

WHY ETHIOPIA DOES NOT INTRODUCE STOCK MARKET? POLICY REASON OR REAL CONDITION :(SYTEMATIC REVIEW)

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Abstract

This paper is systematic review of to access why Ethiopia has not yet establishes stock market.

The objective of this study was to review critically researches about secondary market conducted about the possibility of establishments in Ethiopia and to conclude why Ethiopia does not introduce secondary market so far. That is aiming to review critically researches about secondary market conducted about the possibility of establishments in Ethiopia and to conclude why Ethiopia does not introduce secondary market so far. To conduct this critical review, the researcher considered articles conducted interrelated to stock market exchange in Ethiopia those are both published and unpublished, have full information of their authors and year of publication. The researcher focused on the major factors that are necessary to establish secondary market for discussion. The paper has identified the real objectives and subjective cause that constraints to establish secondary market in Ethiopia and forwarded a conclusion based on the findings.

Keywords: Ethiopia, Market, Secondary, Stock

1. Introduction

The term stock is defined by Jetu as “the capital or principal fund raised by a corporation through subscribers’ contributions or the sale of shares”.

According to Auranzeb (2012), stock market is an important element of an economy because stock market plays a vital role in the growth of key sectors of the economy and that ultimately affects the economy of the country. Stock market plays the significant role for the industry and also for the investor who wants to invest in the stock market to gain maximum return on his savings.

Ethiopia is the second most populous (, with a population of about 100 million), country in sub-Saharan Africa.

The present government is come to power in 1991 by overthrowing the Derg regime. Ever since, the relative role of the private sector in Ethiopia’s economic development has evolved with changes in governments (Asrat, 2003).

The changes depended very much on the type of economic system adopted by the governments.

The Ethiopian economic environment over the years can be classified into three distinct phases: mixed economy, command economy and market-oriented economy (Asrat, 2003).

Financial Markets channel savings to those individuals and institutions that need more funds for spending than that are provided by their current incomes. The financial system consists of many cast list like financial institutions, financial markets, regulators, market participants and others having stake on it. Money and Capital Markets operating within the financial system make possible the exchange of current income for future income and the transformation of savings into investment which result in increased production, employment, income, and living standards. The size of the world stock market was approximated at about \$36.6 trillion at the beginning of October 2008 (Ruecker, 2013)

According to Alemneh (2015), countries who introduced stock market can get better their economy. Savings can be promotes by establishing stock exchange market and providing an alternative financial vehicle. And this helps for individuals to meet their risk preferences and liquidity needs, thereby increasing the saving in the market.

Jetu Edosa Chewaka (2016), stated that the institutional and legal frameworks that regulate the market for stock exchange, and in effect, the current stock trading activity in its infants in Ethiopia may grow into a largely unregulated space in which everyone speculates and plays for short-term gains. It is widely believed that stock markets have the possible to be influential locomotives of economic enlargement in mounting nations such as Ethiopia Efficient stock market provides the public with investment opportunities and mobilizes savings, as well as international capital, for productive corporate financing.

It is also argued that market forces serve to discipline management and public ownership thereby improving the accountability of the business sector. However, developing a robust and efficient securities regulation within which the stock market operates is a painstaking task for many developing countries. In this respect, the challenges squarely recline on designing the legal frameworks capable of protecting the investor, preventing systemic crises and promoting the market they govern The term stock can be defined as “the capital or principal fund raised by a corporation through subscribers’ contributions or the sale of shares”. Stock represents a share of ownership in a corporation. By and large, such kinds of stocks could be identified as security representing equity claims on the earnings and assets of the corporation. In this comment, the term stock is used interchangeably with the term share stock market exchange is founds in several countries (Chewaka , 2016).

As Mebrahtu (2014), Araya &Tadewos() stated stock exchange issued by the international federation of stock exchange on December31st 1991 in 72 countries. The biggest stock exchanges in the world are New York, London, Paris, Frankfurt, Zurich, Amsterdam and Toronto. Some of those stock exchange have long history (Araya & Tadewos,).

