Working Paper 2

Capital market development in sub-Saharan Africa: Progress, challenges and innovations

The ODI research series for financial development in Africa

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Abstract

This paper presents an overview of capital markets in Africa. These markets are composed mainly of stock exchanges and bond markets. Securities markets are non-negligible complements to bank financing on the continent, with bond issuances mostly done by governments and only fewer big corporations listed on the domestic stock exchanges. Corporate bonds constitute a tiny part of the capital markets in most African countries. African capital markets can increase the investor base by tapping into the huge financial resources of institutional investors. Moreover, as state-owned enterprises are among the big economic players in many African countries, privatising some of these through 'democratic' initial public offerings and listing them on local exchanges will increase the number of listed companies and offer investors more choices to diversify their portfolio. The success of these initiatives requires the continuous improvement of the business environment, the establishment of sound and reliable regulatory frameworks, financial literacy and management structures that do not yet fully exist in many African countries. We present case studies of capital market development in Asia to draw lessons for capital market development in Africa.

Key words: Capital market development, Financial development, Africa.

About this series

The ODI research series for financial development in Africa funded by FSD Africa

FSD Africa is a specialist development agency working to build and strengthen financial markets across sub-Saharan Africa. Its mission is to reduce poverty through a 'market systems development' approach addressing the structural, underlying causes of poverty by improving how financial market systems function.

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The research programme is being accompanied by joint FSD Africa and ODI dissemination events in the region and internationally to present and debate the policy implications of the research findings.

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Contents

Acronyms

BRVM	*Bourse Régionale des Valeurs Mobilières*
BVMAC	*Bourse des Valeurs Mobilières de l'Afrique Centrale*
EAC	East African Community
ECOWAS	Economic Community of West African States
GDP	gross domestic product
JSE	Johannesburg Stock Exchange
PE	private equity
SOE	state-owned enterprises
WACMIC	West African Capital Markets Integration Council
WAEMU	West African Economic and Monetary Union

1 Introduction

Financial systems in many African countries remain underdeveloped (Allen et al., 2011, 2014; Beck and Cull, 2013), which results in credit constraints for households and firms, especially small and medium-sized enterprises, and low investment rates. The African financial sector is dominated by commercial banks, with very few investment banks. Apart from the African Development Bank and the Development Bank of South Africa, development banks and specialised banks are very limited in their capacity to raise enough external finance to fill the financing needs of businesses. Consequently, financial constraints have been identified as the most severe obstacle to doing business in Africa and a major hindrance to business start-ups and innovation by firms (Ayyagari et al., 2011; Gorodnichenko and Schnitzer, 2013). The result is very low investment rates in Africa (24%) compared to other emerging world economies, such as China (40%), South Asia (28%) and East Asia and Pacific (32%).[1]

Nevertheless, capital markets play an important role in complementing bank financing on the continent. For example, more than US$560 billion was raised through bonds by governments and private firms in national currencies in Africa since 1997 (see Table 2). In addition, the number of stock exchanges on the continent has grown from five in 1989 to 28 today, with stock markets growing continuously in the number of shares listed and the traded volume. From 1992 to 2018, the capitalisation of African stock markets increased tenfold from $113 billion to more than $1,130 billion.

Despite these improvements in securities (bonds and stocks) markets, African capital markets remain underdeveloped. Excluding South Africa (235 percent of the GDP), the highest stock market capitalisation in Africa was in Mauritius (69 percent of GDP) in 2018. The capitalisation of Mauritius stock exchange was well below the average market capitalisation in the East Asia and Pacific region (83 percent of GDP) and in high income countries (119 percent of GDP). The underdevelopment of capital markets may be explained by many factors, including the small size of the domestic economies, macroeconomic and business environment, quality of institutions, financial infrastructures, etc. The listing and issuance requirements in most African stock exchanges are binding constraints in relation to the structure and capacity of the domestic companies. For example, the lengthy administrative procedures for listing, the high transaction costs, the lack of training and knowledge about capital markets, as well as the lack of transparency in some of these marketplaces are some key constraining factors for the development of many African capital markets (Soumaré, 2020).

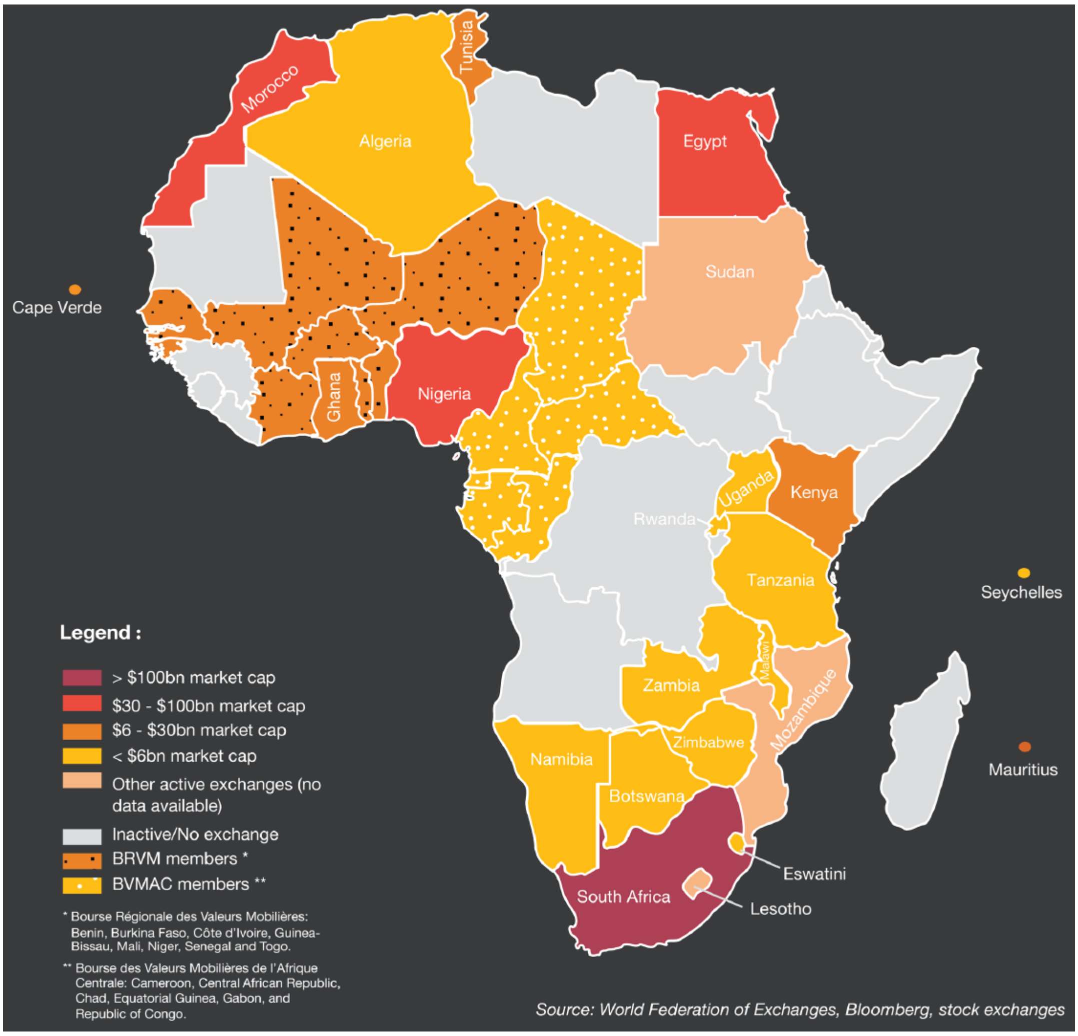
[1] Investment (gross capital formation) is measured by the total value of the gross fixed capital formation and changes in inventories and acquisitions less disposals of valuables for a unit or sector. It is expressed as a percentage of GDP. The percentages are computed using data from the World Bank's World Development Indicators database 2019.

