

THE CHALLENGES OF EMERGING STOCK MARKETS IN AFRICA, A CASE OF RWANDA STOCK EXCHANGE

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Abstract

A number of studies previously carried out indicate that capital market development of any economy is synonymous with the growth and economic development, and almost every African country has put an effort to establish a stock market, including Rwanda. This study focuses on the challenges faced by emerging stock markets in Africa, a case study of Rwanda Stock Exchange.

The main objectives of this study include establishing the types of securities traded, rules governing the market, challenges facing the market and the suggested recommendations to counter these challenges.

A population comprising of five listed companies and the Capital Market Authority were considered and in each case, one respondent was selected using purposive sampling technique. Although this research used more of secondary data that was obtained through literature review, primary data was also collected using an interview guide.

The study has found that currently, the types of securities traded include three government bonds and one corporate bond, and stocks from five companies that have listed and cross-listed on the market.

The study established that rules are provided and well adhered to and challenges facing the market include among others the general public which is not fully knowledgeable about trading in stocks, coupled with less skilled investment experts and lacking long-term credit, all this reduce profitability and thus limit the chances of listing stocks onto the stock market.

It has been suggested that public education through various mediums like television stations, newspapers, radio stations and public conferences with the general public, among others, be increased.

Key words: capital markets, challenges, emerging, Rwanda, stock exchange, e.t.c.

1. Introduction

Capital markets have been seen as very significant components of the financial sector of any economy. They are also considered as playing a vital role in the mobilization of capital in many of the emerging economies.

The capital markets in emerging markets have seen considerable development since the early 1990s. The market capitalization of emerging market countries has more than doubled over the past few decades growing from less than \$2 trillion before 1995 to about \$8 trillion in 2009. As a percentage of world market capitalization, emerging

markets are now more than 12 percent and are steadily growing (Standard and Poor, 2012).

The drive towards the establishment of stock markets in African countries during the past few decades may also be linked to other important developments in the global economy. The financial markets of many advanced countries have undergone tremendous changes and became increasingly integrated. These changes have resulted from the operation of a number of interrelated factors (Cosh et al, 1992).

Stock market development has been central to the domestic financial liberalization programs of most African countries. It seems any program of financial liberalization in Africa is incomplete without the establishment and development of stock markets.

As Pardy (1992) puts it, securities markets have an important role to play in financial liberalization and deepening. The author contends that apart from providing a means of diversifying risk for both capital raisers and investors, securities markets could play other roles. For example, they are a mechanism for capital allocation and corporate monitoring, and a means for government to exercise market-based rather than direct fiscal and monetary policies.

Most African countries have shifted their attention to the capital markets for a number of reasons. Firstly, capital markets are a useful tool for privatization programs. Secondly, there is a growing dissatisfaction with the bank-based finance which until recently was fraught with government controls, the growing awareness of the need for a more integrated approach to financial sector development, the resource mobilization, and finally the promotion of investment and economic growth among other reasons.

Charles (2003:2), however, argues that emerging capital markets in Africa have fewer market participants, less sophisticated and less skilled investment analysts. The author adds that their characteristics raise questions as to the markets capability to mobilize funds and allocate resources efficiently as well as their ability to endure in their financial intermediation roles for foreign and domestic capital.

Analyzed generally, African capital markets have remained under-developed and they have largely not achieved their intended objective. According to Samuel Kamndaya (2010), many African markets are still immature and the market capitalization is mostly dominated by a few firms. He adds that Africa has to attract international investors in order to grow their capital markets and move them to the next level in the years to come. This, however, will require most African countries to have massive economic, political and business reforms in order to win investors' confidence.

Further, firms in Africa still find it quite difficult raising capital for growth and development. Demirgüç-Kunt (1992) observes that firms rely mostly on internal resources and informal credit markets for financing. Commercial banks are the main financial institutions. The author argues that the loan contracts of commercial banks are generally short term, and formal direct credit markets for long term debt or equity do not exist, thereby constraining both corporate and economic growth.