But in this day stock market exchange is not monopolized by the developed countries. In the past decades there has been observed a rapid growth of stock exchange market in the developing countries in such as Latin America, east Europe, Africa in many countries (Mebrahtu,2014).

When we come to Ethiopia the first share offered for public subscription was issued in 1956 by the company then called Ethiopian Abattoirs. Following that years different companies such as bottling company of

Ethiopia(1957),Indo _Ethiopian textiles (1958) and others companies issued shares to the public(Mebrahtu,2014).

According Abera and Mohamod (2011) stock market exchange was started under the sponsorship of the national bank of Ethiopia and later the Addis Ababa dealing group started functioning with share dealing of 15 listed companies and four government bonds as well as a number were reached.

There is long-established economic theory that in production process to create value are land, labor, and capital. But with the collapse of communism and the coming out of capitalism, many countries around the world are moving toward market-oriented economies and securities markets are spring up on all and entrepreneurship. Now the propensity is that finance is given the indispensable concentration among researchers as a essential input for accelerating economic growth of countries (Ruecker, 2013).

Many smallest amount developed countries including Ethiopia face huge challenges in access to finance to the many economic actors. Lack of finance was one of the reasons for lower economic growth of these countries in the past (Ruecker, 2013).

Such countries have bank denominated financial system whereby access to finance for firms, government and households is limited by banks capacity to mobilize savings and their conservative lending policies. Hence the various market participants' needs for quality financial service are not satisfied by the existing bank-dominated financial system. This calls for capital market development that can satisfy their needs with financial products tailored to their needs (Ruecker, 2013).

When it comes to the Ethiopian context, the country has undeveloped primary market and no secondary capital market. According to Kannan, Ethiopia the continent's second most populated and one of the biggest import markets , if capital market started soon ,could boost the current high economic growth (Ruecker,2013).

In addition to the above points, Ruecker insists, Ethiopia would be the most attractive investment destination in Africa, if it had a stock market and one could invest in Ethiopian businesses as inexpensively as people are now investing through private transactions. Letting the private sector develop the capital market would lead to more transparency and more capital allocated to fuel Ethiopia's rapid growth (Ruecker, 2013).

Another writer is Edosa that strongly believe that stock markets have the latent to be powerful engines of economic growth in developing nations such as Ethiopia. He bicker proficient stock market provides the public with investment opportunities and mobilizes savings, as well as international capital, for productive corporate financing (Edosa, 2014)

Despite some of the acclaimed advantages of the stock exchange market for countries, Ethiopia is the only country of the world's 15 most populous countries which does not have a stock exchange. With the current Ethiopian condition, selling shares of companies will take long time and effort, even though the seller is in gloomy need of cash. And when dealers take part in the deal, it is usually observed some exploitation in the value of the share in the process. On the other hand, individual investors are incapable to

invest in practical ventures as it is often difficult to get readily available markets from which they could go and buy. When individuals consider the inflation rate prevalent in the country, they may prefer to keep their money in their homes or save in accounts of banks for a nominal interest rate in consideration of (Alemneh, 2015).

In relation to the above points, Mebrahtu, argued the neglect of non-banking financial institutions resulted due to the focus on commercial banks and this has led to have comparative advantage in mobilizing long-term capital for investment. He fourthly argued that commercial banks are not well structured to meet the long term capital needs of the private sector for several reasons. First, commercial banks' assets and liabilities are of short-term nature, and as such, they are incapable of providing a greater supply of long-term capital to the private sector. Secondly, higher yields on short-term government Treasury bills provide greater incentives for commercial banks to hold a larger proportion of their asset portfolios in short-term government bills. On the other hand, it is argued that capital market institutions such as stock exchanges can better mobilize domestic and international capital. This is because of the following features (Mebrahtu,2014).

Other researcher, Tiruneh, argued that there is adequate shareholding constituency in Ethiopia allowing the establishment of share companies. There are more than 60,000 shareholders where there is no market for share trading and re-trading implying that there is high share illiquidity. If this illiquidity persists, the existing shareholders tend to aggravate and new shareholders will be discouraged to get into share company business which in effect hinders the growth of investment and private sector involvement in the Economy (**Tiruneh, 2012**).

