	50 49%	35 34%	16 16%	1 1%	-
It provides a ready market for investors to buy and sell their shares	30 29%	55 54%	17 17%	-	-
It provides protection for investors which stems from sets of rules of regulators	22 22%	62 61%	18 18%	-	-
It promotes the habit of saving	32 31%	55 54%	15 15%	-	-
It contributes to country's economic development	34 33%	68 67%	-	-	-
It necessitates the determination of true/fair price of shares of companies	32 31%	36 35%	19 15%	15 15%	-

In terms of economic development of the country, promoting saving, building public trust and providing ready market for investors to buy and sell their securities, significant level of agreement was obtained from respondents as the advantages of stock exchange markets.

**Table 16: Factors that affect Stock exchange market development in Ethiopia**

Potential factors	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Lack of (inadequate) regulation and laws	40 39%	45 44%	17 17%	- -	- -
The adequacy of the judicial system	34 33%	36 35%	32 31%	- -	- -
Macro-economic situation of the country	16 16%	34 33%	18 18%	34 33%	- -
Low level of saving rate	34 33%	17 17%	34 33%	17 17%	- -
Awareness of the society about stock exchange markets	46 45%	- -	- -	20 20%	36 35%
Lack of public trust	34 33%	34 33%	15 15%	19 19%	- -
Minimal government interest and support	68 67%	11 11%	23 23%	- -	- -
Lack of transparency in government policies	53 52%	32 31%	1 1%	15 15%	- -
The impact of inflation	68 67%	- -	34 33%	- -	- -
Inadequate potential investor base	- -	17 17%	15 15%	34 33%	36 35%
Other investment opportunities	- -	15 14%	54 53%	34 33%	- -
Lack of transparency in share companies	37 36%	52 51%	13 13%	- -	- -
Prevalence of family-owned companies	16 16%	70 69%	16 16%	- -	- -
Unwillingness of company owners to cede ownership and control	19 18%	49 48%	13 13%	21 21%	- -

### Legal and Regulatory Framework

Legal and regulatory framework of a stock exchange markets is concerned with the protection of investors, efficiency of markets and reduction of systematic risk. From the response of shareholders on the factors that potentially affect the establishment of stock exchange market in Ethiopia, 83% agreed on the impact of the inadequacy of legal and regulatory framework for the

efficient operation of stock exchange in the country. On the adequacy of the judicial system of the country, the level of agreement of the respondents on this factor has declined to 68%.

### **Macroeconomic Factors**

On the economic aspect of the country, 49% of the respondents have stated that macroeconomic condition will affect stock market establishment. With respect to the level of domestic saving , 50% of the respondents have taken it as a factor that it will impact the development of stock exchange market in the country.

The number of share companies or companies in general represents the demand of capital. And when there is growth in the number of established share companies, there is a need for more capital to start business. Hence, companies could be forced to go public to raise capital. On the potential investor base, 68% have disagreed on the inadequacy of the number of investors in the country.

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

Inflation is considered as one of the determinants of the economy, whereby 67% have indicated inflation as one aspect to be considered to affect the liquidity and efficient operation of stock exchange market. This is supported by the data obtained from African Economic Outlook (2014), which indicates inflation rate of the country in 2012 as 20.8%, decreasing in the subsequent years of 2013 and 2014 to 7.9% and 7.4%. (African Economic Outlook, 2014). Although the rate has been showing a decreasing trend in the current times, it is an issue to be dealt with properly by the Government of Ethiopia. When we compare to the likes of Kenya,

Rwanda and Uganda, whose the general inflation rates of 2014 are 5%, 6.9%, and 4.7% respectively, Ethiopia's inflation rate is higher.

Foreign capital inflows have significant contributions to a country's economic growth and development by lessening and mitigating shocks resulting from low domestic saving and investment. Hence increased FDI has positive effect on the liquidity of stock exchange markets.

When we look at Ethiopia's foreign investment inflow, it is high when compared to the likes of Kenya and Rwanda, although it is less than that of Uganda. Besides, the growth rate it has marked during these years has been significant.

**Table 17: Foreign investment inflows in millions of US Dollar.**

Country	2007	2008	2009	2010	2011	2012
<b>Ethiopia</b>	222	109	221	288	627	970
<b>Kenya</b>	729	96	115	178	335	259
<b>Rwanda</b>	82	109	119	42	106	160
<b>Uganda</b>	792	729	842	544	894	1721

Source : African Economic outlook, 2014

## **Government**

Regarding the level of interest or support the Government of Ethiopia has been showing towards the development of stock market, 78% of the respondents have recognized the lack of government's interest as one reason which impacts the successful establishment of stock market in Ethiopia. On the transparency of government policies and strategy towards capital market, 83% have stated that it the policies and strategies of the government lacks transparency, hence is one factor to consider. Meanwhile, in addition to the government's interest, support and policies, the level of corruption is another issue to be looked in to. Thus in this regard, Ethiopia is ranked 110<sup>th</sup>, while Rwanda is ranked 55<sup>th</sup>, Kenya 145<sup>th</sup>, and Uganda 142<sup>nd</sup> as per the Transparency

International index of 2013. This implies that there is a high level of corruption in the country, which could affect the transparency of business dealings.