This paper provides an overview of capital market development in Africa and comparative study of capital markets in Asia to learn lessons from these other emerging markets. It is organised as follows. Sections 2, 3 and 4 provide overviews and landscapes of stock exchanges, bond markets and other capital markets development in Africa, respectively. Section 5 discusses the role of regionalisation of capital markets and the demutualisation trend of stock exchanges in Africa. Section 6 concludes.

2 Overview and landscape of the stock exchanges in Africa

Figure 1 depicts an overview of African stock exchanges as of 31 December 2019. The top four stock exchanges in Africa (in terms of nominal market capitalisation) are in South Africa, Morocco, Egypt and Nigeria. The market capitalisation of each of these is greater than $30 billion. Where data is available, the capitalisation of most of the stock exchanges in Africa is less than $6 billion.

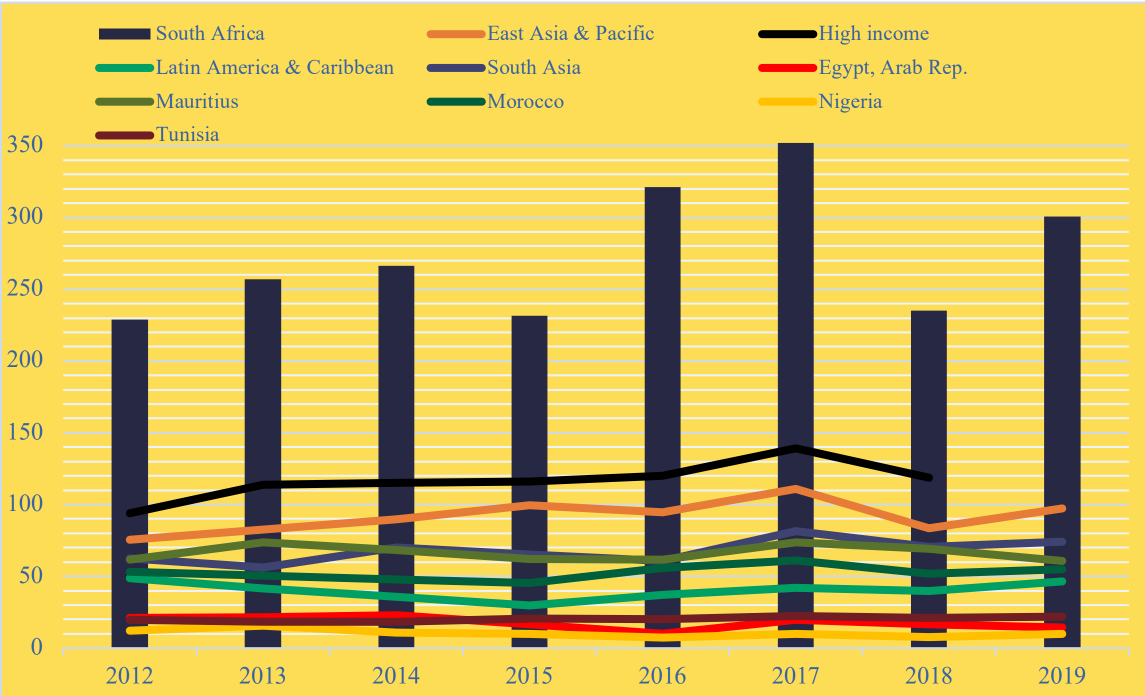
Figure 1: Overview of African stock exchanges, 2019



Source: PwC (2020)

Figure 2 plots the size of the stock exchanges in selected African countries and comparator groups of countries around the world over the 2012-2019 period. The size is measured by the ratio of stock market capitalisation to GDP. We focus on the six largest stock exchanges in Africa in terms of market capitalisation as share of GDP. Clearly, South Africa has the largest stock exchange, in terms of market capitalisation to GDP, among the selected countries, including high-income countries. The second largest stock exchange in Africa is Mauritius, which is close in size to those of the South Asian economies, but smaller than those of high-income and East Asia and Pacific countries. The size of the third largest African stock exchange (Casablanca Stock Exchange) lies between the stock exchanges of South Asian countries and the countries of Latin America and the Caribbean. The other three (Nigeria, Tunisia and Egypt) are the smallest among the selected group of countries.

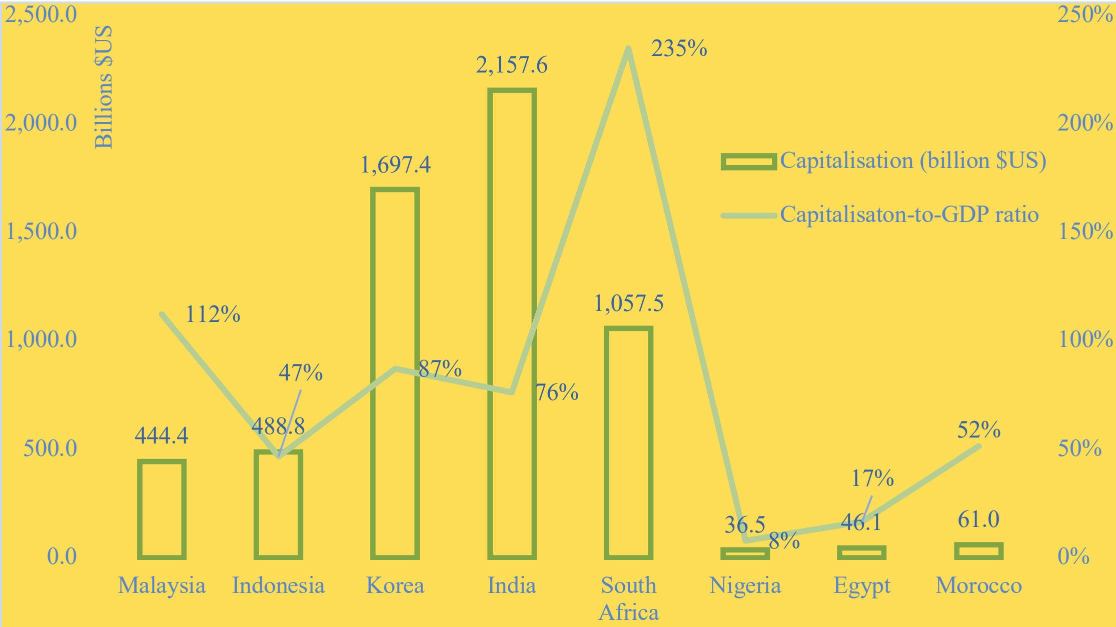
Figure 2: Trend of market capitalisation-to-GDP ratio, selected countries



