THE IMPACT OF REGIONALISATION IN THE AFRICAN CAPITAL MARKETS SECTOR AND THE MOBILISATION OF FOREIGN CAPITAL FOR SUSTAINABLE DEVELOPMENT*

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EXECUTIVE SUMMARY

Successful consolidation of African countries in large regional economic blocs is now a reality with such successful blocs as the Common Market of East and Southern Africa (COMESA), the Economic Community of West African States (ECOWAS) and the South African Development Community (SADC). As world markets operate more and more like “global villages,” corporations search relentlessly for investment opportunities with the lowest production cost, lowest cost of capital, highest investment returns and lowest risk both within and between these “villages”. The consolidation of regional capital markets, combined with a coherent conducive investment environment, is imperative if African countries are to maintain a place at the table of the global economy.

Stock markets, in general, are about options. For savers, the stock market provides an alternative to the money currently placed with the local bank. For entrepreneurs, governments or corporate bodies, the market provides a venue to raise capital to finance projects or businesses. For Africa to attract significant foreign direct investment, the stock markets will also be increasingly used as a platform by foreign investors to raise more capital to finance their projects.

Currently, there are twenty stock exchanges in Africa, which represents about a 40 per cent increase in market capitalisation over the past five years—the increase rises to 160 per cent if the Johannesburg Stock Exchange (JSE) is included. This is an impressive achievement by any standard. However, most African stock markets are characterised by low liquidity due, in part, to poor micro- and macro-structures from central governments. Despite this, on average, African stock exchanges have out-performed most emerging and developed markets for the past ten years. This is in line with the increase in the overall level of foreign and direct investment and increases in the privatisation of state-owned utilities, private sector investment and the overall level of investor confidence.

For the exchanges in Africa to maintain high levels of sustained growth rates, the venture capital market sector needs to be developed further. African stock exchanges are still mainly dominated by major international institutions in the banking and insurance sectors. African governments will need to create the right conditions for budding entrepreneurs to raise capital in the markets. The right regulatory framework, greater transparency, protection for investors, less corruption and less state intervention, are some of the vital ingredients that will have to be in place before investors can take the African stock exchanges seriously. At the moment, a significant number of exchanges have gone some way towards putting most of the above requirements in place.

I. INTRODUCTION

Africa has experienced significant economic growth in the 1990s. However, the role African capital markets played in this sustained growth and development is not yet well established. One of the reasons is that the majority of Africans do not yet understand the basic functions of a stock market. African governments, for their part, still do not have coherent policies in place to push forward the capital markets agenda. For Africa to attract significant foreign direct investment, the stock markets will need to be used as platforms by foreign investors to raise capital to finance their projects. Exchanges will also need to be used by budding entrepreneurs as venues to raise venture capital to help finance their businesses. One of the key reasons why the capital markets sector has received little attention by development organisations is the general perception that stock exchanges do not, immediately, help combat poverty and diseases. It is, however, not difficult to see that well regulated stock markets will help improve cross-border trade and spread wealth across borders and, as a result, create jobs.

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There are currently 20 stock exchanges in Africa located in Botswana, Côte d'Ivoire, Egypt, Ghana, Kenya, Malawi, Mauritius, Morocco, Mozambique, Namibia, Nigeria, South Africa (three exchanges), Swaziland, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe. One more new exchange is expected to be operating in Lesotho soon (African Stock Exchanges Handbook, 1999). The Johannesburg Stock Exchange in South Africa is the continent's largest stock exchange with a stock market capitalisation (SMC) of $170 billion (as at year end, 1998) and the developing world's third largest behind Hong Kong and Taiwan. It is among the most technologically advanced exchanges and accounts for about a fifth of the stock market capitalisation of all stock markets in Africa.

