

Mainstreaming the Capital Market for National and Regional Economic Development

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What does Mainstreaming Capital Markets Mean?

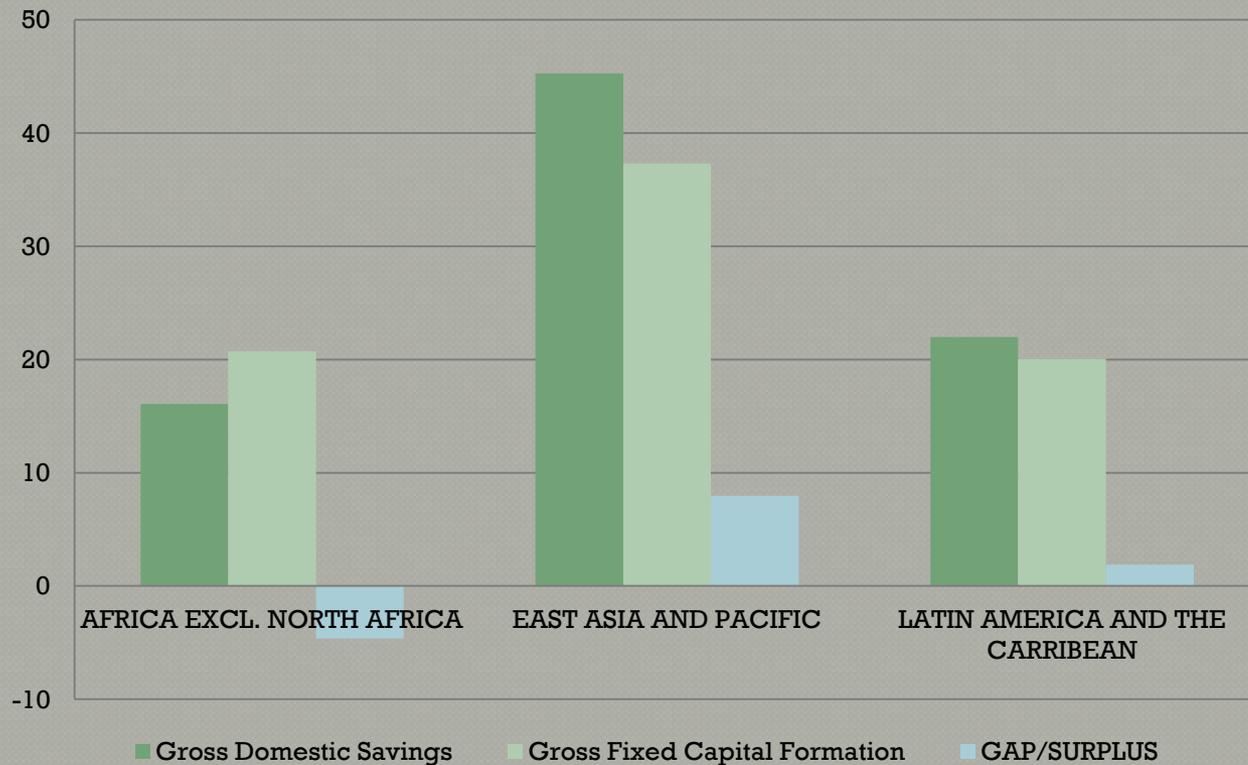
- ◉ Market Depth i.e. size of capital market relative to economy is significant
- ◉ Capital markets instruments are held by savers/investors
- ◉ Users of capital – governments, private sector use the capital market as their preferred source of medium- to long term capital

The Economic Rationale for Capital Markets

- ◉ **Argument for mainstreaming is anchored on the economic rationale for capital markets:**
 - Positive relationship between financial development and economic growth
 - Capital markets represent segment of financial market that deals with medium and long-term funds in the form of debt, equity and derivatives
 - Complements other forms of intermediation such as banking and money market
 - Capital markets makes it easier for economies to have complete markets

High Savings-Investment Gap

Figure 2 Savings Investment Gap 5-Year Average (2006-2010)



