# Is Ethiopia Ready to Commence Capital Market? Analysis of Potential Beddings, Constraints and the Dubious

Mebrahtu Leake Teklehaimanot
College of Business and Economics, Haramaya University
E-mail: mebratuleake@yahoo.com

**Abstract**
After the fall of the Derge regime in 1991, Ethiopia has re-oriented its command economy into a market-led economy. Since then gradual structuring and changes have been made in the diverse constituents of the country's economy. The financial system was liberalized to quill the demand of the market economic model and hasten development though its growth, in terms of diversity and quality, is dawdling. Despite the financial liberalization which enables private firms to emerge, Ethiopia still does not have capital market as the government does not recognize its significance to the country's development. Debates, however, have been made by the wider academic community, experts and researchers on the importance and development of capital market and pressures on the government to initiate the market have been made by international and national stakeholders. This squabble was the prime reason for undertaking this study to identify the promising factors bedding for the establishment, diagnose constraining factors of the same and why the government is ambivalent based on the primary and secondary data collected from major companies established through shares in an initial public offering, government institutions, officials, academicians, financial experts, proclamations and other official documents. The findings of the study depict that the country's fast economic growth, expansion of energy, initiators and public inclination to incorporated companies, invest than save push and increase of capital flow to the country are seminally backing capital market development while government's reluctance, underdeveloped legal and physical infrastructure, immature financial sector, uninformed and small-base domestic investors and nonexistence of skillful and institutionalized market makers are delaying for its development. The study recommends the establishment of market as it is significant to mobilize domestic savings and huge capital to clinch financial gap of financing huge national projects, enhance access to equity fiancé of the private sector and promoting rapid economic development by suggesting possible ways of doing it.
**Keywords**: Capital market, financial liberalization, Economy, Ethiopia

## 1. Introduction

Poverty is widespread and remains a major challenge of sustainable development and stability in Ethiopia, the second populous country in Africa (Easterly, 2002; LWFE, 2006). It is estimated that close to half of the population in urban and rural areas of the country live in absolute poverty due to limited economic opportunities, decades' political unrest, inadequate basic household income, and poor means of survival (Serneels, 2004 and Eshetu and Mammo, 2009). Thus, poverty reduction has become the top agenda of the Ethiopian government by redirecting the economy into market-oriented, implementing different policies and initiating poverty alleviating plans at different periods. Since 1991, the Government has pursued Agricultural Development Led Industrialization (ADLI) as a major policy framework to accelerate economic growth and to eradicate extreme poverty. The Plan for Accelerated and Sustainable Development to End Poverty (PASDEP), 2005/6-2009/10, was also initiated in line with this. For these or other reasons, the country has been registering an enticing economic growth (on average 11%) over the recent years (MoFED, 2011). Besides, official government reports and a study made by Devereux and Sharp (2003) indicate that the dreadful nature of poverty, in the country, is declining due to progressive economic growth and positive policy directions, but still remains the chronic problem in the country.

Other efforts are also made to achieve the long dream of transforming the country into industrialization and middle income nation though little is achieved in this regard. The Growth and Transformation Plan (GTP), 2010/11-2014/15 which actually demands huge resource mobilization for realization is among the recent efforts. The government claims that this plan is instrumental to bring accelerated, sustained and transformative economic growth to end poverty in the country. When officially announced in November 2010, however, stakeholders like the World Bank and IMF said it is very ambitious plan demanding huge resource for which the country can't afford. Thus, financial sector development is at the heart of resource mobilization, industrialization, boosting investment and accelerating economic growth. Bekaert and Harvey (1997) also state that economic growth depends on efficient financial sector in order to pool domestic savings and mobilizes foreign capital for productive investments. Thereby, it seems difficult for the government to achieve the government's accelerated, sustained and transformative economic growth without a vibrant, efficient and enabling financial system. Thus, the establishment of strong, reliable and accessible financial institutions and markets is indispensible to channel resources from unproductive excesses (suppliers) to productive investment (demanders) and enhance foreign capital flows. In doing so, Ethiopia has been engaged in gradual liberalization of its financial sector since 1992

which enables private institutions to flourish (Alemeyehu, 2006), but does not allow capital market to exist.
Capital markets are markets that trade equity (stocks) and debt (bonds) instruments with maturities of more than one year (Saunders and Cornett, 2001). 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 (Asrat, 2003). Stiglitz, *et al* (1993) described that financial markets are essential for mobilization and allocation of resources for industrialization and can be thought as the "brain" of the whole economic system. Literature also reveals that there exists a positive correlation between economic growth and capital market development (see Beck *et al,* 2006 and Bose, 2005), but Beckaert et al (2005) put financial liberalization as key and determinant factor for efficient capital market development to lead into economic growth. Despite the advocated benefits, however, Ethiopia doesn't launch capital market worrying for its curses. Now days, pushes have been coming from stakeholders for the establishment of the market in order to mobilize sufficient financial resources even to finance the ambitious government plans and to ignite economic growth in the nation. This has become worthy studying to reconcile the trade-offs by assessing some fundamental factors that either promise or defy the development of the market.