In recent years, African markets have, on average, out-performed all leading market indicators. Emerging markets specialists believe this is just the beginning of an even greater performance from Africa's fledgling stock markets. This is both optimistic and simplistic, but positive feelings have led some fund managers to back those feelings with cash by investing in the region. A recent example is the Southern Africa unit trust, from Save & Prosper, the retail fund arm of the merchant bank Robert Fleming, which raised £10 million. Others include the Africa Investment fund from US investment bank Morgan Stanley, which raised £230 million, and Baring Asset Management, a UK fund management company.

Of the few African funds that exist, most of the money is invested in South Africa. Yet, spectacular opportunities are more likely to be found in other African markets. Great possibilities lie in the small and, as yet, under-researched countries, which have only set up their stock exchanges since the mid-1980s. The S&P fund is typical, though, as it put 85-90 per cent of its cash in South Africa and the remaining 10-15 per cent in Zimbabwe and Botswana. It is also typical in that it will invest in a mix of quoted and unquoted companies as well as some fixed interest securities.

The change in world politics since the collapse of communism has created a background of opportunity within African capital markets. The fall of Soviet power around the world meant that African nations were forced to take notice of the capitalist approach attached to loans from institutions such as the International Monetary Fund and the World Bank. As a result, since the mid-1980s, many states have undertaken programmes designed to strengthen their economies, moving away from central planning and towards a more conventional capitalist model. This is something that potential investors have looked favourably on. Typically, the World Bank insists that governments agree to fulfil a number of criteria before it will make loans. These include the implementation of floating exchange rates, cutting government spending, liberalising interest rates, following a tight monetary policy and creating a broader tax base, all conditions in which private sector capital can be used for investment and development. Cutting government debt by privatising state-owned companies is another typical pre-condition. Not surprisingly, these are also some of the very conditions necessary for a stock market to function efficiently.

II. STOCK MARKETS: GROWTH POTENTIAL

African stock markets are still in their development phase. However, many emerging market specialists believe that these are the last undiscovered stock markets in the world. There has been some significant undervaluation of African stock markets over a number of years. This undervaluation has been, consequently, translated by most analysts into an out-performance of the African stock market indices relative to other emerging stock market indices even without a substantial foreign investor base. Once a substantial foreign investor base emerges, this out-performance will be significantly magnified.

During the period from January 1994 to August 1998, the U.S. dollar denominated Flemings Africa Index including South Africa (FAiSA) returned 22 per cent while the International Finance Corporation (IFC) Investable Composite Index (IFCI) lost 43 per cent. In the same period the Flemings Africa Index excluding South Africa (FAxSA) returned 169 per cent or a compounded annualised return of 21 per cent per annum. The FAxSA outperformed the S & P 500 Index by 12 per cent. The returns for both the FAiSA and the FAxSA significantly outperformed the returns of the S&P 500, the IFCI Composite and the regional IFC indices for Asia, Europe, Middle East and Latin America during these periods. For the 12-month period ended April 30, 1998, the top two performing stock markets in the world were African markets. The stock market in Ghana was up by 165 per cent in dollar terms for this period making it the world's best performing stock exchange during this period. The market in Botswana was up 94 per cent in dollar terms during the same 12-month period ended April 30 making Botswana the world's second best performing stock market.

The combined stock market capitalisation (SMC) of African stock exchanges almost doubled from $136 billion in 1989 to $225 billion as at the end of 1998. This rise in SMC value is magnified further when one considers the rise in the SMC value for African exchanges, excluding South Africa, from $5 billion to $55 billion during the same period, an eleven-fold increase. It should also be noted that the African share of emerging market SMC has also increased from 3.7 per cent in 1985 to 12.7 per cent in 1996. ING Barings, the international investment bank, projects that the combined SMC of African countries will increase by a factor of five or six by the year 2010. This figure will, significantly, increase with proper regional blocs in place.

Another positive factor that characterises the African stock markets is the very low correlation between African stock markets and the major stock markets. Furthermore, apart from this low correlation (in many cases, even negative correlation) between African markets and the major world markets, there is also very low correlation between African markets themselves. This is due to the economic diversification of African markets. This is unlike markets in the Asian and Latin American regions where intra-regional correlation is high. This combination makes Africa a truly diversified addition to a global portfolio. The situation could, however, change with greater regionalisation of the markets.