Africa's Investment Needs: Infrastructure Deficit

◉ Infrastructure Deficit

- Cost of redressing infrastructure deficit is estimated at \$38 billion of investment per year and a further \$37 million per year in operations and maintenance. There is currently a funding gap of \$35 billion per year
- Traditional approach of direct public investment with support from donors is no longer adequate
- Need to source additional resources from domestic sources either directly (e.g. Kenya Infrastructure Bond) or in partnership with the private sector (PPPs)
- Capital market specializes in providing the long-term finance required for infrastructure

Africa's Financing Needs: The Private Sector

- Africa's private sector accounts for more than 80% of production, two-thirds of local investment and three-fourths of total credit to the economy over the 1996-2008 period. It was also responsible for 90% of formal and informal employment (2011 Africa Development Report, AfDB)
- Main source of financing has been bank credit
- Limited availability of equity and long-term capital

Closing the Savings-Investment Gap with Capital Markets

- Capital markets can help bridge the savings investment gap by:
 - Providing savers with a wider variety of products with different risk-return profiles.
 - Development of institutional investors (pension, collective investment schemes, insurance) boosts savings rate
 - Investors can hold diversified portfolios than they could in the absence of capital markets which facilitates the flow of capital to higher return projects thereby boosting growth and employment

The Benefits of Capital Markets for Companies

- The availability of diversified sources of funding enables companies to minimize their cost of capital.
- A lower cost of capital increases the net present value of projects, thus allowing more investments to be undertaken, thus increasing economic growth and employment creation.

Requirements for effective transmission mechanism

- The effectiveness of the transmission process whereby savings are mobilized and allocated to productive investments depends on the efficiency of capital markets.
- Efficiency of capital markets imply that the prices at which assets are traded are “fair”. This requires a competitive capital market with a large number of buyers and sellers and readily available information on assets.
- The structural characteristics of the market should enhance the trading process. Small and illiquid capital markets make it difficult to achieve the economic benefits of capital markets.

The State of Capital Markets in the ECO WAS Region(December 2012)

	BRVM	GHANA	NIGERIA
Listed Companies	37	34	194
Market Capitalization (\$ billions)	8.10	30.46	57.7
Market Cap/GDP (%)	11.2	8.5	12.3
Turnover Ratio (%)	2.15	.0018	7.32
Comparatives			
	CHILE	MALAYSIA	SINGAPORE
Listed Companies	225	921	472
Market Cap/GDP (%)	116.1	156.2	149.8
Turnover Ratio	16.0	28.8	43.3

Critical Indicators for ECOWAS Capital Markets

- ⦿ 3 Stock Exchanges serving 10 countries
- ⦿ Markets are mostly equity –oriented
- ⦿ Debt markets and weak (there are no corporate bonds listed in Ghana)
- ⦿ Market Capitalization/GDP is small compared to advanced and other emerging markets
- ⦿ Very little in derivatives

Financing Record of African Capital markets

◎ Primary Market data reveals

- Limited number of flotations
- In Africa only Mauritius, Morocco and Nigeria registered a net addition of at least one listing per year during the 10-year period 2002 – 2011.
- Issuers are mostly large companies and subsidiaries of foreign companies
- SMEs are missing from the market

Compare with Banking Sector – Domestic Credit as % of GDP (2012)

	Bank Credit/GDP	Market Cap/GDP
Cote D'Ivoire	27.3	11.2
Ghana	32.3	8.5
Nigeria	20.3	12.3
Others		
Chile	108.0	116.1
Malaysia	134.0	156.2
Singapore	99.5	149.8

- Market Cap/GDP is less than half Bank Credit/GDP
- Non-mainstreaming most severe in Ghana BRVM.