## 2. Role of Capital Market in Developing Economies: the Dubious

Studies have been made to analyze the impact of establishing capital market on economic growth of countries. Those studies conducted in advanced economies have substantiated the significance of capital markets in such economy. Ouandlous (2010), for example, underlined that without the establishment and development of capital markets, none of the advanced economies have achieved outstanding economic development. Mishra *et al* (2010), Asrat (2003), and Bekaert and Harvey (1997) stated also that development of securities market contributes to economic development by pooling domestic savings and attracting foreign capital and channels for productive investments. Walter (cited in Mishra, 2010) argued, in his book *Lombard Street* published in 1873, that it was England's efficient capital market that made the industrial revolution possible. Levine (1997) also indicate that countries which had liquid capital markets (such as USA, UK and Canada) grew economically much faster than countries with illiquid or no markets (developing countries) over the period of 1974-94. Capital markets in the UK and US dominate these countries financial system and are the main reasons for higher productivity growth, greater employment opportunities, advanced technology and economy (Dudley and Habbard, 2004). However, investigations in developing countries have varied results.
Stiglitz (1989) and Singh (1999) reveal that establishment of capital market in developing countries has little relevance in economic growth. Some studies, made in the African content, claim that securities market could not be a backbone of the African countries economy as these countries didn't ripe and well-positioned socially and economically and capital markets may not sufficiently be liquid. Singh (1999), for example, explained that establishing a capital market, for African economies particularly those in Sub-Saharan African (SSA), at this stage of their development is likely to do more harm than good, because they are politically instability prone to high volatility and institutionally unorganized; African countries would do better to use their human, material, and institutional resources to improve their banking systems than to promote capital market.
More opponents of the capital markets establishment in developing countries evidence their argument as these countries do not have well organized institutions and markets are less well regulated and more poorly organized than their counterparts in developed countries. Hence, they can lead the economy into perplexing crisis. For developing countries to establish financial market, they must invest and improve their infrastructure, make changes in their policy and uphold activities that can attract the private sector cross-border fund flows and make them competitive and preferable of their counterparts. For this or another reason, many countries, including Ethiopia, have locked their doors leaving the banking sector to dominate in the financial intermediation of the continent. Africa has about 23 stock markets most of which initiated by governments for technocratic and political reasons, Moss (2003) or established during the colonial era. They are characterized as illiquid and inefficient with rarely traded shares, (Yartey and Adjasi, 2007), contributing only less than 2% of global securities market transaction. Thus, Africa has been heavily dependent on official development assistance (ODA) to finance persistent balance of payments deficits. With low incomes and generally weak economic and investment policies and financial services, most African countries and mainly the Sub-Saharan Africa (SSA) have been unattractive to private investors, and thus received little private capital.
Proponents of capital market development in developing economies, on the other hand, argue for its contribution in liquidity, private sector development, risk diversification, acquisition of information about firms, corporate governance, capital efficient use, savings mobilization and reducing dependency on banking sector by complementing it, not substituting. Murinde (2006) noted that capital market development is important in developing countries to complement and facilitate reforms in the banking sector. It is also noted by Ouandlous (2010) for emerging economies to imitate the achievements of the advanced economies, they have to establish and develop capital markets. Thus, philosophical changes and shift in recent years have happed in many African countries by refreshing their economic and political systems (Asrat, 2003). Financial sector reform has become

part of the development agenda. A study made by Murinde (1999), for example, indicated that most African governments are now keen to develop capital markets as a direct way of mobilizing risk capital for the corporate sector. They have begun to consolidate the importance of capital market in attracting foreign portfolio investment, private sector development and the integration of domestic economies to the wider world (Murinde, 1999). Nevertheless, the importance of the market in developing economies is still blurred.

## 3. Methodology

### 3.1. Description of the study Area

Ethiopia, a country with over 84 million population and one of the poorest countries with USD 350 per capita income (WB, 2012), is located in the Horn of Africa. This study was mainly undertaken in the capital city of Ethiopia, Addis Ababa, owing to the following reasons. Addis Ababa, established in 1886 and with the population about 4 (four) million, is the seat of the African Union (AU), United Nations Economic Commission for Africa (UNEC), NGOs and other international organizations (UN-HABITAT, 2008). It is also the seat of all federal ministries, head offices of major businesses, consultancies, and major business centers persuading capital market development. For instance, from the total of 17 banks and 14 insurance companies in the country, 52.9% and 50.7% are concentrated in Addis Ababa, respectively (NBE, 2011) and all the head offices of the banks and insurance companies are situated in the city. Addis Ababa is also considered as a land of opportunity, where hundreds of thousands of people coming from all corners of the country in search of better employment opportunities and services.

Historically, Addis Ababa had opened up a stock market in the Imperial era in 1950s. A short-lived stock market started informally in the late 1950s and was formally established in 1965 (Asrat, 2003). In February 1963, the NBE took the initiative to set up the share dealing group called the Addis Ababa Share Dealing Group. The share-dealing group facilitated operation of the shares of mainly banks and government bonds (Pischke, 1968). The National Bank of Ethiopia (NBE) was responsible to set rules and regulations for the market. However, in 1974 the military government came to power and declared a centrally planned command economy and nationalized all foreign owned companies. Hence, the infant stock market ceased to exist.

### 3.2. Data Sources, Collection and Analysis Methods

In a one and half-year study period, both primary and secondary data were collected. The study was conducted from July 2010 to December 2011 gathering data to acquire first hand information through different data collection methods and enriched by reviewing secondary sources. Primary data were collected using questionnaire, focus group discussion, key informants interview and personal observation. Currently, shares are traded in order to establish new companies in a very traditional primary market by opening temporary offices for a fixed short period of time. Recent banks, insurance, transportation, oil, and real estate and construction companies has been established predominantly through initial public offering. Thus, due to this solitary inclination, they are purposively included in the study. Six banks, four insurance companies, two oil and four construction companies were judgmentally selected based on their year of establishment in order to solicit information about the blessings they are enjoying and pains they feel. In doing so, a questionnaire interview was first developed, pre-tested and employed to collected data from 160 randomly selected employees working at the head offices of these organizations to gather information regarding the crystal balls and obstacles of the financial sector and share based establishments. Besides, interviews and discussions were made with managers of the companies. Interviews were also conducted with officials and representatives of the National bank of Ethiopia, Financial Intelligence Center, Ministry of Trade, Ethiopian Investment Agency, and Ethiopian Commodities Exchange (ECX) in order to grip on government's view, and to identify the reasons thereof on initiating the market and draw a lesson from the later.