It is inspiring to note that the IFC recently provided seed capital for the launch of a West African Fund. It is also encouraging to note that the IFC has added many African emerging markets to their emerging market indices. Morgan Stanley, through its Morgan Stanley Capital International (MSCI) affiliate, also launched, in late 1997, two Africa Indices (MSCI Egypt and MSCI Morocco), thus bringing to three the number of markets covered by the MSCI, South Africa being the third market. Furthermore, the IFC in their Emerging Markets Database (EMDB) covers eleven African markets and includes five (Egypt, Morocco, Nigeria, South Africa and Zimbabwe) in their IFC Global Composite Index (IFCG). The other six markets covered by the IFC include Botswana, Côte d'Ivoire, Ghana, Kenya, Mauritius and Tunisia and are included in the IFCG Frontier Composite Index.

The IFC eloquently summarises the rationale for investment in the African stock markets in a with the following positive comments: "Africa is the new frontier (and its) economic potential is largely untapped. Its plentiful resources have been enhanced by economic and political progress over the last decade… Africa presents a tremendous potential market… The game is just starting in Africa and willing players… will have their just rewards. The rewards of investing in Africa justify the high risks. Returns… have been among the highest in the world and the outlook is good" (IFC, undated).

III. REGIONALISATION OF AFRICAN CAPITAL MARKETS

International trade and investment flows have increased more rapidly than world GDP over the last two decades. This rapid growth of international transactions has sometimes been referred to as "globalisation". However, it has sometimes often been argued that globalisation has not contributed to overall world growth, but only benefited a small number of countries, while many others have failed to reap the benefits of rapid increases in international trade and investment flows. In other words, the globalisation process contains an in-built bias that leads to a concentration of trade and investment flows and greater inequality.

For the African capital markets, the way forward is through the formation of strong regional blocs, which will then, ultimately, lead to a meaningful global agenda. The question is, will regionalisation improve the overall performances of the African stock exchanges? Globalisation and regionalisation are not necessarily antagonistic, but rather mutually reinforcing. African stock exchanges need to integrate with the rest of the world and, in doing so, they must first come together and establish their own regional blocs.

Regionalisation is currently taking place in the continent. In fact, the world's first regional exchange is the *Bourse Regional de Valeurs Mobiliéres* (BRVM) in Abidjan, Côte d'Ivoire, which commenced trading in early September 1998. The BRVM will serve the eight French speaking West African nations – Benin, Burkina Faso, Guinea-Bissau, Côte d'Ivoire, Mali, Niger, Senegal and Togo. It is expected that five to ten companies from each of the eight BRVM member countries will be listed on the BRVM. The BRVM will use electronic trading and settlement (T+3) systems. The eight member nations of the BRVM will be connected via satellite.

There are also currently plans for two other regional exchanges in Africa. These are the planned regional exchange for Anglophone West Africa (Nigeria and Ghana) and an exchange for East Africa

(Kenya, Uganda and Tanzania). These exchanges will increase market liquidity while, simultaneously, stimulating the addition of substantial depth to the capital markets in these African sub-regions. During a meeting in Johannesburg this year, leaders of the SADC stock exchanges resolved to speed up the linking of their trading, clearing and settlement systems with the aim of building the region's market into a world contender. The Namibian stock exchange is already linked to the Johannesburg stock exchange.

As a way forward and for stronger regional co-operation between the SADC exchanges, plans were in place to bring the Johannesburg Stock Exchange, the Bond Exchange of South Africa and the South African Futures Exchange (SAFEX) under one umbrella. However, both the Bond Exchange and SAFEX rejected the planned merger, put forward by JSE, during separate meetings on the 24th November 1999. This is a blow to the spirit of regionalisation in the SADC region. It is, however, hoped that the three exchanges will work more closely together in the future rather than a full merger.