Contrary to the above facts, Ethiopia has remained without establishing secondary market .So the initiation of this reviewing is to investigate why the country does not need to establish secondary market and to conclude whether this is due to policy case or due to real situation that constraint to do that.

2. METHODOLOGY

Comprehensive search was executed by selecting potential relevant published and unpublished literatures from various outlets presumed to be relevant focusing to stock market, its challenges and prospects as well as feasibility in Ethiopia. Thus, to provide background and context, policy documents, and relevant systematic reviews were also reviewed. A review of literature was made by using Google, Google scholar.

Inclusion criteria

To conduct this systematic review, the researcher considered both published and unpublished articles interrelated to stock market exchange in Ethiopia that have full information of their authors and year of publication. But in this research articles only in abstract, and have no full information about their authors and year of publication are not considered. To achieve the objective of this review, the conclusions and analysis of the researchers were critically reviewed.

Characteristics of included studies

A total of 16 papers or studies were included for further review. Of the included literature, 15.38 percent (n = 2) were quantitative cross-sectional studies while the remaining 84.6 percent (n = 11) were qualitative studies. All of the papers whether they are qualitative or quantitative evaluates, whether Ethiopia can introduce secondary markets or not by identifying the real situation in Ethiopia.

3. DISCUSSION

4. FACTORS AFFECT THE EFFICIENCY AND IMPLEMENTATION OF STOCK EXCHANGE.

5.1. Government Commitment

As to the paper published by Ruecker (2011) several institutions like the Addis Ababa Chamber of Commerce and Sectoral Associations works to introduce a capital market and a stock market in Ethiopia though they have failed to get permission from the government. But the government was not in position to accept the simulation to form the security market. However, recent remarks of government officials show that there is potential introduction of a secondary market for bonds in the foreseeable future.

Chewaka (2014), was one of the supporters of this idea and he stated in his paper which is titled as "legal aspects of stock market development in Ethiopia: comments on the challenges and prospect", despite the fact that stock market has been considered as important instrument to have efficient and modern market, Ethiopian has been remained with nonexistence of the stock market and affected its liquidity that has negative effect in the economic development due to having no institutional, legal and policy framework for stock market activity.

Alemneh (2015), confirms the government of Ethiopia's commitment to establish stock market exchange is not discernible. The legal and regulation framework is not all-inclusive.

Tiruneh (2012), another researcher that he has found absence of institutional capacity is the obstruction for security market establishment in Ethiopia.

Similarly, Abera (2011), revealed the commercial code of Ethiopia did not cover anything about the stock exchange regulation as to the board composition, minority rights, resource and disclosure necessities.

Ahferom (2011) also aligns his finding with the above. As to his findings, government has given little attention to the establishment of stock market.

4.2. Macroeconomic Conditions

Macro economic conditions are the other factors that are significant to establish secondary market.

As Ruecke, has designated the the whole economic growth in real GDP during the fiscal years (2003/2004-2009/2010), was on average 11.3 percent. During the alike period, the average growth in the service sector was 13.0 percent, 10.3 percent in agriculture, and 10.2 percent in industry. This detail is evidenced for the

Ethiopian gross national production is growing. Gross national production increase is a good factor to establish stock market exchange (Ruecker, 2011).

Research carried out by Abu (2014), the Ethiopian new economic environment is favorable to stock market exchange. In addition to that, Mebrahtu (2014) fully justified the Ethiopian economy favorably to the establishment of stock market exchange. The fast economic growth, energy expansion are good contributors to the establishment of stock market exchange.

4.3. Corruption and Transparency

Ethiopia has ratified the United Nations Convention against Corruption, and the African Union Convention on the Prevention and Combating of Corruption. In this case Ethiopia is ranked 126th of 180 nations in Transparency International's 2008 Corruption Perception Index. This is an improvement from its ranking of 138th of 179 nations in the 2007 index. According to Transparency International, a score of less than 3.0 out of 10.0 indicates that there is popular corruption. Ethiopia's score is 2.6 (Ruecker, 2011).

Similarly, Tiruneh (2012) confirmed the Ethiopian government is taking major action on corruption.