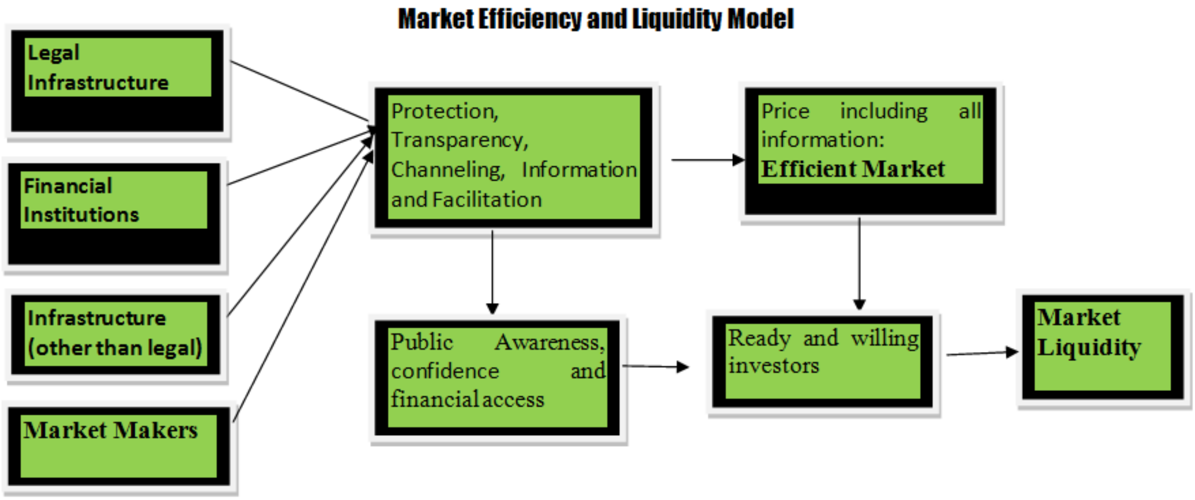
As triangulated data gathering system is advantageous to balance the limitation of one by the merit of the other and to enrich the study with more and deep information, three different focus group discussions (constituting 8 individuals each, purposively selected senior and experienced academicians of business schools in public universities and private university colleges, consultants and experts) were administered to identify enablers beddings for the market development or pains demoting it. Different financial proclamations, economic policies, plans, regulations and directives as well as media products were consulted and critically reviewed, as a secondary source, to substantiate the first hand information. The study investigated the determinants that either enable to promote or relegate the bubbling idea of commencing the capital market in the country which can be justified qualitatively. Hence, the collected data was concretely analyzed qualitatively supplemented by descriptive statistics.

### 3.3. Conceptual Framework: Establishing Efficient and Liquid Capital Market

Every day and in every transaction, in the money and capital markets, individuals and financial investors and other participants are to make important financial decisions and transactions. These participants are interested to be sure that the market functions smoothly. Among other things, capital markets require sound legal and physical infrastructure to demonstrate transparency, protect participants and undertake seamless transactions. Liberalization theory which was developed as Washington consensus after the works of John Williamson (1989) calls for price and market to dictate the economy. Nevertheless, any developmental model existing in a particular state of economy cannot be applicable to another as the reality depends on the economic, social and cultural perspectives of each nation while benchmarking the best practices of the developed nations. Advocators of regulated capital market evident that the wave of major economic crises of the recent past (1970's, 1990's and 2007) has emerged from the highly liberalized economies. Mishkin (2007) put preconditions for capital markets, but Stiglitz (2004) suggested the IMF not to pressure developing countries to liberalize their capital market rather work together to design the interventions that properly address failures. Owing to their weak institutional system, low human capital development and technological immaturity, market regulation (government intervention) is contended as a path of prosperity for developing economies. What is more, the teleological perspective of capital market regulation is better seen for creating efficient and liquid capital market in developing nations though the degree of regulation is of a contemporary debate among scholars. Debaters side on opposite side of a coin, some seek dynamic and effective regulation to promote public confidence, protect inventors from malpractices and the economy from wild conditions of the cashless society and imperfect market. The main emphasis of the regulation is on full and fair disclosure of information on securities issues to actual and potential investors. That is creation of efficient market where traders have full information regarding the securities to be traded and avoids insider information that maximizes the advantages of few. Generally, according to Franklin and Richard (2001), with securities markets it is usually argued the main purposes of regulation are investors' protection and enhancing the efficiency of markets to achieve of broader social objectives.

Market infrastructure constituting the institutions and systems that facilitate trade and custody of securities is mandatory for the smooth function and acceleration of market transactions. An efficient and well-functioning market infrastructure reduces obstacles to trading flows and allows for low-cost settlement of financial transactions and raises investor confidence. A study conducted by UNECA (1999) discloses that for a capital market to operate with some degree of efficiency, infrastructure, both physical and legal, are among the essential factors. Public awareness including investors understanding of the value creation is also among the vital factors for capital market development. As Rose (2003) indicates because economic conditions exert a profound impact on the money and capital market, the investment decision maker must be aware of economic data series that reflect trends in employment, prices, and related types of information. The role of financial institutions and media is significant in this regard by propagating information to savers, increase awareness on public, increase financial access, mobilize financial resource from excess areas and channel it to shortage areas where investment opportunities are ample. Economists like Stein et al (1998) describe institutions enable to reduce transactional and information costs and make markets operate with efficiency and liquidity. Yartey (2007) also explains that the existence of well developed financial intermediary institutions, particularly the banking sector, is important for stock market development.