Source: World Development Indicators (2020)

Figure 3 compares the top four stock exchanges in Africa to stock exchanges of four emerging markets. Except for the Johannesburg Stock Exchange (JSE) in South Africa, all the other major exchanges in Africa are less capitalised in absolute terms and as a percentage of GDP than the other four frontier markets of Asia considered. The JSE, the top stock exchange in Africa, is less capitalised than the Korea Exchange and the National Stock Exchange of India in nominal value. However, when normalising nominal values by economy size, JSE becomes the most well capitalised (235%), followed by Malaysia (112%), Korea (87%), India (76%), Morocco (52%), Indonesia (47%), Egypt (17%) and Nigeria (8%). The market capitalisation-to-GDP ratio of South Africa is greater than the average value of the high-income countries (118.9%), greater even than the ratio of the United States of America (148.5%). This may be due to the number of listed companies (365) and the variety of instruments offered by this market, not typical of other African stock exchanges.

Figure 3: Market capitalisation in 2018 of the top four African stock exchanges versus other emerging markets



Sources: World Federations of Exchanges (2018), World Development Indicators and website of the Casablanca Stock Exchange.

As Figures 2 and 3 show, except the JSE in South Africa, the African stock exchanges are under-developed compared to stock exchanges in other regions of the world. One main constraint of stock exchanges development in Africa is the limited diversity of instruments available for trading and the very small number of listed stocks. Most of the stock exchanges are in their early developmental stage, although some of them have been around for quite some time. Except for South Africa, where derivatives are currently traded, the available financial instruments are only equity shares and bonds in all the other markets. More generally, stock markets in Africa attract very few investors and are not so liquid.

The main problems encountered by African stock exchanges in their development are the lengthy administrative procedures for listing, the binding listing conditions deemed not accessible to all companies, the high transaction costs, the lack of training or knowledge about stock markets, the lack of transparency in some exchanges (Soumaré, 2020), as well as the lack of privately managed local pension funds with the capacity and incentives to evaluate different kinds of securities. In some other markets, macroeconomic and other market conditions that are not conducive to listing (and/or investing) are a major impediment.

Comparing the transaction costs of some of Africa's most advanced exchanges to transaction costs applied in developed markets around the world shows that fees are relatively expensive in Africa. For example, there is an upper limit for fees applied to companies for admission and further issuance of securities on the London Stock Exchange.[2] Meanwhile, in exchanges like the *Bourse Régionale des Valeurs*

[2] See fees at https://www.londonstockexchange.com/companies-and-advisors/aim/publications/fees/fees.htm.

Mobilières (BRVM) and the Stock Exchange of Mauritius,[3] the transaction fee is a percentage of the transaction value (except government securities in Mauritius). In Mauritius, for example, the fee for a transaction not exceeding 3 million Mauritian rupees is 1.25%, decreasing to 0.9% for transactions above 10 million rupees, but there is no upper limit for fees. So, a transaction of 100 million rupees (approximately £2.15 million) costs 0.9 million rupees (£19,330). The maximum cost for such a transaction on the London Stock Exchange is £11,250.

Technology can contribute to lowering transaction costs in many of these markets. Many stock exchanges across the Africa continent and around the world have modernised their trading system by moving away from the manual trading system of clearing and settlement they had in the past. Most of them have changed to automated trading systems. For example, the Botswana Stock Exchange introduced the automated trading system in August 2012 to increase transparency and efficiency in the trading of securities. Its trading was previously conducted manually, with brokers meeting daily at the Exchange House to execute trades for their clients. Ghana also introduced an automated trading system, and opens for continuous trading every working day from 10:00 to 15:00 Greenwich Mean Time. The Bank of Ghana's Central Securities Depositary handled the settlement of trades on a T+3 (business days) basis. The trading system was manual. The Nairobi Securities Exchange also changed its clearing and settlement procedure. The Nigerian Stock Exchange adopted the Nasdaq X-Stream trading platform in 2013. This technology moved the dealers away from slower automated technology and sped up trading. As of October 2019, all derivative products listed on the JSE Derivatives Market could be traded using the Trading Technologies platform.

[3] The regional stock market of the eight West African Economic and Monetary Union member states. Transaction costs can be found at http://www.brvm.org/fr/textes-reglementaires/tarification and https://www.stockexchangeofmauritius.com/regulations-governance/transaction-fees.

3 Overview and landscape of the bond markets in Africa

Table 1 presents indicators for bond markets in Africa and Asia. In both continents, bonds listed on the domestic exchanges have been mainly issued by domestic issuers, especially the public sector.

Table 1: Number of bonds listed in selected exchanges, 2018-2019

	2019					**2018**				
	Total	Domestic		Foreign	Share public (%)	Total	Domestic		Foreign	Share public (%)
		Private	Public				Private	Public		
Number of bonds listed										
Botswana Stock Exchange	46	29	15	2	32.61	49	30	17	2	34.69
Bourse de Casablanca	39	26	13	0	33.33	46	33	13	0	28.26
BRVM	58	16	42	0	72.41	44	14	30	0	68.18
Johannesburg Stock Exchange	1849	1498	172	179	9.30	1719	1357	158	204	9.19
Nigerian Stock Exchange	133	26	106	1	79.70	108	22	85	1	78.70
Rwanda Stock Exchange	19	0	19	0	100.00	17	0	16	1	94.12
Stock Exchange of Mauritius	58	57	1	5	1.72	49	48	1	NA	2.04
The Egyptian Exchange	106	17	89	0	83.96	109	20	89	0	81.65
Tunis Stock Exchange	258	233	25	0	9.69	266	238	28	0	10.53
Hong Kong Exchanges and Clearing	1388	521	843	24	60.73	1195	397	773	25	64.69
Japan Exchange Group	370	15	319	36	86.22	371	20	311	40	83.83

Korea Exchange	13938	8561	5371	6	38.53	13362	7968	5390	4	40.34

Notes: NA stands for not available. Share public (%) is the size of the public sector related to the size of the bond market for each item.