The Johannesburg Stock Exchange and the Nigerian Stock Exchange have also signed a memorandum of understanding, which will encourage technology transfer, staff secondment, dual and new listings and training between the two exchanges. The implications of the "bloc-effect" are far reaching. What this simply means is that financiers in Europe or America interested in investing in Africa will find it easier to do business in these regional stock market blocs. Foreign direct investment (FDI) will grow as a result. More importantly, it will be easier for investors in countries within blocs to raise capital in the region to expand their businesses. For instance, an investor from Ghana will encounter fewer problems raising money from the Nigerian Stock Market to set up a business in the Côte d'Ivoire.

One feature of many African stock exchanges, as a result of their relative youth, is the advanced technology in place in these exchanges; many of these exchanges were formed at a time when the technological development of trading and settlement systems was already advanced.

In today's world, no nation can realise its full economic potential on its own. Cross-border and regional co-operation will maximise prosperity for each of the member states in the continent, as is the case for other regions of the world. Africa has much to learn from the European Union, which is increasingly focusing on the private sector as the engine of growth and on the establishment of a free trade area. To be active participants in the new world order, African countries have to liberalise their financial markets, reduce price support and subsidy programmes, and direct resources to more efficient projects (IMF, 1999).

The continent already has a number of active and well-structured economic blocs. These include, among others, ECOWAS, COMESA and SADC. These blocs will play key roles in the regionalisation of the capital markets. The OAU also actively promotes trade and investment among African countries and hopes to spark the creation of an African common market in the next decade. A common aim of all these blocs is to unify the varying tariffs between African countries and to expand inter-African trade. This, if successful, will make trading across the various exchanges easier and more cost effective. Furthermore, the free market would not be confined to commercial trade but will also aim to promote the free flow of capital and investments between the member countries.

Asia's financial crisis has been a dominant theme in almost every recent professional gathering. What exactly precipitated the Asian crisis? Without being too simplistic, a heavier reliance on debt rather than equity might be the major cause of the crisis. Corporations and financial institutions were focusing on attaining growth targets without being accountable to discerning shareholders, and that led to inefficiencies and excesses. Of course, this was accentuated by a set of other structural problems, namely inadequate regulations and insufficient transparency among banks, corporations and the governments, otherwise known as crony capitalism. Another consequence was an excess inflow of private capital, some of which was channelled into unproductive investments leading to excess capacity and financial market over-valuations.

The crisis in Southeast Asia had very little effect on the African region's capital markets, except for South Africa. This was partly due to the fact that there were relatively few foreign capital investments into the African capital markets. The sub-Saharan region attracted less than three per cent of all private capital flows to developing countries over the past seven years. The channels for speculation in sub-Saharan markets are not available, with no futures or options markets (South Africa excluded) to facilitate short-selling of the region's currencies or stock markets. Regionalisation could dramatically improve the derivatives and foreign exchange markets which are non-existent in most African markets.

IV. THE ROLES OF GOVERNMENT AND THE PRIVATE SECTOR

The distribution of international capital is being conducted in a very discretionary way, leaving Africa on the sideline. Competition to attract foreign investment is intensifying as emerging stock exchanges adopt development strategies based on increased integration in the world markets. Thus, for the African markets to survive well into the next millennium, it is important that the respective governments in the region put in place sound fiscal and monetary policies. This should be accompanied by macro-economic reforms that will: bolster investor confidence, build a strong supervisory and regulatory infrastructure, help cultivate modern risk-management techniques within the private sector, put more emphasis on privatisation, and help to open the economies to foreign participation with bold trade and financial sector liberalisation to improve efficiency (Collier, 1997).

Many leading private institutions are strong players in their home market but are only small operators in the regional and global arena. Forming strategic alliances or expanding regional presence through mergers and acquisitions is a way to overcome this handicap. Businesses and financial institutions should create regional companies and services to expedite the process of the region's integration. Corporate sector reforms should involve the improvement of corporate disclosure and accounting standards to facilitate the move to a market-driven investment culture.