The active act of market exchange, without causing a significant movement in price and with minimum loss of values, is significantly determined by the existence of professionals, specialist, and brokerage companies (Asrat, 2003). Market liquidity is seminal to create ready and willing investors all the time since such market makes investment less risky and more attractive. This enables companies to enjoy permanent access to capital from investors and households as saving remains less attractive. Market liquidity is firmly associated with the availability of smooth and sophisticated exchange markets coupled with public awareness, investors' protection and skillful and able intermediaries. Azu (2009) states that capital market liquidity can be improved through reducing monetary policy, creating awareness, building confidence, potentially growing economy, reducing transaction barriers, and aligning of banks to support the market. Market makers serve as liquidity providers and increase trading volume in developed market (Charitou and Panayides, 2009). The existence of experts and specialists who devotedly make market analysis and justification of prevailing and new developments is critical for capital market. Based on this conceptual scanning, the basics for the establishment and development of capital market are structurally modeled as below.




## 4. Results and Discussion

To establish a well functioning and vibrant capital market, the fulfillment of certain preconditions potentially promise for its launching and identification of bottlenecks that hinder the realization is essential. In this study, major potential factors bedding and others constraining capital market establishment are identified and explicitly described as follows.

### 4.1. Potential Beddings

**Growing economy:** Ethiopia has been registering an enticing economic growth and it is one of the fastest growing in the world notwithstanding the global economic shock and financial crisis. According to the government official reports, the country has been growing at about 10 to 11% for the last seven (7) years since 2004/5 though the World Bank and IMF limit the economic growth within the range of 7% and 9% over these times. Even by the latter growth rates, the country's economy has been growing high as compared to the 2011 6%, 5.2% and 4% average economic growth IMF projection for lower income countries (LICs), Sub-Saharan Africa and the entire world, respectively (IMF, 2011). This stimulates foreign investors and the Ethiopian Diaspora to invest in diverse investment potentials including agriculture, manufacturing, tourism and others investment opportunities open for foreign investors. This increasing trend of investors prefer to establish large scale companies through issuing shares in an initial public offering to take the advantages of corporations. Based on the survey, these entrepreneurial and forward looking investors of the Ethiopia Diaspora are perpetually putting a pressure on the government to establish a secondary market.

**Privatization Scale-up:** among the appealing economic measures promoting private sector development is the privatization program that the Ethiopia government has been working by establishing a privatization agency (Privatization and Public Enterprises Supervisory Agency). So far, the government is the major actor in the economy as it has monopolized or has significant market share on crucial sectors like sugar, cement and beer factories, telecom services, etc. Government institutions and agencies play a crucial role in the market. Recently, however, many state-owned companies have been privatized. According to the privatization agency, since 1995, it has privatized 287 enterprises including breweries. This is seen as a positive move surfacing an enabling ground for the private sector to play and have an influential role in the economy.

**Increasing capital flow to the country:** In countries, like Ethiopia, where saving is low, foreign direct investment is an alternative means to improve investment. The investment by the foreign investors and the Ethiopia Diaspora is increasing overtime but slightly affected by the global economic downturn happened since 2007. According to the consulted official reports of the NBE and Ethiopian Investment Agency, FDI has shown an increasing trend as more investors from Turkey, China, India and the Middle East are investing mainly in agriculture, textile, hotels and restaurants. The total FDI inflows into Ethiopia have increased continuously from US$ 135 million in 2000 up to US$ 545 million in 2004. But the yearly FDI inflows have shown fluctuations between US$ 545 and US$ 206 million in the period of 2005-2011. FDI inflows into the agricultural sector, which is about 45% of GDP, 80% export and more than 80% of employment, accounts for 32% of the total FDI inflows to Ethiopia. Despite the increasing trend, FDI in Ethiopia is very low even by African standard. Remittance has also been growing from the diaspora. NBE reported that official receipt of remittance to Ethiopia grew to US$1.5 billion in 2011 showing a growth of 87.4% as compared to the previous year.

**Invest than save payoff:** saving is not encouraging in the country as real interest rate is negative. The interest rates on deposits do not compensate the high inflation rate in the country. The national bank has set the minimum interest rate on deposits at 5%, but inflation rate is fluctuating between 20% and 30% and even was beyond 30% in 2009 and 19.6% in 2012 (CSA, 2012). Due to this handicap, the study finds that households prefer to put their money under their mattress or invest it in potential and less risky investment opportunities. This has become, in recent years, an advantage for initiators of incorporated companies to pool resources from small saver households.

**Inclination to incorporated companies:** as discussants of this study evident historically, during the derge regime, most companies were sole proprietorships and partnerships or national corporations. But after the liberalization process, many private companies flourish in the country. With the establishment of Awash International Bank (AIB) in 1994 through initial public offering, incorporated companies, particularly banks, insurances and construction companies began to exist. Ethiopian Diaspora experienced advanced markets have become major catalysts in initiating incorporated companies. This brings a new paradigm to citizens to invest their petty money on shares of these companies than putting in negative earning deposits. Thus, aware citizens have become bold domestically in putting pressure on the government to launch capital market and end-up chilling the private sector.

**Ethiopian Commodity Exchange (ECX), a vibrant lesson:** Ethiopia has established a commodity exchange with the proclamation no. 550/2007 with an initiative to revolutionize the traditional agriculture through creating a new marketplace to serve all actors and add value to the primary producers. This market is the first of its kind not only in Ethiopia but in Africa. Initially, many consider the establishment of this unique platform to all in the agricultural value chain as madness as they believe it doesn't work in the 85% uninformed rural and immature infrastructure. But it has become a rubber bridge bringing diverse partners, from farmers to traders to processors to exporters and consumers. Then it is praised for its exemplary works of providing reliable end-to-end system and linking financial services, transportation, etc. Though it is a few years since establishment, EXC has become an institution that many African nations dream. Therefore, it is a vibrant and lively lesson that the country could learn too much and scale up best practice to launch the capital market.

