A closer look into the capital markets in East Africa

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The East African region has a relatively shallow and illiquid capital markets compared to many other parts of the World. Kenya has by far the largest and most developed market in the region. The Nairobi Securities Exchange (NSE) is the oldest market in the region, being established in 1954 - and commands about 60 percent of all capital market activities in the region, as measured by: number of companies listed in stock markets, depth of the market, number of investors, price volatility and market liquidity. Dar es Salaam Stock Exchange (DSE) is the second followed by Uganda Securities Exchange (USE) and then Rwanda Stock Exchange (RSE), the three exchanges are relatively smaller and newer - being established about 20 years ago in response to economic reforms that included privatisation of state-owned entities, listing of treasury securities, and for providing platforms for long term and efficient capital raising by the private sector enterprises.

The four markets (Kenya, Tanzania, Uganda and Rwanda) have the combined Gross Domestic Product (GDP) of about $195 billion, its stock markets total equity market capitalization is $ 35 billion, about 120 listed companies (100 if cross listings are excluded), outstanding combined bonds listed in the four markets are worth about $20 billion. Liquidity (turnover) in the equity segments is at $1.8 billion per annum (five percent of market capitalisation), liquidity on bonds segments is about $4 billion. Our total population is estimated at 180 million people, out of these only about three million people have investment accounts in stock exchanges.

The above data informs us much about our region and the state of its capital markets. The data tells how little we make use of the capital markets to finance enterprises and development projects. Which begs for a question, how are we currently financing our long-term economic activities? As for the short-and medium-term economic activities and projects, commercial banks have been effective — both in the mobilization of domestic savings and in the intermediation. What is clear though is that we have not been as keen to intermediate our domestic savings to finance our long-term enterprises and projects via capital markets.

On a closer look into the data above one could tell that our corporate enterprises, local governments and municipals, infrastructure projects, are largely financed outside the capital markets. It says that we need to awaken our conscious to the fact that capital markets have historically played a significant role in the financing of economic development, propel financial literacy and inclusion, in implementation of inclusive economic empowerment, as well as the democratisation of finance.

We may argue that, in most measures: i.e. number of listings, market participants (retail and institutional investors), markets capitalization, price volatility and valuations as well as liquidity, our stock markets are still relatively small. For example there has been not more than 3 listed companies in the four exchanges for the whole of 2020; that only Kenya has infrastructure bonds, that the whole regional do not have a single listed local government or municipal bonds; shares and bonds are rarely traded – sometimes trading occurs in few stocks, particularly those representing the majority of market capitalization — mainly banks, alcoholic beverage, cement and telecommunication companies; turnover ratios are still very thin.

Where should we be? How should we understand it? Deep, transparent, and accessible financial markets are vital to supporting economic growth, rising consumer demand, and supporting productive innovation. V.brant financial markets play a critical role in channelling financial resources (savings) into productive investment and fostering growth of enterprises and the economy.

And, to be able to sustainably achieve the level of deep, diversified and liquid markets, a good combination of both banks (providing short-to-medium term capital) and capital markets providing platforms for long-term and specialised funds, is critical. Robust financial markets allow countries to move beyond short term, volatile capital flows by attracting longer-term investments that strengthen a country's economic stability by providing more resilient foundation of capital flows.

However, given the newness of most of our stock markets, coupled with lack of awareness and financial literacy as well as the fragmented nature of our financial markets, entrepreneurs access to long-term capital and the investment capacity of institutional investors participation in the financial markets remains limited among stringent capital allocation decision process and financial markets are therefore small, narrow and illiquid.

DSE officials follow trading activities in Dar es Salaam. PHOTO|FILE

Our stock markets suffer from both structural and infrastructural bottlenecks – some key institutions to support the capital markets ecosystem (i.e. corporate transactions underwriters, investment banks, market-making institutions, private equity funds, etc) do not exist in most of our markets.

Privatisation via stock exchanges had not been executed as was anticipated; the level of awareness is still relatively low; a culture of embracing transparency is still a challenges to many family owned businesses; listing requirements for some markets restrict many businesses from raising capital and listing into these exchanges; trading, clearing, and settlement systems are sometimes slower than usual.

Similarly, some markets restrict foreign participation in some of the listed products. Such bottlenecks induce inactivity in markets.

But much more needs to be done to improve liquidity and attract more company listings.

Key steps include promoting transparent and accountable institutions, providing adequate shareholder protection and investor education, strengthening regional collaboration, and encouraging financial innovation.

Governments continuance to support exchanges by way of privatizing public enterprises via exchanges, and by providing an enabled environment, including tax incentives to encourage listing of private enterprises, especially small and medium-size enterprises, is critical to the growth of our stock markets.

On the positive note, however -- despite the newness, narrow and illiquid level of our markets, we may need to note that we have undergone substantial changes in past two and a half decades, i.e. in early 1990s there was a single stock market, with less than 30 listings, with the current situation where we have four exchanges with 120 listed entities is something worth noting; even though we know that we can do better than this.

In conclusion, as region promotes commercial agriculture, industrialization, infrastructure developments; as region intends to look inward in terms of how we finance our development - let us remind ourselves that for dynamic and more inclusive economies, we need among others to closely pay attention and consciously developing our local capital markets so that they become vital sources of long-term financial resources mobilization for our sustainable growth and development.

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