It is very important for the protection of individual investors that only stockbrokers who are licensed and regulated by particular stock exchanges are used to transact investment business. Such stockbrokers would also be conversant with current legislation and be able to advise investors accordingly. International Standard Securities are such a firm of stockbrokers.

Potential investors have to believe that relevant policy changes put in place regarding market regulations and the role of government will be adhered to. So far, most countries that have agreed to programmes have stuck to them. South Africa is proving to be a major success story, and this is now encouraging investors to look at other parts of Africa they may previously not have considered.

The World Bank anticipates that the economies of sub-Saharan Africa will grow at a rate of 3.9 per cent a year from now until 2003, boosted by inter-regional trade and a recovery in commodity prices. There is a strong body of opinion that believes that to get the best returns investors must get into African stocks as soon as possible and in markets other than South Africa. This is easier said than done. Apart from South Africa and Egypt, most of the exchanges have fewer than 50 quoted companies, with more than 80 per cent of each market's worth concentrated in its top 10 stocks. Most of those are the African subsidiaries of multinationals, such as Barclays, Unilever, Mobil and Standard Chartered. With the advent of universal Internet use, this is beginning to change. The lack of information has always proved a barrier to external investment for Africa and the Internet provides a window into the continent for external investors.

Possibilities now exist for the flotation of African companies in external markets, offering tremendous potential profit for investors. There are obvious pitfalls, but the risks have to be balanced against the possible rewards. Ghana has headed the pack with the flotation in the London markets of Ashanti Goldfields, in which the government had a 55 per cent stake and Lonrho the remainder. In the early 1980s, the mine had been run down to a fifth of current production because exchange controls had forced it to stop investing in new equipment. Since the mid-1980s the mine has been transformed, allowing the government to sell 27 per cent of the company for £1.1billion to help repay foreign debt. However, a recent major forward exchange transaction, which went terribly wrong, cost the company millions of dollars. This is the other side of market liberalisation. South African companies listed in foreign markets include Old Mutual and South African Breweries. M-Net, another South African company, will soon be listed on the Nigerian Stock Exchange. Further opportunities exist in the continuing privatisation programme in Ghana. Morocco has state companies worth £2 billion earmarked for public listing. There are also active privatisation programmes in Uganda.

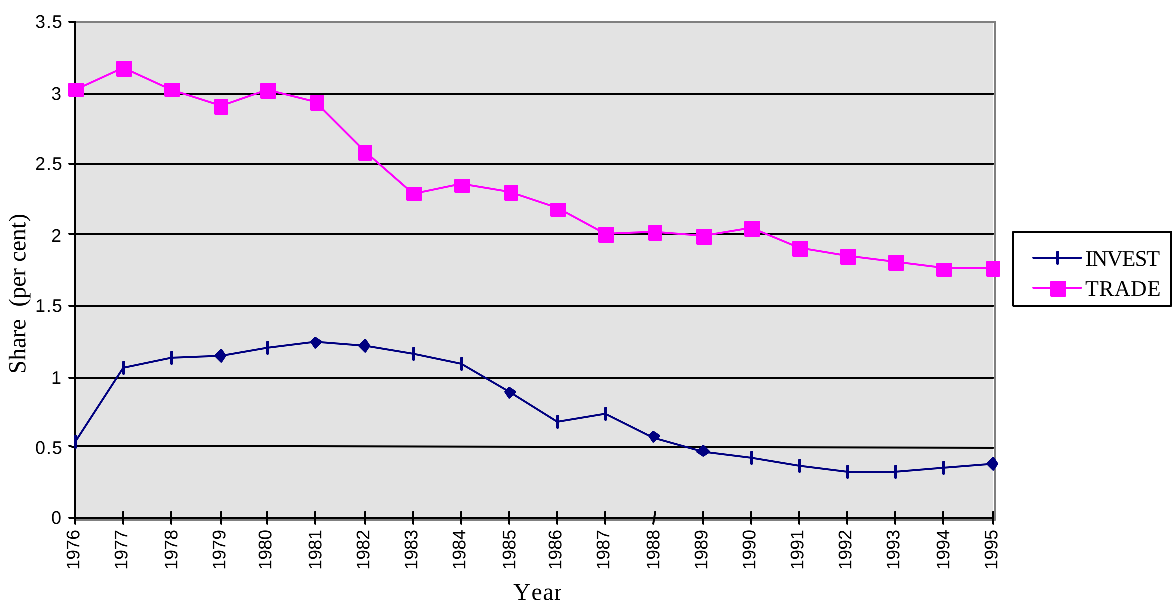
Many countries, such as Zimbabwe, Ghana and Botswana, now allow foreigners to buy at least part of a company and to repatriate dividends. Others demand authorisation before a foreigner can deal. Most African countries still don't have markets. There is plenty of scope for Africa to justify the perception of being the last great emerging market.