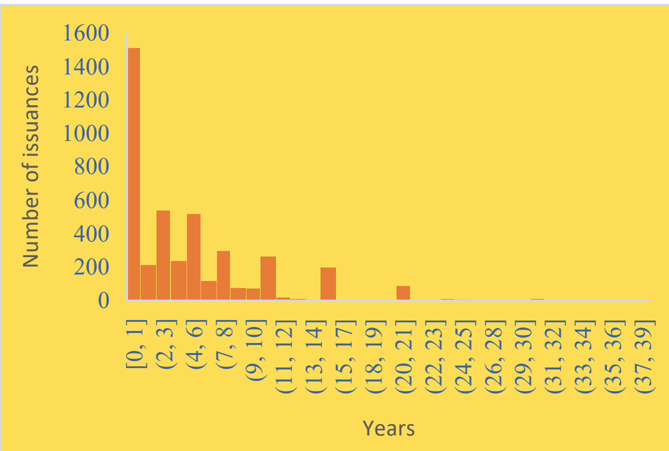
Source: World Federations of Exchanges (2019)

Table 2 shows that corporate bonds markets dominate in terms of number of issuances only in Tunisia, South Africa and Botswana; for the rest of the countries the market is dominated by public bonds issuances. However, the outstanding amount is dominated by government papers in all the countries where data is available.

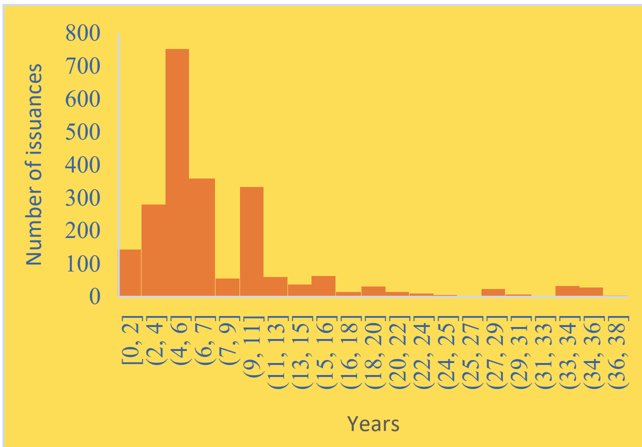
Another important feature is that most of the government bonds have short-term maturities compared to corporate bonds (Figure 4**Error! Reference source not found.**). In fact, about 85% of corporate bonds listed on the African domestic markets that have not yet matured have an average maturity of 11 years, while 81% of government bonds have an average maturity of 8 years. The majority of government papers are T-bills with a maturity of less than a year. T-bills are usually used for liquidity management, particularly in the conduct of monetary policy. Only 12 out of 42 countries issued very long-term (more than 20 years) bonds listed on the domestic market: Angola, Botswana, Egypt, Ghana, Kenya, Mauritius, Morocco, Namibia, Nigeria, South Africa, Tanzania, Tunisia. This can be explained by the pool of investors, their risk-taking behaviour which is also related to macroeconomic fundamentals, country risk and the limited depth of local markets. The lack of a benchmark yield curve that can provide pricing signals to potential corporate issuers impedes development of corporate bond markets.

Figure 4: Distribution of the maturity of bonds issued in African domestic markets

<u>**Government bonds**</u>



<u>**Corporate bonds**</u>



Source: Compilation of authors with data collected from www.cbonds.com.

African government and quasi-government bonds perform better than other indices around the word, including the S&P 500 (Figure 5). The returns of African government and quasi-government bonds were less volatile compared to other indices even between February and May 2020, a period when most stock indices dropped sharply due to the Covid-19 pandemic.

Table 2: Number and outstanding amount of government, corporate and municipal bonds listed on domestic markets

	Government bonds			Corporate bonds			Municipal bonds		
	Min. Start Year	# bonds issued	Outstanding amount (US dollar billions)	Min. Start Year	# bonds issued	Outstanding amount (US dollar billions)	Min. Start Year	# bonds issued	Outstanding amount (US dollar billions)
Algeria	2006	30	2.90						
Angola	2012	511	12.75						
Benin	2014	46	2.99						
Botswana	2004	13	2.03	2005	36	0.32			
Burkina Faso	2013	45	2.24	2015	1	0.12			
Burundi	2016	731	0.81						
Cameroon	2011	53	1.52						
Cape Verde	2013	61	0.26						
Central African Republic	2020	1	0.01						
Chad	2015	21	0.50						
Congo	2019	18	0.64						
Côte d'Ivoire	2014	67	6.90	2013	10	2.09			
Egypt	2001	151	162.94	2019	1	0.11			
Equatorial Guinea	2019	14	0.27						

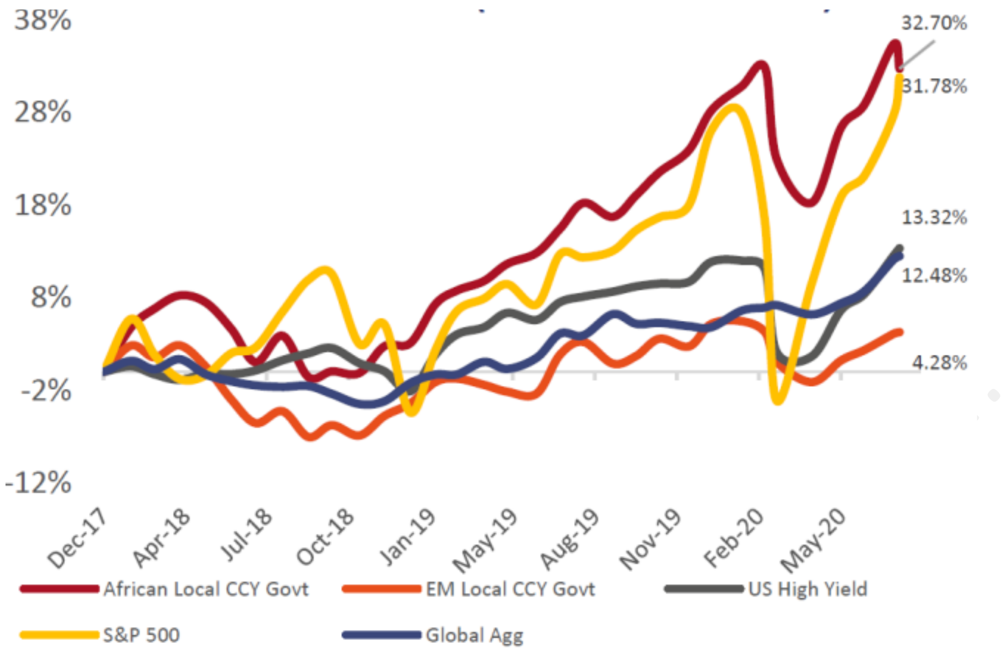
Eswatini	2013	78	0.40	2014	50	0.01			
Gabon	2016	31	1.11						
Gambia	2019	171	0.40						
Ghana	2013	139	15.12	2016	51	7.61			
Guinea-Bissau	2018	18	0.26						
Kenya	2007	159	30.58	2014	11	0.30			
Lesotho	2011	62	0.14						
Madagascar	2019	58	0.27						
Malawi	2019	52	0.40						
Mali	2016	49	1.88						
Mauritania	2019	16	0.14						
Mauritius	2006	228	9.09	2013	45	1.11			
Morocco	2000	98	45.34	2006	64	4.18			
Mozambique	2005	84	2.40	2015	16	0.42			
Namibia	2004	75	3.41	2012	31	0.31			
Niger	2016	31	1.77						
Nigeria	2008	140	46.86	2013	52	1.85	2012	22	1.64
Rwanda	2014	111	1.10						
Senegal	2013	30	2.66	2018	1	0.06			
Seychelles	2019	85	0.17						