Charles (2003:3) contends that a company which has used its overdrafts to finance the purchase of say, fixed assets will not be able to repay its overdraft on demand and will be in breach of its banking terms. The author

adds that the interest rate on overdrafts can change quickly and significantly, causing pressure on the company's profitability.

This trend continues to make it quite difficult for firms in the developing countries to secure long term credit required to finance business growth and expansion. This is so because most commercial banks would prefer to lend to the already established customers with strong collateral and additional guarantee, which requirement most of these firms may not meet. The failure to expand and increase business portfolios also reduces these firms' profitability, thus limiting the number of firms listing on the securities markets.

Prior to 1989, there were just five stock markets in sub-Saharan Africa and three in North Africa. Today, there are more than 20 stock exchanges, (Benimadhu, 2010). According to Nkontchou (2013), there are 23 domestic and 2 regional stock markets operating across the African continent today and the number of listed companies is 2000. Thus, the average number of listed companies in each African stock market is 80. Rwanda as one of the newest stock markets has a far less average of listed companies than the sub-Saharan African average.

In Rwanda, the idea of the capital market establishment started in 2005. The capital market started as Rwanda-Over-The-Counter (OTC) market in January 31, 2008, and later grew to be a Rwanda Stock Exchange (RSE) in January 2011. The RSE is operated under the jurisdiction of Rwanda's Capital Market Authority (CMA), previously known as Capital Markets Advisory Council (CMAC), which reports to the Ministry of Finance and Economic Planning (MINECOFIN).

The Capital Market Authority of Rwanda was established with the main objective of

guiding the development of the capital (stock) market in Rwanda. When it started, it had admitted 7 members to operate in the Rwanda OTC market (CMAC, 2009). Currently, there are three categories of membership and these are Stockbrokers, Dealers and Sponsors. The stockbrokers buy and sell both on their own behalf and on behalf of the investing public. Dealers trade with their own funds while sponsors provide advisory services to companies looking for ways of raising Capital.

According to Wikipedia, initially the exchange market only sold bonds - one offered by the country's central bank; the National Bank of Rwanda and one by the Commercial Bank of Rwanda. Later in 2009, equities began to be listed on the exchange. By January 2010, the only cross-listed equity on the exchange was the Kenya Commercial Bank (KCB) Ltd which was listed on the Nairobi Stock Exchange, and cross-listed on Dar-Es-Salaam Stock Exchange and Uganda Securities Exchange.

The capital market in Rwanda comes at a time when the economy is growing fairly steady and there is need to raise capital both for firms and for economic growth. However, there are still only a few listed companies, five in total and there is generally a slow growth of the stock market. This study therefore seeks to establish the challenges that are affecting the development of the stock market in Rwanda and to suggest ways and means of boosting the capital market in Rwanda.

The main objective of the study is to analyze the challenges that affect the development of the stock market in Rwanda.

- To document the types of securities and volumes traded in the Rwanda Over-The-Counter market.
- To analyze challenges facing both the market (OTC) and to establish

reasons why companies are reluctant to list on the market.

- To establish the strategies undertaken by CMA to promote and develop capital markets in Rwanda.

In order to guide this study, the following research questions were formulated as follows:

- What are the types of securities and volumes traded on the Rwanda Stock Exchange market?
- What are the specific challenges that prevent companies from listing and affect the market development?
- What are the strategies put forward by CMA for the development of a vibrant Rwandan capital market?

The study focused on Rwanda stock market headquarters and all five listed companies on Rwanda Stock Exchange were included in the study. The study was conducted in Kigali city because all the listed companies and those eligible for listing have their headquarters in the capital city. The study period covered the beginning of the market in 2008 to date- 2014.

2. Method

This study is more of qualitative in nature and a case study approach was adopted. A sample of six respondents were selected on the basis of purposive sampling procedure from a population of all five listed companies namely, BRALIRWA Ltd, Bank of Kigali, Kenya Commercial Bank (KCB) Ltd, the Nation Media Group (NMG) and Uchumi Super Markets Ltd, and the Capital Market Authority (CMA). To obtain data about challenges facing RSE and reasons why many companies are not listing on the stock market, the researcher used the CMA staff and secondary data sources. An

interview guide was employed to collect primary data while secondary data was obtained by reviewing literature. For data processing, analysis and interpretation, editing and tabulation were the means used.