**Energy Expansion:** Energy is the backbone of economic development. Ethiopia has immense potential for hydroelectric, wind and geothermal energy generation. Most of its major rivers are suitable for the generation of hydroelectric power with the total capacity of 45,000 MW. But the country is able to produce only 2,000 MW (4.4%), getting more than 90% of energy from bio-mass accelerating the destruction of the country's forest resources. Over the last ten years, efforts have been made to shore up the energy capacity of the country in order to increase the population access to electricity, promote the establishment of large scale industries and advocate green economy. The government has initiated hydroelectric and wind power projects in different parts of the country. By this effort, the energy capacity of the country has increased from 250 MW (1991) to 2,000 MW (2011). According to officials, the government has also planned to ignite the power generation into 10,000 MW at the end of the Growth and Transformation Plan (GTP) in 2015. To achieve this target, it has already started a self financing grand dam (Abay Renaissance Dam) expected to generate about 6,000 MW. This project is anticipated to quench the huge energy demand of the country, attract foreign investors and generate income by exporting to neighboring countries, and is assumed to play a vital role in regional integration.

## 4.2. Constraints

### 4.2.1. Government Reluctance and Ambivalence

The after 1991 financial sector liberalization is not extended to diverse vehicles including capital market establishment. The Government of Ethiopia has remained reluctant and ambivalent to launch the securities market (specifically the secondary market) in the country. Based on the information obtained from discussions with government officials, the government, presently, has no intention to launch the market for several reasons. What is looking askance and dubious to the government is the importance of the market to the country's economy as it more sleeps over the dynamics and fickle behavior of the capital market than on the opportunities. The officials connote almost frequently such statements: "We have limited resources and it is a choice where and how to use them," and this is "a priority dilemma". "We have other basic and obligatory functions to do first in order to enhance social welfare". "Thus, capital market is not the government's priority at this moment and it is untimed to the country". This ambivalent stance of the government and disaccording resources towards furnishing basic capital market constituents is quashing the market's development. In anyways, the government, at present, is not generous to establish securities market in the country.

### 4.2.2. Underdeveloped Infrastructure

**Legal and Regulatory frameworks:** Though the importance, extent and form of regulating capital (securities) market is debatable, countries have been rethinking on their regulation particularly after the 2007 global financial crisis. Now days, market regulations are believed to improve market efficiency, protect investors and enhance public confidence. Information obtained from the study reveals, for countries like Ethiopia where systems and structures are not well cultivated, the availability of legal framework and supervisory body is essential for the establishment and development of capital market to ensure the macro and microeconomic stability.

Discussants uphold the significance of market regulation to envisage transparency and protect participants from information asymmetry and market anomalies. But, Ethiopia has no sufficient and up-to standard proclamations, legal and regulatory frameworks to regulate the exchange of securities, even issued in the initial public offering (primary market). Under the proclamation no. 166 of 1960 commercial code, Book-II (Business organizations), Title-VI (companies limited by shares) describes only the functions of companies to raise capital through initial public offering. The code pinpoints the formations of partnerships, joint venture, private limited companies and share companies. It further details the provisions for the establishment of private limited and share companies. Articles 381-389 of the code give rights: to at least 10% holding shareholders to ask for investigation in the company's state of affairs if they believe it is going wrong (Art. 381); to be a member, to vote, and to challenge a decision of the company or to receive dividends and a share in a winding-up (Art. 389). Art. 333 also give shareholders the right to transfer unrestricted shares. The commercial registration and business licensing proclamation no. 686/2010 is a common proclamation for all business types registered in the Ministry of Trade. Article 12 of this proclamation (sub-articles 1-5) states only the general requirements for the establishment of share companies. The code and the proclamations fail to explain the subsequent transactions of the securities in an open market (secondary market), and ways of regulation. There are no criteria for listing and delisting of companies in the market. The decades' old code and other proclamations are inadequate to supervise and regulate the fraudulent activities of share issuing companies, to protect investors from market irregularities and off balance sheet activities. They deprive shareholders the right to be informed and get relevant and timely information and restricts the free transfer of shares. Thus, share issuing companies are operating traditionally under unregulated market. Besides, there is no independently designated body to govern the modus operandi of share issuing companies out of the banking sector. The central bank (National Bank of Ethiopia) is responsible, under the proclamations of no. 84/1994 for licensing and supervision of banking business and no. 592/2008 for banking business, to regulate the banking sector. Banks offering and selling securities are required to comply with the bank proclamations under the watchdog of the National Bank of Ethiopia. Thus, the inadequacy of regulations and absence of regulatory body for non-banking sector is depreciating the confidence of households and small base investors on their former investments and their future participation in share issuing companies.