V. IMPACT OF FOREIGN DIRECT INVESTMENT

It is becoming increasingly clear that in order to supplement the continent's low domestic savings rate, Africa must attract significant foreign investment flows. This will necessitate a higher level of integration between African financial systems and global financial markets which, in turn, would require improved financial information, lower business and currency risk, and financial infrastructure and regulations acceptable to major foreign institutions. African financial markets provide enormous opportunities for the continent to achieve higher economic growth. Free capital movements will facilitate allocation of savings and channel resources into productive uses, thus promoting sustainable development. Open financial accounts will support the multilateral trading system by broadening the channel through which countries can finance trade and attain higher levels of income (Bhattacharya, Monteil and Sharma, 1997). Regional financial flows will, no doubt, expand opportunities for portfolio diversification and provide investors in both industrial and African countries with the potential to earn higher rates of return on their investments. Unfortunately, the liberalised financial markets will also lead to sharp and unpredictable reversals of capital flows. Volatility in capital flows was the main cause for the financial crises in 1997 and 1998.

These crises, with their unacceptably high financial and development costs, raise concerns about the net benefits of international capital flows into Africa. Africa experienced declines in both total world trade and investment flow from 1984 to 1995 (figure 1). Current estimates, however, show marked improvement in both variables.

Figure 1: Sub-Saharan Countries Shares of World Trade and Investment Flows
1976-1995



Source: World Trade Organisation, (1996). *Annual Report*.

In the continent, the percentage increase of private loans from banks is still low or negative and this has an adverse effect on private capital flows into the capital markets. After the debt crisis of the 1980s, most commercial banks are cautious about providing loans to investors, as they are still trying to recover previous loans. It should, however, be emphasised that African economies, with the exception of Nigeria and Côte d'Ivoire, borrowed mostly from multilateral organisations such as the International Bank for Reconstruction and Development. Portfolio equity flows are also still small but growing. Foreign direct investment has increased, especially in non-CFA countries, with positive per capita growth in some African countries, for instance in Botswana, Ghana and Mozambique. Their growth is a powerful signal of rising investor interest and confidence. Since 1994, twelve Africa-oriented funds have emerged to manage about two billion dollars in assets. Examples include the Morgan Stanley Africa Growth Fund, the New Africa Investment Fund, and the Calvert Africa Fund. In addition, the focus of these funds has expanded from South Africa to Botswana, Côte d'Ivoire, Ghana, Kenya, Mauritius, Zambia, and Zimbabwe. For African stock exchanges, the benefits are clear: improved liquidity, greater incentives for privatisation, increased incentives for policy reforms and improvement of financial infrastructure.

There are a number of factors that dent investor confidence. These include political instability and weak macroeconomic fundamentals, weak or low growth, the size of markets, and a high degree of inward orientation. Structurally, factors that inhibit investment include heavy regulations, corruption, slow progress on privatisation, limitations on the number of listed private firms, a limited pool of investable assets, poor infrastructure, high production costs, and high indebtedness. To ensure that African stock exchanges continue to attract private investment, it is vital that African policy makers claim as their own a reform agenda that, among other things, calls for microeconomic and macroeconomic reforms.