### **Public Awareness and trust**

On the level of public awareness of stock markets, 55% disagreed on the idea that the public awareness is low to affect operation of the stock exchange market. Concerning public trust, 66% of the respondents have recognized it as a factor that affect stock market development. The data indicates that there is a moderate level of awareness by the public on stock exchanges, whereas a high proportion of the respondents have indicated that public trust matters for the efficient functioning of stock markets.

On the existence of better investment opportunities than buying of shares in companies, although 53% appear to be neutral about it, 33% of the respondents did not agree on its impact. Only 14% have accepted it as a factor.

### **Corporate Governance**

Corporate governance is one of the most important issues in share companies. This is because unlike privately owned companies, where ownership and management are close, share companies suffer from agency costs as owners (shareholders) do not have the chance to oversee the day-to-day management of companies.

Regarding the effect of lack of transparency in providing relevant and timely information on the business affairs of share companies, 87% have accepted as one factor. On the impact of prevalence of family owned companies have on stock market development, 85% of respondents have accepted it as a factor. Finally, 66% of the respondents have indicated that the reluctance of owners of companies to go public as a result of fear of ceding control is another factor that could affect the number of participating parties in the market.

## **CHAPTER FIVE**

## SUMMARY, CONCLUSION AND RECOMMENDATION

The survey results and review of empirical studies and analysis of some of the qualitative aspects of stock markets show the following major benefits of stock exchange markets:

- Shareholders usually face problems in getting the buyers for their shares at a fair price and in-time. This inability will make shares illiquid, which will therefore affect the public's perception towards buying of shares. If individual investors are affected, then companies will have difficulty in raising capital through issuance of shares to the public. A well regulated stock exchange market will provide ready market whereby investors could easily buy and sell their shares, thereby rendering liquidity to stocks of companies, hence helping both investors and companies in their financing needs.
- As per the survey, most companies have indicated that they usually use bank loans to finance their business. However, the process of getting loans from banks is not an easy exercise, as banks require large collaterals, or the banks are constrained by liquidity or the process of loan approval by some banks is not sometimes expeditious. Besides, it is usually unthinkable for new companies to get loans from banks as new companies may not have sufficient collateral to back their loans. A well regulated stock exchange market could serve an alternative source of finance for new as well as existing companies by providing a market.
- As per the analysis some share companies are suffering from poor corporate governance, where founders, directors and executives of share companies are found pursuing their own interests rather than the interest of shareholders, particularly of the minority shareholders. A well regulated stock exchange market requires transparency of business dealings, disclosure of material facts in the company and reporting to a regulatory body that will be established for this purpose. Thus, it could enforce a better corporate governance in companies.
- Stock exchange markets could also win the public trust and be an investment alternative for the public as regulators will enforce the shareholders' rights properly.

Despite the acclaimed benefits, establishing a stock market in Ethiopia may not be a smooth process as some of the pre-requisites are not in currently in place in the country.

- The commitment of government in pursuing the establishment of stock exchange markets is not visible. Besides, government's strategies and policies are not clear enough with respect to capital markets.
- The legal infrastructure and regulation framework is not comprehensive and the laws pertaining to share companies is not up to date. There are no regulatory frameworks and institutions to take care of the regulation and supervision activities.
- Corporate governance is not fully developed and the governing laws on corporate governance are not up-to-date. However, the recent activities of revising the commercial code of Ethiopia is on progress, so also the National Bank of Ethiopia's draft directive on corporate governance.
- The country does not currently have standards for accounting and auditing. However, there are activities to adopt international financial reporting standards by companies in the country.
- Technological infrastructure of the country is in its development stage, which needs to be further improved to facilitate smooth transaction settlement and flow of information.
- In terms of such macroeconomic factors, like economic growth, inflation rate, foreign direct investment, the country's position is good when compared to other Sub Sahara African countries.
- The financial sector which is expected to compliment the development of stock exchange market, is growing in terms of number of banks and bank branches.
- The awareness level of the public is not high as there is no stock market in the country. The level of public trust which is related to the level of awareness and incidents that have happened during recent times could be affected.

## **Recommendations**

- The Government of Ethiopia should show its commitment in setting clear policies and strategies on capital markets as such markets could be one source of finance for the government's long range projects,
- The 1960's Commercial Code of Ethiopia should be revised to reflect the current business dynamics. It has to also incorporate relevant provisions with regard to stock exchanges and corporate governance in line with internationally recognized corporate governance principles like that of the principles of Organization of Economic Cooperation and Development (OECD)
- The role the media plays in promoting the stock exchange market is highly recognized. Therefore, the country's media should do more in giving more coverage for business and financial matters.

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