Seminally important to attract foreign investors and the development of capital market is the suitability of the country to do business. Doing business is a fundamental factor on how easy to do business when complying with relevant regulations. According to the World Bank's partial and relative measures affecting 10 areas in the life cycle of a business, as listed below, Ethiopia's world ranking is much lower as compared to other countries. The country is ranked, overall, out of 183 countries in 2012, 111 sliding down from its previous year's position (104) and following from behind its neighboring countries, Rwanda (45) and Kenya (109), which are in a better position to attract for investment.

| **Doing Business World Ranking: Ethiopia** | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Country** | starting a business | dealing with construction permits | getting electricity | registering property | getting credit | protecting investors | paying taxes | trading across borders, | enforcing contracts | resolving insolvency |
| **Ethiopia** | 99 | 56 | 93 | 113 | 150 | 122 | 40 | 157 | 57 | 89 |
| **Rwanda** | 8 | 84 | 50 | 61 | 8 | 29 | 19 | 155 | 39 | 165 |
| **Uganda** | 143 | 109 | 129 | 127 | 48 | 133 | 93 | 158 | 116 | 63 |
| **Kenya** | 132 | 37 | 115 | 133 | 8 | 97 | 166 | 141 | 127 | 92 |
| **Sub-Saharan Africa** | 123 | 112 | 122 | 119 | 110 | 112 | 115 | 134 | 117 | 127 |

Source: Doing Business/World Bank, 2012

**Business Orienting media, a missing Link:** media (newspapers, TV, radio, online, etc) has an influential role on the public and companies. It plays a significant role in enhancing the public awareness and informs individuals, groups, entities and governments about new developments. Media influences the investment behavior of citizens. It propagates information that could be incorporated in prices of commodities and assists for the existence of efficient market. Such kind of media updating the general public about everyday's business, finance and overall economic functions is totally absent in Ethiopia. Information about the list of companies that are offering shares to the market, the amount of shares sold, money mobilize, status of formation, after formation status and any returns after establishment is not readily available to the public in any form in the media. During establishment, almost all share companies promise mouth-watering returns and profits. All share companies unilaterally set birr 1,000 (about USD 55) as the par value of the share. But there is no media that professional defines and/or invites experts to elucidate the credibility and reliability of the promises, and updates the success or failure story of the companies. There are no professional explanations about why all companies take a similar fixed par value of their shares. Unfortunately, the media that thousands of people with shares in a number of businesses dream printing and airing share trading prices, as what discussants called it, is a missing link.

**ICT, undeveloped 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. Though improvements and expansion have been seen, the general public and more particularly the business community is not blessed to modern, fast, fair and equitable use of ICT in Ethiopia. The state-owned telecommunication company, Ethio-telecom the sole telecom service provider, provides sluggish, unreliable and expensive internet and phone services. As of September 2011, there were only 10.5 million mobile phone, 0.854 million fixed line and 0.128 million internet subscribers which account 12%, 1% and 0.15% of the population. This coverage is very low by any standard. The farmer, the backbone of the country's economy accounting more than 80% of employment, is scantly addressed by the ICT territory and internet is unthinkable in rural areas.

#### 4.2.3. Immature Financial Sector

In order to establish and develop a full-fledge and well functioning capital market, the existence of strong financial institutions such as banks, mutual funds, pension funds, credit unions, saving associations, etc is inevitably. Despite these benefits, Ethiopia has no diverse and well developed financial sector. The sector consists of only microfinance institutions, insurance companies and banks. Currently, Ethiopia has 17 banks, 14 insurance companies and 30 micro-finance institutions. Notwithstanding with the relative improvements, the sector is still thin and infant even by African standard and is distinguished with the following standings.

**Untested, Acute and Technology Shy banking sector is dominant**: the country directed its economy into market-orientation since 1991, but there are sectors still prohibited for foreign investors. The banking sector, playing key role in mobilizing, intermediating and channeling resources into diverse uses in the economy, is not open to foreign investors depriving citizens from getting access to alternative banking services. The performance of this sector is untested by fierce competition like what is happening in majority of the remaining world. Banks have relatively shown improvements in terms of bank numbers, branch networking, capital and profitability, but access and service delivery is limited providing very scant products and services to the public. Based on the survey, the public commonly use banks for (i) temporary deposits and (ii) loan facilities. Ethiopian banks are also technologically backward and sluggish service deliverers. Limited modern banking services such as Automated-Teller Machine (ATM), internet and SMS banking have been started in some banks very few years back. Bust most payments and settlements are still paper based and the system is backward that all types of customers appear in person in physical operational areas for settlement, clearances and other banking services. But it is worth mentioning that the National Bank of Ethiopia and the commercial banks are taking encouraging measures to modernize their service delivery system, but remain a lot to do to join the advanced trajectory of banking system.

**Excessive Liquidity:** According to the Licensing and Supervision of Banking Business Proclamation No. 84/1994, and Banking Business proclamation no. 592/2008, all licensed banks are strongly required, at the end of each financial year, to transfer to their legal reserve accounts, in the National Bank of Ethiopia, a sum of not less than 25 percent of their net profit. As pursuant to banking business proclamation (Art. 20), directives no., SBB/45/2012 requires banks to maintain liquid assets not less than 20% of their total current liabilities. But banks are liquid much higher than the requirement. Based on the data collected from 2005-2011, on yearly averages, less than 50% of deposits mobilized are extended as loan. Thus, above half of deposited amounts in commercial banks remain unproductive. Discussants believe the stringent government policy on loaning system of banks creates excessive liquidity and discourages banks (specifically private banks) to undertake intensive deposit mobilization movements.

**Public Banks Dominance**: as of 2011, there are 17 banks operating in the country, of which 3 are public banks. Looking at this number seems public banks operating in the country are too small. Nevertheless, the fulcrum to rotate the axis of the financial sector is in the hand of these government banks. They are dominant in terms of bank branches, capital and deposit mobilization. For instance, out of the total 970 bank branches throughout the country, the Commercial Bank of Ethiopia (CBE, a government bank) alone has 547 branches. CBE has also been mobilizing about 60% to 70% of the domestic saving between the periods of 2005 to 2011. From the total banking sector capital of 15.9 billion Ethiopian birr (which is about 92 million dollars) in 2011, the share of the 14 private banks is only 44%, the remaining held by the public banks, significantly by CBE. This indicates that there is a long way that the country should go to promote the private sector to play a significant role in the economy.

