Capacity Building Workshop on the Role of Capital Markets in Mobilizing Domestic Resources in Africa

Draft Concept Note

Department of Economic Affairs

September 2018
1. The Context

i. Introduction

Africa’s financial markets are mainly dominated by domestic institutional and private investors. The domestic institutional investors include banks, most of which are ill-functioning, state owned and protected from outside competition, and insurance companies and pension funds. Capital markets recently began developing, though at a slow pace, and most African countries are still lagging behind. The number of active stock exchanges in Africa has grown considerably since 1989. However, most African countries’ stock exchanges tend to be small and fragmented and they are characterized by a few listed companies.

Capital markets are crucial and imperative for the efficient functioning of financial markets and for governments in the promotion of both domestic and foreign savings and investments. The mobilization and effective use of domestic resources has been identified as the most sustainable way of financing development. Mobilizing domestic resources through the development of capital markets will go a long way in financing Africa’s development and in creating wealth for the African citizens. In this regard, the need for key industry players to list on the stock exchanges in order to further deepen the African capital markets cannot be overemphasized.

The African Heads of States have emphasized the importance of domestic resource mobilization for the development of the continent. Domestic resource mobilization has become imperative as a result of the increasing developmental requirements of the continent including Agenda 2063 and the Sustainable Development Goals. Prioritising and investing in the capacity building of Member States so as to improve the capital markets is essential. Capital markets play a vital role in increasing the mobilization of savings, therefore improving the efficiency and volume of investments, economic growth and the development of Africa.

The Addis Ababa Action Agenda (AAAA) of the Third Conference on Financing for Development called for the development of domestic capital markets, in particular, long-term bond and insurance markets, to meet longer-term financing needs. The AAAA also called for the strengthening of regional markets to achieve scale and depth that cannot be attained by the small and ineffective markets. The small size of capital markets in Africa contributes to their high operational costs and inefficiency. The integration of financial markets in Africa is crucial for better mobilization of resources, available within and outside the continent, and a stronger level of investment and economic growth.

ii. The evolution of capital markets in Africa

The total capitalization of African securities markets is currently estimated at around US$2 trillion, up from US$113 billion in the 1990s. However, 65% of the total market capitalization and 25% of the total listings are in South Africa. African equity markets have seen some improvements in the volume of initial public offerings (IPOs) during the year 2017, driven mostly by South Africa, Egypt and Tunisia. Africa’s stock markets are still illiquid, turnover ratios are very thin, at less than 1 per cent in many markets. Africa’s share of the global equity turnover is less than 0.05 per cent. Low liquidity
implies more difficulty in supporting a local market’s own trading systems, market analysis, and brokers as volume is too low. Most markets are capitalized below US$50 billion, some with fewer than 10 listings. Overall, the prospects for growth in the African equity markets, including cross-border IPOs of African companies, are good, with South Africa, Egypt and Nigeria expected to lead the growth.

The bond markets have steadily increased over the years but nonetheless remain undeveloped. The bond market was about 140 per cent of global GDP as of 2013. In most African countries, however, the size of the bond market is less than 10 per cent of countries’ GDP. Factors such as: economic size, openness of the countries’ capital account, size and concentration of the banking sector, bureaucratic practices, interest rates spread, exchange rates volatility, fiscal balance challenges, corruption, quality of accounting standards, and size of domestic credit all impact the development of local bond markets. Non-local currency corporate debt activity continues to increase, indicating the increasing appetite for debt financing by African governments. Most of the non-local currency debt transactions are denominated in US dollars, with sovereign, supranational and non-US agencies accounting for over 75% of the total value of debt between 2013 and 2017. This debt was mainly raised by the financial sector, mostly Nigerian and South African banks.

iii. Challenges faced by capital markets in Africa

African capital markets suffer from infrastructural bottlenecks. Trading, clearing, and settlement systems are slow, some exchanges still operate using manual systems. In addition, private firms seem to lack confidence in the stock markets, selecting not to use them as a means of raising capital. The concern is that the risks associated with the required disclosure for IPOs are not adequately compensated by additional returns. Another challenge is that the costs that are required for companies to trade on the capital markets are high and cumbersome which discourages most companies from going public. African countries should work to overcome these challenges, partly by boosting the investor base by attracting foreign institutional and private investors. Increasing the investor base will work to improve competition and liquidity in the local market, which is necessary for the growth and development of African capital markets.

2. Rationale of the Workshop

The Workshop aims to bring together capital market practitioners with a view to building consensus on the role of capital markets in mobilizing resources for Africa’s development, in particular funding Agenda 2063 and the Sustainable Development Goals. Best practices will be shared from across the continent on what measures have been taken to build the capacity of capital markets to fund infrastructure projects in particular, and to finance long term projects in general. The Workshop will provide an opportunity to frame concrete policy options and actions for capital markets to be further developed and integrated in order to facilitate integration and harmonization of economic and financial policies.

3. Date and Venue

The Workshop will take place from 5 to 7 December 2018 in Gaborone, Botswana.
4. Format of the Workshop

There will be a general introduction on the theme of the Workshop, followed by presentations and a high level policy dialogue aimed at articulating the issues on the role that capital markets can play in mobilizing resources for Africa’s development. The Workshop will discuss various Capital Markets related issues on the continent and provide guidance to Member States. The subsequent sessions will be organized in breakaway sessions to exchange views on the following sub-themes:

i. Infrastructure and Technology

Inadequate and poor infrastructure remains the major obstacle towards capital market development in Africa. Some stock exchanges are still trading using the manual open-outcry systems. Lack of technological platforms to integrate the capital markets in Africa is a major challenge. Johannesburg and Nigerian stock markets have made progress in terms of ICT development and through this reform the number of their listed securities and brokers increased. Investing in capital markets infrastructure is vital for the development of the continent as this can simplify trading across borders and contribute towards the transformation of Africa.

ii. Liquidity

Liquidity plays a crucial role in capital markets development of Africa. The continent is still facing a challenge of low liquidity, as indicated by the turnover ratio which is less than 5% in many markets and the share of global equity which is less than 0.05%. The illiquidity in Africa’s stock markets implies more difficulty in supporting the local market’s own trading system. This also limits access to long term financing and hindering of countries’ capacities for local equity and debt financing. Therefore much needs to be done in order to improve the liquidity and attract more company listings.

iii. Regional Integration

Africa has made great efforts in terms of regional integration through different cooperation agreements that have been signed to foster the development of economies, more recently the African Continental Free Trade Area (AfCFTA). Regional integration can steer up competition, increase infrastructure investments and open up an opportunity to raise more funds. In this regard, there is need to establish appropriate instruments to encourage cross-border investments through cross-border trading of shares and other securities.

5. Expected Outcomes

It is expected that the workshop will result in the following:

- A report of the proceedings of the Workshop.
- An understanding of the role that capital markets can play in mobilizing resources for sustainable development.
- Recommendations for Member States on the steps that should be taken to further develop capital markets in their individual countries and regions.
- Sharing of best practices from across the continent.
6. PARTICIPATION

The Workshop will attract about 50 participants, including representatives from African stock and securities exchanges, stockbrokers, regulatory authorities, private sector and regional economic communities. The African Securities Exchanges Association, United Nations Economic Commission for Africa, African Development Bank, the African Capacity Building Foundation and the African Union Commission are also expected to attend.

7. CONTACTS

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