3. Results and Discussion

The main findings of this study were made based on the specific objectives of this research study. According to CMA, the types of securities traded include three government bonds; one being short term and the other two medium term, having a total face value of eighteen and a half billion (18,500,000,000) Rwanda francs, and a one ten-year corporate bond from I & M bank. Further, the companies that have listed and cross-listed their shares include, Bank of Kigali, BRALIRWA Ltd, and the cross-listings are Kenya Commercial Bank (KCB) Ltd, Uchumi Super market Ltd and the Nation Media Group (NMG).

The study established that various rules are provided and well adhered to and challenges facing the market include among others the general public which is not fully knowledgeable about trading in stocks. On the issue of companies being reluctant to list and trade on the market, it was found that a number of companies are small and do not meet the minimum listing requirements especially the financial statements of three consecutive years. Another important issue is that there are only a few skilled and experienced investment analysts in the region. This results in dependence on short term bank loans. This inaccessibility to long-term credit reduces corporate profitability, thus limiting the number of companies that would wish to list stocks onto the stock market.

It was further established in this study that lack of awareness is one of the major challenges faced by Rwanda Stock Exchange. Respondents explained that the

public has not yet understood the benefits of the stock market and that most people do not even know what a stock market is all about. Higher listing requirements were also noted as a critical challenge especially on the requirement of having at least three-years consecutive financial statements well audited. The other problems cited included having a limited number of investment analysts, low demand for securities, high transaction costs, poor infrastructural facilities and low volumes of transactions. There was also an issue of companies that are either partly or wholly owned by foreigners or by families who are not interested in making their businesses publicly owned.

This study came up with a number of suggestions that are intended to boost the stock market of Rwanda as follows:

- There should be continued public education through various mediums like television stations, newspapers, radio stations and public conferences with the general public, so as to create more awareness and increase its acceptability.
- It is further suggested that CMA should work with consultancy firms in advising and encouraging companies to regularly prepare financial statements in a manner that complies with the acceptable accounting/ auditing principles. This will position most firms to meet one of the most demanding requirements to be eligible for listing.
- It was found out through this study that CMA and the government of Rwanda have plans to include even small and medium enterprises (SMEs) on the stock market before the year 2014 ends.

The strategies established by CMA are embedded in a five-year strategic plan for the development of the capital market in Rwanda. This follows the strategic priorities of:

- The public education and awareness that targeted at least 2000 investors by the end of the year 2009. The CMA has established inter-university competitions on capital markets and its impact on the economy, which is a strategy, intended to improve awareness among the educated, and the general public at large.
- The legal framework which has two pieces of legislations; one is responsible for establishing the capital market authority and the second is a law that regulates capital markets and it was approved by the cabinet of Rwanda.
- Capacity building through training the market participants, investors and the general public to ensure that people understand the meaning and operations of capital markets.
- The listing process which is already on-going and to encourage more foreign companies for cross listing.

The study found out that the targeted number of investors of about 2000 by the year 2009 was not realized. CMA Executive Director argued that investment in capital markets is long term and that it involves public education and then waiting for the educated to make investment decisions. There are two listed local companies so far and three cross-listed companies.

4. Conclusion

This section examined conclusion made based on the findings of the study. It is worth noting that emerging capital markets, like Rwanda Stock Exchange are always confronted with a number of challenges ranging from a lack of awareness, to a failure to meet the listing requirements among other factors in most cases.

The capital market in Rwanda is young and in an emerging economy whereby most companies are family owned and the accounting and auditing systems hardly meet international standards. This study established that in Rwanda, Accounting Law was published in the year 2010. In such a situation, hardly can many companies meet the listing requirements that a young stock market needs to put in place in order to ensure investors that their investments are secured. Further, big companies may not wish to undertake all the required stringent procedures for participating in such a small market; they do not consider their effort worth the expected benefits.