**Limited Access**: as aforementioned, the banking sector has been growing in terms of bank numbers, branch networking and deposit mobilization after the financial liberalization. The number of banks and braches increased from 3 and 200 (in 1994) into 17 and 970 (in 2011), respectively. However, Ethiopia is still one of the most under banked countries in the world with 970 bank branches serving about 84,975,606 (WB, 2012) populations (one branch serving over 87,000 people). As compared to some African countries, for example Kenya (one branch serving 37,630 people), Ghana (one branch to 54,000 people) and Nigeria, the most populous country in Africa (one branch serving 27,591 people), Ethiopia is a country with a lot of its people unbanked. Bank branches are also unfairly distributed and concentrated in major cities and towns of the country. 38% of bank branches are concentrated in Addis Ababa, the capital city, with residents only 2% of the country's population. Similarly, there are only 221 branches of 14 insurance companies that one insurance branch serves over 380,000 people in major cities.

**Low deposit mobilizing status:** domestic saving in Africa is in its lowest standard. The lower saving culture has been the chronic problem to finance development endeavors and large scale projects in Africa countries. The gap (deficit) between the domestic savings and invested capital in the continent is financed by borrowings to the larger extent supplemented by foreign assistances. Ethiopia's domestic saving is also at its lowest rate by any standard. At the end of the PASDEP period, gross domestic saving was only 5.5% of GDP. Official reports of March 2012, however, saving went up to 8.8% of GDP due the government's publicly floating saving bonds for the construction of Grand Abay Renaissance dam in the Nile River. This rate, however, is by far lower than Sub-Saharan standard (17.9%) and other developing countries like Angola and Gabon where domestic saving is as high as 40% of GDP. Survey results manifest that this is due to financial illiteracy, low income and high inflation rate exhaustively income used for consumption and inability of financial institutions to mobilize resources from households. Thereby, many doubt the achievement of GTP targets as the government may suffer huge financial gap from domestic sources since major domestic investors are not willing to make huge investments in the saving bonds issued for the dam due to liquidity problems. Thus, academicians and practitioners have been recommending the government to mobilize required capital from internal and external sources through launching the capital market

#### 4.2.4. Uninformed and Small Base Investors

The domestic investors in Ethiopia are not well informed about trading securities and the functionalities of capital market due to lack of public awareness campaigns, limited exposure to global markets and for educational matters. It is uncommon that concerned institutions conduct organized and vigorous seminars, conferences and workshops to spark, extend and enhance the concept of capital market in the general public and particularly investors. What is more, the inexistence of institutional investors due to lower level saving capacity and practice is another limiting factor to put a baseline for the establishment of the capital market. Many companies have been and are established under conservatively financed initially publicly traded companies in a traditional window-shopping system, shares held by thousands of investors none of whom hold a large percentage of shares and nowhere to sell then after to get back even the principal. Due to the small base of domestic investors and limited capacity of the private sector, shortage of capital is a constraining fact to ensure rapid economic development in the nation.

#### 4.2.5. Shortage of professionals, the human element

In Ethiopia, universities and other higher learning institutions do not specialize and excel in some specific disciplines. Almost all are multidisciplinary offering wide range field of studies. Most senior scholars and experts in the country are educated in foreign universities in untailored way to the country's interest and situation. The education system of business and economics is also adapted from advanced economies specifically the United State and is trivially reflecting the actual practice in the ground. All the 31 universities offer business and economics courses at undergraduate level in a holistic approach. They are not specifically producing tomorrow's financial brokers, specialists and dealers (market makers) who will mediate transactions and make markets to operate in equilibrium. Thus, academicians included in this study demand the government to refresh its educational policies and summon on higher learning institutions to introduce specializations to produce innovative and skillful professionals and experts to surface a ground for the establishment of vibrant and economically worthy capital market.

## 5. Conclusion and the Way Forward

Ethiopia has some positive factors contributing for the development of the capital market. Some of these factors include fast economic growth, energy expansion, booming of private sectors and privatization process, capital flow improvement, household investment habit than saving and inclination to the establishment of incorporated companies. While recommending the establishment, however, it is worth mentioning that the country is left with a lot of works to bestow the ground by modernizing and advancing, at least the bare minimum, its infrastructure (Payment and settlement, ICT, physical market, etc) in order to smoothly facilitate the transactions if not making seamless. Developing regulatory framework and designating an independent regulatory body so as to modestly watchdog the activities of the market to create public confidence, protect investors, and minimize market anomalies. Alongside, the establishment of institutions and training centers and introduction of professionalism in the area to produce skillful and competent workforce to this world of work is also another must to do activity. Gradualism loosening of the arresting economic regulations to assist the market and relaxing the closed sectors to foreign investors and markets is also relevant to attract large scale investors to attract huge capital from different corners of the world.

Although the capitalization of all African stock exchanges is very small and the markets are characterized by their low liquidity, they are expected to accelerate the transformational process of Africa and envisage the economic growth of the countries as Africa is booming and viewed as future destination of the investment eyes of global investors. Ethiopia can take good lessons from the already established markets in developed and developing countries, especially emerging markets. It has to benchmark the practice to launch the market apart from 'learning by doing'. African Stock Exchanges Association (ASEA) was registered with the object of, inter alia, establishing an association for systematic mutual cooperation, exchange of information, materials and persons, mutual assistance and joint programs between the members. This is an opportunity for Ethiopia to seek technical assistant to establish the market either unilaterally or jointly with other member states until it is ripped for the sector running independently. Ethiopia has pioneered Commodities Exchange market (EXC) that many African countries are, now days, aspiring to learn from. Scaling up of the good lessons of this vibrant to the capital market development is another fortune for the country.