4.4. Business Environment

Business environment has high pressures on the real secondary market performance. Concerning to this, Ruecker put, the Ethiopian status in relation to business environment:

The country is ranked 116th of 181 in the World Bank's 2009 Ease of Doing Business Survey. This compares to a ranking of 109th of 179 in the 2008 survey. Ethiopia is ranked 118th in starting a business, 95th for employing workers, 123rd in getting credit, 78th in enforcing contracts, 154th in registering property, 113th in protecting investors, 37th in paying taxes and 74th in closing a business. With respect to the World Bank's governance indicators, it performs below average. It is ranked at the 19.8 percentile for regulatory quality, and it is at the 33.5 percentile for rule of law. Ethiopia is ranked 121st of 141 in the Fraser's Institute Freedom of the World Index, 91st of 122 in the Milken Institute Capital Access Index, 134th of 141 in the UNCTAD Inward Potential Performance Index for 2004-2006, 133rd of 179 in the Heritage Foundation's Economic Freedom Index and 121st of 134 in the World Economic Forum's (WEF) 2008-2009 Competitiveness Index. The personal income tax rate is progressive and ranges from 10 to 35 percent.

The corporate tax rate is progressive and ranges from 10 to 35 percent, with a flat tax of 30% on incorporated businesses (e.g. private limited companies or joint stock companies). The 15 percent Value Added Tax is levied on those companies whose turnover is above birr 500,000 per year.

The capital gains tax is 10 percent and the tax on interest income is 5 percent (2011).

4.5. Foreign Investment

Where saving is low, foreign direct investment is an alternative means to improve investment in countries, like Ethiopia. To attain this objective, the government has to encourage foreign investment in order to spur growth, employment and exports (Ruecker, 2011). There are munificent inducements such as a five-year tax break for manufacturers and investors in agro-industrial activities who export at least 50 percent of their

products are offered to foreign investors. Additionally, there are also duty free allowances for the import of machinery (Rueker, 2011).

As a result of this in 2002, the minimum capital requirement for wholly foreign owned investments was lowered from USD 500,000 to USD 100,000. There is no restrictive visa, residence and work permit requirement. Foreign companies do not face any discrimination with respect to tax treatment, denial of licenses, import or export policies, and tariffs. Foreign investors can freely remit profits, dividends, principal and interest on foreign loans, fees related to technology transfer and proceeds from the liquidation of a business (Rueker, 2011).

Mebrahtu in his research titled "Is Ethiopia ready to commence capital market? Analysis of potential beddings, constraints and the dubious" stated the condition of foreign investment in Ethiopia as follows:

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, foreign direct investment 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 foreign direct investment inflows into Ethiopia have increased continuously from US\$ 135 million in 2000 up to US\$ 545 million in 2004. But the yearly foreign direct investment 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 gross domestic product, 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 Diasporas national bank of Ethiopia 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.

4.6 .Stakeholder's Opinions about the Current Situation

As scrutinized from the opinion of stakeholders, there is synchronization regarding the need to establish a capital market in the country. Their opinion is bottomed on the importance of rising long-term fiancé, in order to enable easy transfer of shares when required and for the overall economic development of the country in general. Some also accentuate putting in place of a regulatory body and its mechanism, as well as other prior conditionality in the form of capacity building, awareness creation among the business community and the public in general.

4.7. Conditions of Legal and Regulatory Infrastructures

In general, there is no institutional, legal and policy framework for any capital market activity in the country. The absence of such framework will definitely be an obstacle for launching a capital market in Ethiopia. It is therefore crucial that this framework is put in place prior to the launching of a formalized capital market. Lack of trained human resources could also be a serious obstacle in running and managing a securities market, and security market activities in particular. These obstacles for capital market operation should be overcome once a decision is reached to launch the market (Ruecker, 2011).

4.8. The Regulatory and Securities Enforcement

In order to establish a fair, orderly, transparent, and well-regulated capital market in which investors will be willing to place their confidence, it is absolutely necessary that the integrity and effectiveness of the regulator enforcing security laws is confirmed by the market participants. All personnel of the regulator shall be subject to a code of conduct or ethics (Ruecker, 2011).