Sierra Leone	2019	79	0.52						
South Africa	1998	75	125.70	1997	1677	35.34	2008	20	1.20
Tanzania	2010	199	5.66	2010	3	0.04			
Togo	2015	43	2.67	2012	6	0.15			
Tunisia	2007	48	6.65	2007	198	1.05			
Uganda	2011	74	4.83	2013	1	0.01			
Zambia	2007	220	2.96						
Zimbabwe	2015	9	0.97	2017	1	0.01			
Total		4224	510.24		2255	55.08		42	2.84

Note: this table provides the number and outstanding amounts of bonds listed on African stock exchanges and issued by African governments, firms and municipalities. This description is based on bonds that have not yet matured. The column “Min. Start Year” provides the year of issuance of the oldest bond in each country.

Source: Compilation of authors with data collected www.cbonds.com.

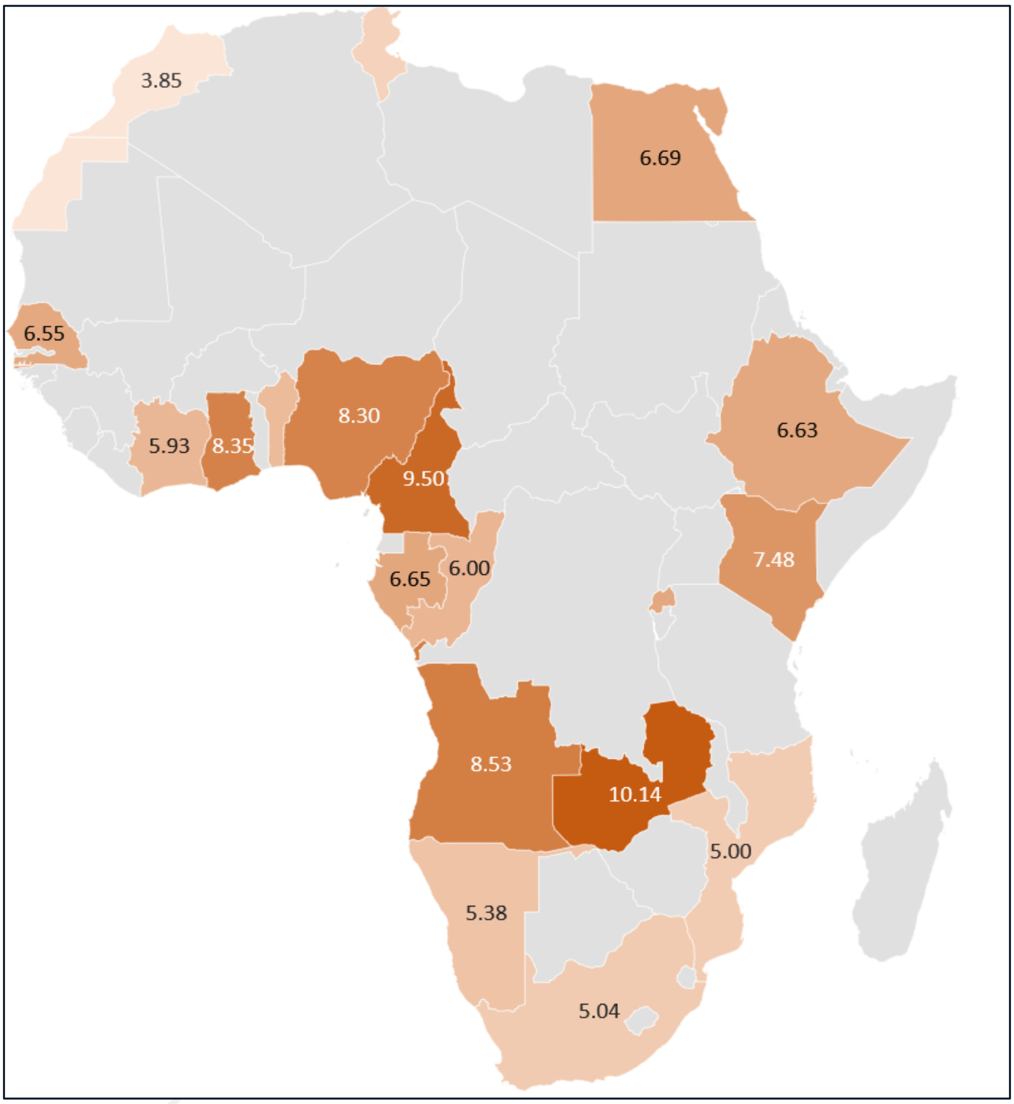
Figure 5: Performance, total returns



Source: African Development Bank Weekly update, Fixed income research, 7 August 2020.

Apart from the domestic bond markets, the last ten years have witnessed an increase in Eurobonds issues by African countries. Since 2010, 20 countries have issued Eurobonds on the international capital markets: Angola, Benin, Cameroon, Côte d'Ivoire, Egypt, Ethiopia, Gabon, Ghana, Kenya, Morocco, Mozambique, Namibia, Nigeria, Republic of Congo, Rwanda, Senegal, Seychelles, South Africa, Tunisia and Zambia. More than $120 billion has been collected by these countries and the largest issuers are Egypt, South-Africa and Nigeria. This appetite for Eurobonds has been supported by observed sustained economic growth over the past two decades in the majority of African countries, prolonged low global interest rates and portfolio diversification strategies in mature markets, with investors looking for additional yields (van der Wansem et al., 2019). In addition, the lack of conditionality in the funds collected in these markets and the drive to signal financial strength are two pull-factors that make this funding source attractive for African governments. Nevertheless, the challenges for African countries issuing international bonds are the relatively high interest costs compared to concessional financing and the concentrated principal payments at maturity. The average coupon rate varies from 3.85% in Morocco to 10.14% in Zambia (see Figure 6). In addition to these publicly reported borrowing interest rates, other indirect fees to be added to the direct cost, such as the cost-of-carry, the hedging cost, etc., all of which have to be considered when evaluating the total cost of borrowing from these international markets. Recently, a number of these economies have run into difficulties in servicing foreign-currency denominated debt – particularly as commodity prices (and local currencies) have plunged since the onset of the Covid-19 crisis. Zambia notably has recently been unable to make a $42.5 million Eurobond repayment, becoming the first African nation to default on its debt since onset of the crisis.