Factors Working against Mainstreaming

- ⊙ **Businesses (especially SMEs) have not patronized capital markets**
- ⊙ **Macroeconomic instability**
- ⊙ **Well-known structural weaknesses**
 - Small and illiquid markets
 - Limited number of listings
 - Weak regulatory capacity
- ⊙ **Globalization has created unanticipated competition from larger, more developed capital markets**

The SME Puzzle

- Limited participation of SMEs was attributed to onerous listing requirements
- Attempts to attract SMEs through alternative markets have not been successful
- Most Exchanges have Alternative/Growth/Development markets with simplified requirements for SMEs
- In Africa, only Casablanca, Egypt, JSE and Mauritius have attracted a meaningful number of listings to their alternative markets

Why SMEs are not in the Market

- ◉ **SMEs come with inherent disadvantages**
 - Relatively high credit risk
 - Severe information asymmetry
 - High transaction cost per deal relative to large companies
- ◉ **Family businesses with no interest in sharing ownership**
- ◉ **Fear of political victimization**

The Emergence of Private Equity

- ◉ Private equity is a major competitor to public equity markets (including SME /Alternative markets)
 - In 2012 \$3.3 billion in private equity funding raised for African ventures, the highest annual amount since 2007 and represents a 136 percent increase since 2012
 - Ghana Venture Capital Trust Fund and partner funds invested in 46 SMEs during 2007-2011

Globalization & Competition

- Liberalization of markets, removal of capital account restrictions and technological changes have turned the world into one pool of capital. Companies that hitherto relied on domestic markets are now able to tap international markets at lower cost
- African stock exchanges are in competition with markets in developed countries
- Local stock exchanges are unattractive to many companies, especially large companies
 - Many South African companies have transferred their primary listings to major international exchanges such as London
 - Zambeef in Zambia raised \$55 million on London's AIM
 - Nigerian Banks are tapping Eurobond market (First Bank, Zenith, Access, Fidelity, Access)

In Summary

- ◉ We need to work harder to mainstream capital markets in the Region

What is to be Done?

◉ Regional integration option

- Integrated markets provide for free mobility of capital thus providing a large pool of resources and a market with attractive liquidity
- Issuers are free to issue across borders
- Economies of scale allows exchanges to operate at a lower unit cost and become competitive
- Has been proposed as an option for overcoming disadvantages of African capital markets

Core Requirements

- ⦿ Removal of capital account restrictions
- ⦿ Harmonization of laws and regulations
- ⦿ Integrated market infrastructure
- ⦿ Works better as part of a comprehensive regional financial integration (i.e. Focus on capital markets alone creates disjointed financial market)

The record so far.....

- West African Capital Markets Integration Council (WACMIC) is making great progress but primarily driven by stock exchanges and regulators
- We need governments to get on board with ECOWAS protocols similar to:
 - EAC Treaty provides a strong mandate for financial integration – reflected in rapidly growing cross listings
 - SADC Protocol on Finance and investment
- No such protocols exist to anchor ECOWAS financial market integration

The Way Forward Market – Building Blocks of a Reinvented Capital Markets Strategy

- **Traditional targets of policy intervention must be pursued with consistency**
 - Strengthened regulatory capacity
 - Building investor base
 - Operational efficiency of markets
- **Policy areas that require rethinking**
 - A revamped regional integration approach
 - New SME strategy
 - Strengthened debt markets
 - Attention to small countries with no stock exchanges

Regional Integration

- ⦿ Regular ECOWAS forum on capital market integration
- ⦿ Situate capital market integration within a wider program of financial market integration (including banking, insurance, etc) with full capital account liberalization within ECOWAS
- ⦿ Authorities of the ECOWAS have a major role to play. Treaties/Protocols should mandate comprehensive financial integration

SME Strategy

- ◉ Policies for promoting SME finance should be joined up with support for private equity and venture capital (tax incentives, BDS support, etc)
- ◉ Provides a steady feed of growing SMEs to capital markets where they have a chance of growing into larger companies

Debt Market Strategy

- ⦿ Government debt management is key
- ⦿ Debt strategy should go beyond financing the deficit to provide attention to market development needs
- ⦿ Consistency of benchmark issues to provide a yield curve
- ⦿ Consider option of independent DMO (e.g. Nigeria) to ensure that all dimensions of public debt management are handled with consistency

Small Countries with No Stock Exchanges

- How do we support smaller countries now edging towards the establishment of capital markets (e.g. Sierra Leone, Liberia, Gambia,)?
- Options
 - Full blown exchange - viability is not easily achievable
 - Sequential (start with OTC?)
 - Bilateral link with existing exchange (e.g. Trust Bank of Gambia listing on the GSE?)