Microeconomic reforms. Microeconomic reforms that reduce transaction costs and combat corruption are essential for the smooth running of emerging stock markets. For example, there is the need to put efficient securities trading systems in place. There is also the need for computerisation of clearing systems that would allow securities to clear within hours. A number of countries have already embarked in that direction. A significant amount of legal reform also needs to take place, in order to ensure that transaction distortions are minimised. For example, corporate laws need to be reformed to allow more transactions like mergers and acquisitions, bankruptcies, and leveraged buyouts. The broader goal is to improve the transparency of property rights laws. For the long term, African governments should encourage their best firms to explore listing on international exchanges, which often have more stringent disclosure and accounting requirements. Aside from exposing these firms to global best practice, it creates knowledge spillovers and a broader investor perception of the listing firms' home economy.

Macroeconomic reforms. According to Olson (1996), it is ineffective to consider even minimal development in isolation of specific macroeconomic issues. The synchronisation of infrastructure is necessary at the national level to strengthen policies, payments and regulations in the capital markets sector. The establishment of a regional capital market requires the absence of restrictions on capital movements and on dividends and profits, together with the harmonisation of general taxation, regulatory and legal requirements as a framework that could be used to launch them. Policy makers need to put more emphasis on raising output growth, emphasising the need for openness, ensuring relative stability of real effective exchange rates, and maintaining low external debt (Porter, 1993). These are conditions that foster high investment rates by domestic and international investors. At the same time, African governments need to embark on wider privatisation of state-owned enterprises. Far too many investors complain that not enough has been done to reduce the role of the state in the capital markets.

Are there any useful lessons that sub-Saharan African exchanges can learn from the East Asian crisis? There are four potential lessons, all linked to the efficient functioning of the financial system.

First, if a government senses that its financial institutions are developing problems, it should not hesitate to decisively tackle the problem before it leads to an implosion of the relevant economy. For example, the Nigerian government’s recent decision to close insolvent banks was a wise one because their poor performance would hamper the effectiveness of other well-run banks. What is important is that a financial system should allocate credit efficiently.

A second lesson centres on the question of central bank independence. The ability of central bankers to focus on single objectives such as price stability is a virtue that feeds into maintaining general macroeconomic stability. Equally importantly, it signals to investors and other economic actors that the government's capacity to intervene in economic management for a variety of reasons is severely constrained.

A third lesson is on the need for an efficient financial system regulatory infrastructure. One of the strengths of the American financial system is the regulatory excellence of the Federal Reserve Bank System. Using numerous teams of bank examiners and regulators, they quickly spot flaws in the financial system that could be detrimental to the U.S economy, and potentially the global economy. One of the criticisms levelled against Southeast Asia's economies is the weak regulatory structure for monitoring bank activity. In the presence of a better regulatory system, the maturity and interest mismatch and numerous bad loans that plagued these institutions may have been spotted much earlier, before they wrecked havoc. In too many countries, the need for well-trained and capitalised bank regulators and examiners is underestimated until the financial system approaches collapse under the weight of bad loans.

Fourth, so long as one is willing to examine the evidence, it becomes clear that balance of payments crises are often self-induced. Blaming the IMF will do no good.

VI. THE IMPACT OF VENTURE CAPITAL

Banking systems are inherently conservative and status quo oriented. But conservative approaches are not enough if developing stock exchanges are to help reduce poverty. Mechanisms are needed to channel resources to the highest potential payoff, even though the risk may be higher than for traditional uses. Small businesses with no credit history need funding for expansion so they can grow into large businesses. African stock markets could provide the medium for such businesses to raise capital. There is, therefore, a need for risk capital for people with ideas and capabilities but without money. Historically, much risk capital has come from wealthier people who know the potential users personally. Extended families play this role in many cases. Among religious or ethnic minorities, group solidarity is often helpful. Indeed, the great economic success of some groups results in part from their ability to mobilise resources within the community for promising enterprises. Larger firms, often suppliers, in an industry also may provide capital to new, smaller firms when they know the new firms' capabilities or potential.