It was suggested that measures to encourage more firms for listing be put in place and such measures included; intensifying public education and awareness programs, a revision on the prevailing listing requirements and putting in place a tax levy or reduction on foreign companies for cross-listing.

The strategies undertaken by CMA which include a legal framework that is already in place; there is also public education and awareness and encouraging foreign companies for cross-listing. It was established that half a dozen companies have shown interest in listing onto the stock market

and it is hoped that in the course of the years ahead, more companies will keep on listing on to the market.

5. Policy Recommendations

A number of recommendations spring from the findings of the study, ranging from education about and promotion of the exchange to streamlining transactions and encouraging the development of investment trusts and funds. More sound macroeconomic policies are also needed. The recommendations are:

1. **Mount an intensive education and promotion campaign:** The greatest challenge to the Rwanda Stock Market is to improve the level of knowledge of the local investors. A programme of continuous education for the investor, the intermediary, the issuer and the regulator is extremely important for the successful development of the Rwanda stock market. This education campaign should involve the development of financial journalists and improvements in the quality of financial market publications. Financial education should be strengthened in the secondary schools and particularly in the universities.

As markets become more sophisticated, there is increasing need for investment advisors and other personnel who are capable of analyzing complex financial concepts such as options and other derivatives. More and more radio and television programs should be used to reach more people explaining financial investments in securities in both English and Kinyarwanda and Swahili languages, to supplement the inter-varsity competitions on capital market and its impact on the economy, in increasing the general public awareness on capital market and its impact.

2. **Provide fiscal incentives:** There is need to provide incentives for firms who may want

to list on to Rwanda Stock Exchange. One such incentive is differential taxation in favor of listed companies. Such an incentive will help increase the number of listing companies on the exchange and improve liquidity of the market.

3. Provide incentives for market research: Greater access to quality research on information useful for investment analysis can be expensive. The introduction of research cost reimbursement packages to brokerage and other intermediaries providing such services will improve the availability of investment information, which will in turn make the market more efficient.

4. Follow prudent macroeconomic policies: There is need for the government of Rwanda to consistently follow prudent macroeconomic policies. High interest and inflation rates, budget deficits, etc., may not only create financial instability, but also feed uncertainty, which affects stock market development.

5. Integrate the Rwanda Stock Exchange with the regional and international financial system: Rwanda Stock Exchange is already a member of Africa Stock Exchanges Association (ASEA) and plans are ongoing for the establishment of East Africa bourse, integrating the four East African stock markets, that is, the Nairobi Stock Exchange in Kenya, the Dar-Es Salaam Stock Exchange in Tanzania and the Uganda Securities Exchange in Uganda.

Because of the current trend of integration and globalization of economies, the management of the Rwanda Stock Exchange must aim at continued integration with other international capital markets. Once succeeded in this direction, the regulatory authorities must enforce the various regulations on securities. If this is done, both

local and foreign investors will feel much protected and freely commit more of their financial resources to the RSE.

6. Regularly review primary and secondary market regulations: Primary market regulatory activities on new issues including disclosure, accounting and listing standards must be reviewed periodically to conform to changing international standards. Secondary market activities, such as surveillance and supervision of dealers to maintain high standards, must be monitored to boost investor confidence.

7. Encourage the development of investment trusts and funds: The fact that most of the investors on the RSE are small investors and also unsophisticated points to the need to encourage brokerage managers to develop funds and unit trusts, including pension funds and index funds.

8. Nurture a progressive and sound banking system: The banking sector is vital to the development of the capital markets. A progressive and sound banking system is required to quicken the development of the financial market.

9. Improve the communication infrastructure: There is need for the government to continue the already started measures of improving the physical infrastructure, particularly the telecommunication infrastructure, which is the pivot around which business on the financial market revolves and improves.

10. Encourage additional cross-listing: There is a positive spillover effect of the regional cross-listing of KCB Group, Nation Media Group, and Uchumi Super markets to the Rwanda RSE. Other well managed and qualified firms must therefore be encouraged

through incentive packages to move to regional and international cross-listing.

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