## 6. Reference

Alemayehu, G. (2006). Structure and performance of Ethiopia‟s financial sector in the pre & post reform period: With special focus on banking‟, Research paper no. 2006/112, Addis Ababa University.

Asrat, T. (2003). Prospects and challenges of developing Securities Market in Ethiopia, African Development Review

Azu, O. (2009). Market liquidity and strategies for improving liquidity in the capital market. Waifem regional course on operations and regulation of capital markets, Accra, Ghana.

Beck, T., Lundberg, M. and Majnoni, G. (2006). Financial intermediary development and growth volatility: Do intermediaries dampen or magnify shocks? Journal of International Money and Finance, 25.

Beckaert, G., Harvey, C.R. and Lundblad, C. (2005). Does financial liberalization spur growth? Journal of Financial Economics, 77.

Bekaert, G. and Harvey, C.R. (1997), Capital markets: An engine for economic growth. National Bureau of Economic Research, Cambridge.

Bose, N. (2005). Endogenous growth and the emergence of equity finance, Journal of Development Economics, 77.

Charitou, A. and Panayides, M. (2009). Market making in international capital markets: Challenges and benefits of its implementation in emerging markets, International Journal of Managerial Finance, 5. Emerald Group Publishing Limited.

CSA (2012). Country level Macroeconomic performance report. Federal Democratic Republic of Ethiopia, Central Statistical Agency (CSA), Addis Ababa

Devereux, S. and Sharp, K. (2003). Is Poverty Really Falling in Rural Ethiopia? Institute of Development Studies at the University of Sussex, UK.

Dudley, W. and Hubbard, R. (2004). How capital markets enhance economic performance and facilitate job creation.Global markets institute, Goldman sacks.

Easterly, W. (2002). Growth in Ethiopia: Retrospect and Prospect, memo, Institute for International Economics.

Eshetu, B. and Mammo, M. (2009). Promoting Micro, Small and Medium Enterprises (MSMEs) for sustainable rural livelihood. DIIPER Working Paper Research series. Aalborg University, Denmark.

IMF (2011). World economic outlook: World economic and financial surveys. International Monetary Fund, Washington Dc.

Kashyap, A., Rajan, R. and Jeremy S. Stein, J.S. (1998). Banks as liquidity providers: An explanation for the co-existence of lending and deposit-taking. Proceedings, Federal Reserve Bank of Chicago, May issue.

Levine, R. (1997). Financial Development and Economic Growth: Views and Agenda, Journal of Economic Literature, 35.

Luterian World Federation (LWFE) (2006). Department of World Service Country Programs Ethiopia.

*Mishkin S. F.* (2007). *The economics of money,* banking and financial markets, 8 th edition, Pearson Education, Inc., Boston

Mishra, P.K., Mishra, U.S., Mishra, B.R. and Mishra, P. (2010). Capital market efficiency and economic growth: The case of India, European Journal of Economics, Finance and Administrative Sciences, 27.

MoFED (2011). Annual Progress report on Growth and Transformation (GTP). Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development (MoFED), Addis Ababa.

MoFED (2006). Plan for Accelerated and Sustained Development to End Poverty (PASDEP). Federal Democratic Republic of Ethiopia, Ministry of Finance and Economic Development (MoFED), Addis Ababa.

Moss, T. (2003). Adventure capitalism: Globalization and the political economy of stock markets in Africa," London: Palgrave Macmillan.

Murinde, V. (2006). Capital markets: Roles and challenges. International conference on "Accelerating Africa's Development Five Years into the Twenty-First Century", Tunis

Murinde, V. (1999). Financial Institutions and the Mobilization of Resources for Development. In K.-M. Steve (Eds.), African Economy: Policy Institutions and the Future. London and New York: Rutledge.

NBE (2011). Annaual Report for 2010/11. Federal Democratic Republic of Ethiopia, National Bank of Ethiopia (NBE), Addis Ababa.

Pischke, J.D. (1968). Share and share trading in Addis Ababa, Haile Selassie-I University, Addis Ababa.
Ross, A. (2003). Fundamentals of Corporate Finance, 6th edition, McGraw-Hill, USA
Saunders, A. and Cornett, M. (2001). Financial markets and institutions: A modern perspective, McGraw-Hill, New York, USA
Serneels, P. (2004). The Nature of Unemployment in Urban Ethiopia. Center for the Study of African Economics Working Paper Working Series. CSAE: Berkely Electronic Press.
Singh, A. (1999). Should Africa Promote Stock Market Capitalism? Journal of International development, 11.
Stiglitz, J.E. (2004). Capital-market liberalization, globalization and the IMF. Oxford review of economic policy, 20.
Stiglitz, J.E., Jaime, J. and Park, Y.C. (1993). The role of the state in financial markets. *Proceedings* of the Annual conference on development economics supplement, World Bank.
Stiglitz, J.E. (1989). The Development of Financial Markets for Economic Development, the Economic Reconstruction of Latin America, a conference in Rio de Janeiro.
Ouandlous, A. (2010). Capital Markets and Economic Development: A Framework for Newly Liberalized Economies, Journal of Business and Economics Research.
UN-HABITAT (2008). Ethiopia: Addis Ababa urban profile. United Nations Human Settlements Programme (UN-HABITAT), Nairobi, Kenya.
WB (2012). Doing buisness. Country profile: Ethiopia, the International Bank for Reconstruction and Development, The World Bank, Washington DC.
Yartey, C. A. and Adjasi, C. K. (2007). Stock Market Development in Sub-Saharan Africa: Critical Issues and challenges. IMF Working Paper, Washington Dc.
UNECA (1999). The promotion f capital markets in Africa: Assessment of needs in capital markets development southern, western and central Africa. Addis Ababa, Ethiopia.