Figure 6: Eurobonds average coupon rate in Africa



Source: Compilation of authors with data collected from www.cbonds.com, accessed August 2020.

It is clear that although African capital markets have significant potential to expand given the huge financing needs for economic development, these markets still need a clear development strategy for the years to come. To help local currency bond markets to grow in Africa, the African Development Bank Group launched the African Financial Markets Initiative in 2008.[4] This is implemented through two key foundational pillars, namely the African Financial Markets Database and the African Domestic Bond Fund, which is the first multi-jurisdictional fixed-income exchange traded fund in Africa. It invests in local currency government and quasi-government bonds. The objectives are:

- to contribute to the development of local currency debt markets in Africa;

[4] See https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-financial-markets-initiative-afmi (accessed 8 January, 2021).

- to enable governments to improve the terms at which they borrow in domestic financial markets, thus reducing their dependence on foreign currency denominated debt;
- to help enlarge the investor base in African domestic debt markets;
- to improve availability and transparency of African fixed-income markets data;
- to provide alternative sources of long-term funding for borrowers in African currencies;
- to act as a catalyst for the development and stability of financial markets as well as for regional financial integration; and
- to create a permanent forum for discussion and provision of technical assistance on domestic bond market issues.

This initiative of the African Development Bank and other regional initiatives to be discussed later aim to foster an enabling environment for the development of bond markets across the continent and to enlarge the investor base.

4 Overview and landscape of other capital markets in Africa

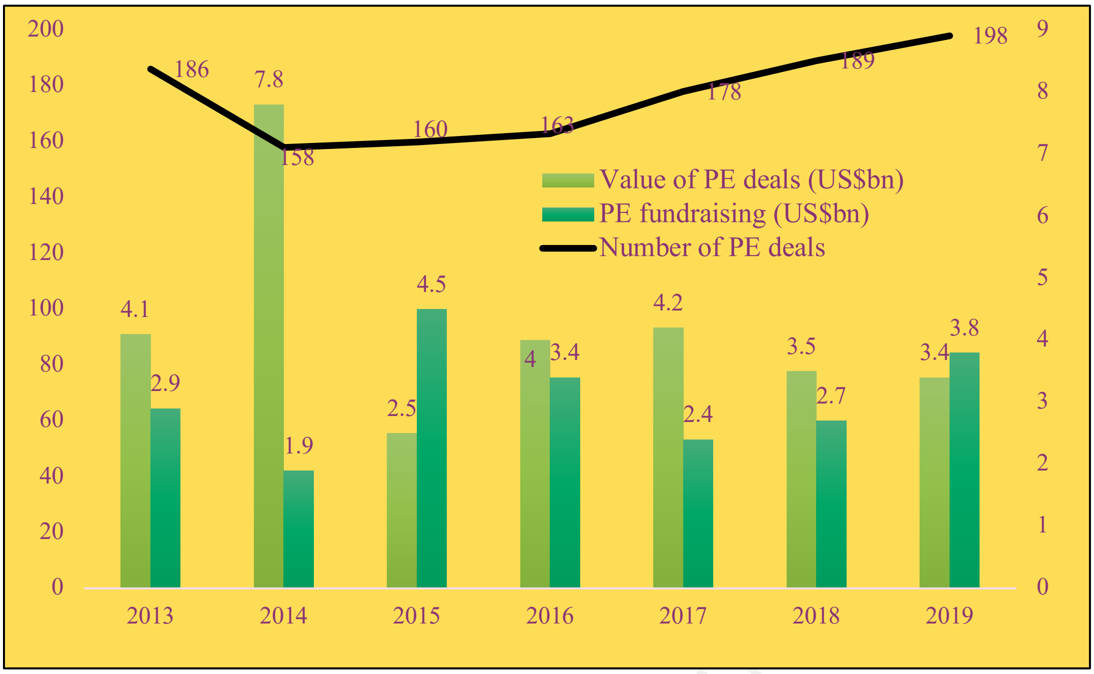
4.1 Overview and landscape of private equity markets

Private equity is an alternative type of private funding, different from stocks and bonds capital raising, in which investment funds and private investors invest directly in private companies or engage in buyouts of publicly listed companies. In recent years, several investment funds have been active in Africa offering this alternative mode of financing, and to overcome the weaknesses of banking finance and the narrowness of African financial markets. There are basically two types of private investment fund: development funds used to finance existing businesses that need capital to expand, and venture capital funds that finance start-ups with high growth potential.

The number of deals[5] increased from 158 in 2014 to 198 in 2019 (Figure 7). Overall, 1232 private equity deals took place in Africa between 2013 and 2019 with a total value of $29.5 billion. Over the same period, private equity fundraising on the African continent amounted to $21.6 billion. The total value of private equity funds raised increased from $2.4 billion in 2017 to $3.8 billion in 2019, which indicates investors' confidence in Africa's private equity industry.

Figure 7: Number and value of African private equity (PE) deals, by year

[5] A deal refers to an entry of capital (equity) or an exit (sale of its share capital to another investor) of the capital of a company by an investment fund.



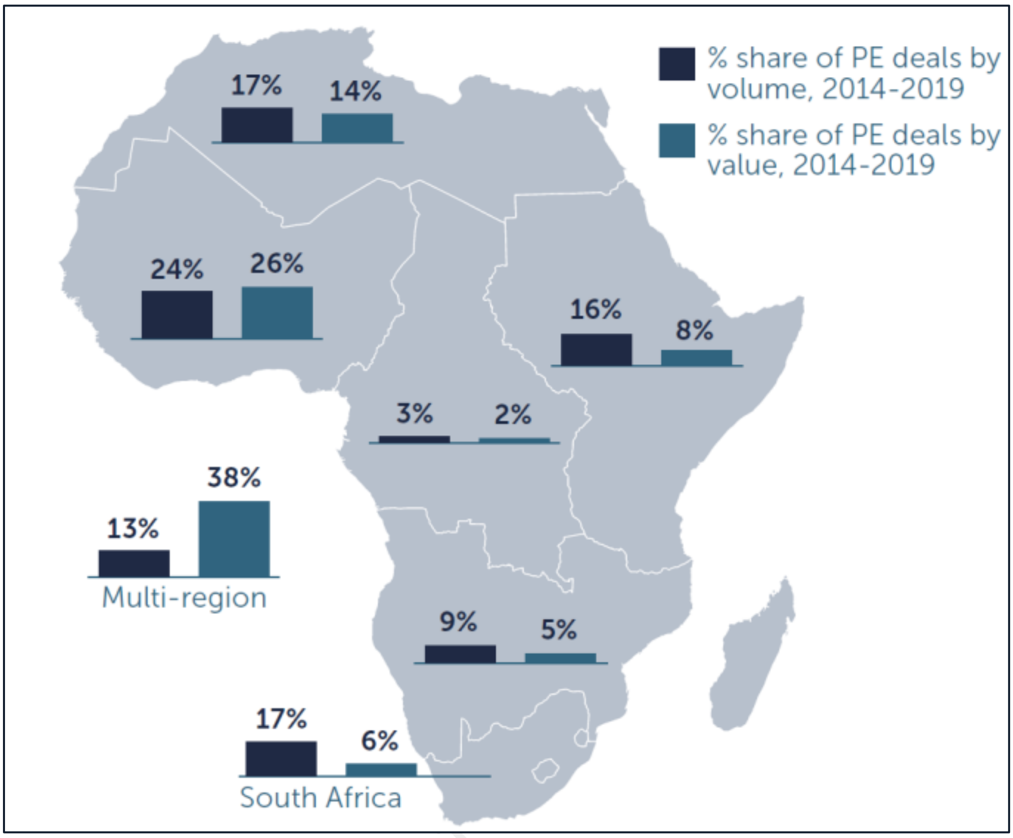
Source: 2019 Annual African Private Equity Data Tracker