4.9. Adequacy of the Judicial System

There is no system of civil courts where securities cases can be prosecuted by a dedicated governmental authority. There are no specific training programs to educate prosecutors and judges on capital market regulation, including corporate governance. There are commercial courts that specialize in hearing commercial cases, but there are no courts that specialize in hearing only securities law and company law cases. There are provisions in the jurisdictions laws that may be used to prosecute securities violations (Ruecker, 2011).

4.10. Accounting and Auditing

Though accounting and auditing standards have been improving in Ethiopia, they are not yet at an internationally acceptable level. With the National Accounting and Audit Board governing the nation's accounting and audit practice, and issuing certificates and accreditations for audit and accountancy firms by observing the quality and standards of financial reporting in the country as well as the adoption of the International Financial Reporting Standards (IFRS), accounting and auditing standards should improve in the near future. Additionally, the Association of Chartered Certified Accountants (ACCA) is most recently focusing on IFRS. The NBE has already developed a guideline for standard financial reporting and has trained its staff in this regard. What the NBE is now waiting for is the enactment of the proclamation into law (Ruecker, 2011).

4.11. Corporate Governance

The overall standard of corporate governance is low. More specifically, the legal and constitutional instruments do not provide an adequate regulative framework, key international conventions and standards are not ratified, investor and creditor protection laws are inadequate, and the absence of an organized capital market is a remarkable deficit and contributes to a lack in

transparency. However, recent developments prove an emerging commitment to corporate governance standards and a corporate governance code is expected to be introduced in the near future (Ruecker, 2011). In addition to that Alemneh concluded, share companies are suffering from poor corporate governance, where founders, directors and executives of share companies are found pursuing their own interests rather than the interest of shareholders, particularly of the minority shareholders (Alemneh, 2015).

5. CONCLUSION AND RECOMENDATION

Ethiopia has encouraging dynamics contributing for the development of the capital market. Such as fast economic growth, energy expansion, blooming of private sectors and privatization process, capital flow

improvement, household investment habit than saving and inclination to the establishment of incorporated companies, qualified companies for the establishment.

Nevertheless, it is important to mention that the country is left with to improve governance, institutional, legal and policy framework which are vital for stock market activity. This is emanated from the lack of commitment.

Ethiopia is endowed with many resources which are important to establish stock market. In addition to that, the new Ethiopian economic system is favorable to stock market exchange. Additionally; the Ethiopian government is taking important measurement to reduce corruptions. The other important ant points for stock market are business environment. From this side Ethiopia is showing a progress in business indexes.

The last recent years, the follow of foreign direct investment is increasing specially from the emerging economic countries.

Stake holders are strongly demand to establish stock market for they need smooth financial transactions.

Another opportunity to start market exchange is the presence of accounting and auditing board that has recently established and functioning its intended objectives.

In relation to the above, the experience Ethiopian commodity exchange is good positive indicator stock market can be effective and possible in Ethiopia.

But to start the stock market, several institutions are necessary which are not available and not well established in Ethiopia. Because according to Abera (2011), Ethiopian companies are qualified in the eyes of stock exchange listing requirements, the establishment of stock exchange in Ethiopia is feasible. Thus, the government needs to consider the establishment of stock exchange in Ethiopia.

The study indicates, the objective conditions in Ethiopia are favorable to start capital market. Because the basic factors to establish stock market are available. The only thing that must be thought by the government is to establish regulators and security enforcement and other legal infrastructures.

In general, if the government is committed to revise and finalize the country's commercial code concerning to accounting and auditing registration, developing strong, governance and enforcing companies to adopt the international financial reporting system as well as establishing stock market related institutions and procedures; it is possible to start stock market exchange.

So the reason why Ethiopia does not establish stock market exchange so fare is,dueto the lack of government committeemen's not because of the real conditions or objectives. Because according to Abera (2011), Ethiopian companies are qualified in the eyes of stock exchange listing requirements, the establishment of stock exchange in Ethiopia is feasible. Thus, the government needs to consider the establishment of stock exchange in Ethiopia.

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