Although the number of deals has sharply increased in recent years, Africa is still lagging behind when compared to private equity activities in other regions of the world. In 2019, $555 billion of private equity funds was raised worldwide (McKinsey, 2020). In other words, Africa only represents 0.68% of the world share. Private equity fundraising in Asia appears to be 24.7 times bigger than that in Africa in 2019.

The distribution of investments made by African private equity funds on the continent (Figure 8) shows that the deals are concentrated mainly in Western and Northern Africa. Western African economies captured 26% of the total deals value over the period 2014-2019. The two big players of this region are Nigeria (68% of the regional value) and Ghana (22% of the regional value). Northern Africa captured 17% of the volume and 14% of the total value of deals. Egypt (42% of the value of regional deals), Morocco (28% of the value of deals in the region) and Tunisia (24% of the value of regional deals) are the three main players in this region.

In the other regions, South Africa alone captured 17% of the total volume of African private equity deals and 6% of value of deals between 2014 and 2019. The amount of capital invested in South Africa is almost the same as that invested in Eastern Africa (16% of the volume and 8% of the value). In East Africa, most of the private equity funds were invested in Kenya (56% of the region’s total volume and 54% of total value), Uganda (21% of volume and 15% of value) and Tanzania (9% of volume and 13% of value).

Figure 8: Share of number and value of African private equity deals, by region, 2014-2019



Source: AVCA (2020)

4.2 Overview and landscape of crowdfunding markets

Crowdfunding is a way to raise funds by using online platforms to ask a large number of people to fund a project or venture. Also known as alternative finance, the crowdfunding market is composed of different types of crowdfunding (see Table 3).

Table 3: Models of crowdfunding

Model	Definition
Equity-based crowdfunding	Individuals or institutional funders purchase equity issued by a company.
Donation-based crowdfunding	Donors provide funding to individuals, projects or companies based on philanthropic or civic motivations with no expectation of monetary or material return.
Crowd-led microfinance	Crowd-lenders provide micro-loans to unbanked/below income borrowers via an online microfinance platform, for zero or low-interest returns.
P2P consumer lending	Individuals or institutional funders provide a loan to a consumer borrower.

Real estate crowdfunding	Individuals or institutional funders provide equity or subordinated-debt financing for real estate.
P2P business lending	Individuals or institutional funders provide a loan to a business borrower.
Profit-sharing	Individuals or institutions purchase securities from a company, such as shares or bonds, and share in the profits or royalties of the business.
Reward-based crowdfunding	Backers provide finance to individuals, projects or companies in exchange for non-monetary rewards or products.
Balance sheet business lending	The platform entity provides a loan directly to a business borrower.
Invoice trading	Individuals or institutional funders purchase invoices or receivable notes from a business at a discount.

Source: Cambridge Centre for Alternative Finance (2018)

According to Moed (2018), 57 crowdfunding platforms were operating in Africa in 2015, including 21 in South Africa and 9 in Nigeria. The African crowdfunding market was composed of 21 donations-based platforms, 19 equity-based platforms, 13 rewards-based portals, 2 peer-to-peer lending platforms and 2 hybrid platforms. According to the Cambridge Centre for Alternative Finance (2018), African-based firms received $58.40 million in funds raised in 2016, accounting for 32% of all alternative finance generated in Africa. Less than half (45%) of all business funding came from equity-based models and 52% came from debt-based models. The West Africa region is the leading market with a total market share of 41% in 2016. It is followed by Southern Africa (28%) and Eastern Africa (24%). North Africa and Central Africa capture 5% and 2%, respectively. In the Middle East, businesses raised $117.39 million, representing approximately 70% of the total alternative finance volume in the region in 2016. This amount is twice the capital raised by Africa-based businesses.

5 Other issues related to capital market development in Africa

5.1 The role of regionalisation

Most local capital markets in Africa are clearly very small in size. Regionalisation could be a route to deepening African financial markets, with countries coordinating to pool their strengths (Irving, 2005). As regionalisation and capital market development advances, there may be opportunities for existing smaller national exchanges within a region to specialise in different industry sectors or types of share issues as a way of improving efficiency.

Regionalisation or regional financial integration can be defined as a market or institutionally driven process of broadening and deepening the financial interrelationships within a region. Regionalisation is expected to create larger markets and expand the spectrum of opportunities for financial intermediation, which makes it more cost-effective to improve financial infrastructure and diversify financial services offerings. Efficiency effects also arise from the increase in the number of participants promoting diversification and healthy competition, and thus, eventually results in lower prices for services (Ekpo and Chuku, 2017). Finally, regionalisation could increase capacity to withstand financial crisis even though greater regionalism may mean greater contagion effects in the future.

There are several ongoing initiatives to create regional stock exchanges in Africa. One of the most accomplished is the regional stock exchange of the West African Economic and Monetary Union (WAEMU) region, the BRVM, shared by eight countries in the region.[6] A similar initiative was undertaken to consolidate the regional stock exchange of the Central African Economic and Monetary Community by merging the *Bourse des Valeurs Mobilières de l'Afrique Centrale* (BVMAC, the Community's securities exchange) with the Douala Stock Exchange. The merger took place in 2019 and will help create economies of scale and scope to increase the size, depth and liquidity of the stock market.

The West African Capital Markets Integration Council (WACMIC) was initiated to allow the integration of capital markets in the Economic Community of West African States (ECOWAS). The over-arching objective of the Council is to establish a harmonised regulatory environment for the issuance and trading of financial securities across the region. The Council will work to create cross-border capital markets, where a passport mechanism will exist with a single listing system: the

[6] Although the BRVM started life as an eight-member country exchange, it is relatively illiquid and local institutional investor base relatively underdeveloped.

passport will allow a registered broker in a given jurisdiction to trade on other stock exchanges; while the single listing will allow a company to be listed on a single stock exchange with the stock available for transactions by all brokers in the defined area. The passport system would start on a regional basis within the existing regional economic communities. ECOWAS is a prime example on this subject (see box below).

Box 1. The WACMIC initiative in the ECOWAS region

The West African Capital Markets Integration Council (WACMIC) was inaugurated on 18 January 2013 as the governing body for the integration of capital markets in ECOWAS. The over-arching objective of the Council is to establish a harmonised regulatory environment for the issuance and trading of financial securities across the region, as well as to develop a common platform for cross-border listing and trading of such securities in the sub-region. WACMIC comprises the Director Generals of the region's securities commissions and the Chief Executive Officers of the securities exchanges (in WAEMU, Ghana, Nigeria, Sierra Leone and Cape Verde).

The Council is tasked with designing the policy framework and managing the implementation of the process that will facilitate the creation of an integrated capital market in West Africa. Specifically, the Council is to:

- Supervise the capital market integration programmes
- Set up standards and validate all works done by the technical committees
- Coordinate relevant stakeholders, such as ECOWAS, the West African Monetary Institute and WAEMU
- Monitor and assess the state of preparedness of the member states in the integration process
- Source funds and other resources for the implementation of capital market integration
- Monitor standards and compliance after integration.

The work carried out under the auspices of WACMIC will lead to the integration of financial markets in three major phases:

- Integration Phase 1: Sponsored access trading (brokerage firms)
- Integration Phase 2: Common passport for qualified West African brokers in ECOWAS
- Integration Phase 3: Establishment of a common trading platform in the region.

Similar initiatives to integrate capital markets are ongoing in the East African Community (EAC). Here, concrete progress has been made, including in achieving relative success in attracting cross listings on at least a few of the national stock exchanges and cross-border investment by the EAC's institutional investors (despite the lack of a common currency). Three of the markets (Dar es Salaam Stock Exchange, Rwanda Stock Exchange and Uganda Securities Exchange) have connected their trading systems and linked with the EAC Capital Markets Infrastructure platform.

Regarding bonds, a regional bond market development agency known as *Agence UMOA-Titres* was created in 2013 by the Central Bank of the WAEMU countries to help member states use their domestic capital markets to raise the resources they need to fund their economic development policies at reasonable costs. This is a market dedicated to public bonds and Treasury bills, shared by the eight countries of WAEMU with a common currency.

Moreover, another attempt to deepen African capital markets is represented by the African Continental Free Trade Area signed in March 2018 by 44 African Heads of States to establish a single continental market for goods and services, with free movement of capital and business travellers.

5.2 Demutualisation of exchanges

Most stock exchanges around the world move from mutual associations of exchange members operating on a not-for-profit basis to a limited liability, for-profit company accountable to shareholders. This is known as demutualisation (Elliott, 2002). By changing the ownership structure, it can be beneficial to the concerned organisation by allowing them to raise money by trading shares, which potentially leads to faster growth.

Historically, most stock exchanges were not-for-profit organisations owned by their members. The new trend in the industry is to consider alternative governance structures other than the traditional mutual or cooperative models. According to Abukari and Otchere (2020), the proportion of demutualised stock exchanges increased from 10% in 1999 to 62% in 2013. Demutualisation is supposed to improve liquidity and respond quickly to the needs of the market, unimpeded by member committees and their diverse interests (Abukari and Otchere, 2020). It also gives access to capital markets for fundraising. Being publicly quoted also gives exchanges and their management a clearer idea of their worth. Moreover, demutualisation leads to stock market growth and stability and to better growth decisions (Sial et al., 2015).

Demutualised exchanges in developed markets from 10 in 1999 to 25 in 2003 (Yartey, 2007), with the JSE becoming the first in Africa to demutualise in July 2005. The Nairobi Securities Exchange was demutualised in 2014, and the Nigerian Stock Exchange followed suit in 2017. In Southern Africa, the Botswana Stock Exchange finalised its demutualisation in 2018. This global trend is likely to continue across the continent and will bring more transparency and inclusiveness in the way stock exchanges are managed.

6 Conclusion

It is well documented that Africa has one of the lowest financial inclusion rates in the world. The financing of the economy is essentially bank-based, with underdeveloped capital markets across the continent except in South Africa. These markets are composed mainly of stock exchanges and bond markets, even if other capital markets such as private equity markets and crowdfunding platforms are gaining ground. While stocks traded on exchanges are issued mainly by big firms, for bonds, governments are the main issuers. Corporate bonds constitute a tiny part of the capital markets in most African countries. Despite this under-development, there is still huge potential for market expansion given both the financial development gap and the huge infrastructure development gap in Africa.

African capital markets can increase their investor base by tapping into the huge financial resources sitting in deposit accounts of African pension funds and sovereign wealth funds. According to Soumaré (2020), African pension funds hold about $700 billion, and the assets of sovereign wealth funds in sub-Saharan Africa are estimated at $16.4 billion. If these funds were channelled into the continent's local capital markets, they would improve the liquidity of many African exchanges and bonds markets. However, this would require appropriate market mechanisms (sound regulatory framework, transparent management structures and safe business environment), which do not fully exist today, with some markets having made significant progress and others much less so. In many cases, not only are the investment vehicles offered domestically too risky from the perspective of institutional investors, but funds are prevented from investing abroad. One successful use of pension and other public funds for economic development is the case of the Province of Quebec in Canada, where the *Caisse de Dépôt et Placement du Québec* pools public funds in a fund management vehicle for investment in financial markets and in the economy. Similar successful examples are the *Caisse des Dépôts et Consignations* in France and the *Caisse de Dépôt et de Gestion* in Morocco. These pooled funds managers are some of the largest institutional investors in their domestic markets and around the world. To enable pension funds and other indigenous institutional investors to contribute significantly to the growth of their domestic economies, management institutions need to be set up with specific objectives and must have sound regulatory frameworks and business environments.

State-owned enterprises (SOEs) are among the big economic players in many African countries. In South Africa, 5735 large companies have been formally registered (Small Business Institute, 2018), but less than 400 of them are listed. The privatisation[7] of some of the SOEs through 'democratic' initial public offerings and listing them on local exchanges will increase the number of listed companies and offer investors more choices to diversify their portfolio. Allowing citizens to hold

[7] See, for instance, Estrin and Pelletier (2018) for recent experiences and lessons to be learned from privatisation of state-owned enterprises in developing and emerging economies. Of course, some of these mistakes should be avoided.

shares in these large companies will not only increase the number of market participants, but also increase the number of traded stocks available. The listing of these SOEs could increase not only their ability to mobilise additional financial resources for innovative projects, but also will improve their corporate governance and performance. Such initiatives require continuous improvement of the business environment, with sound and reliable regulatory frameworks, financial literacy and management structures, all of which do not yet fully exist in many African countries.

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