For the most part, however, budding entrepreneurs lack access to capital from these sources. If they are to obtain capital, it must come from a source with which they have no personal acquaintance. This is where venture capital enters the development business. A venture capital financier looks for promising enterprises to back with funding and limited technical advice, perhaps for a considerable period of time. If the enterprise fails, the financier simply loses his stake. If it succeeds, the financier has acquired an equity stake in the company that allows him to benefit in proportion to the success and, sometimes, far out of proportion to his initial investment.

This need for venture capital is not limited to developing countries. The United States has the most developed venture capital industry in the world. Venture capital activity is aimed primarily at small and medium enterprises. Large enterprises are a different matter as they have the capital base and visibility that make them candidates for conventional lending, as well as bond sales and equity sales on a broad scale. At the moment, the venture capital sector within the African stock exchanges is almost non-existent, largely because large companies mainly dominate the markets. This sector, if developed, will go a long way to improving liquidity in the stock exchanges.

VII. FACTORS THAT PROMOTE MARKET EFFICENCY

In general, there are several key factors which can promote and improve efficiency in the African capital markets sector:

Improved environment. Trade liberalisation, strengthening of the rule of law, improved legal and support institutions, better governance, improved transparency and better transport and telecommunications have helped to make it easier to do business in many African countries.

Economic reform. Many African countries have stabilised their economies, sometimes through the devaluation of overvalued currencies. They are reducing inflation rates and cutting budget deficits. Others are raising educational standards and, more generally, upgrading their human and technological resources.

Private sector encouragement. Many countries are stimulating economic growth by making life easier for the private sector. At least twenty African countries have broad-based privatisation programmes in place. When one looks at particular sectors, the number is even bigger. Some 25 countries in Sub-Saharan Africa are transferring all or part of their telecommunications ownership from the state to the private sector. In South Africa, for example, Telekom Malaysia, together with SBC Communications from the United States, has invested $1.2 billion in Telkom South Africa. The results of the privatisation efforts in Africa are already visible. Countries in which privatisation has attracted significant FDI include Ghana, Mozambique and Uganda.

Better FDI regulatory framework. The great majority of countries have substantially improved their FDI regulatory frameworks. Many more countries now allow profits to be repatriated freely or offer tax incentives and similar inducements to foreign investors. Many African countries have investment promotion agencies (IPAs) to assist these investors.

Venture capital provision. Small and medium sized companies constitute about 90 per cent of the businesses in Africa. Of this, a significant portion represents the informal sector. The small business and informal sectors do not, traditionally, have adequate access to credit facilities. A diversion of some FDI into the small business sector and helping the informal sector with a portion of ODA would help create jobs and improve the quality of live among the poor.

VIII. CONCLUDING REMARKS

In summary, the achievement of sustainable development in the African capital markets sector requires an increase in investment; in particular, foreign direct investment and micro-financing through venture capital. This will require both the maintenance of a stable macroeconomic environment and far-reaching improvements in governance. There will need to be discipline and transparency in the capital markets sector. The world is starting to rethink Africa's role in global markets. The challenge African stock exchanges will be facing in the years ahead is how to exploit the growing investor interest in their markets to create a virtuous cycle of growth. Secondly, the task for all African governments is to strengthen the institutional architecture of their economies to prevent capital flight and to minimise its consequences when it does take place. To effectively tackle these challenges, the management of the various African stock markets will have to:

(a) persuade their respective governments to stop interfering with the market because it sends out the wrong signals when governments want to be market regulators and participants at the same time;

(b) actively encourage investment in Africa. Africa needs to sell itself better to foreign investors;

(c) help create markets in which it is easy to buy and sell securities and thus instil confidence in investors;

(d) help reduce corruption and promote regional integration and stability. Africa is seen abroad as being endemically corrupt and war-torn. It does the market a lot of harm when corruption and regional conflicts are regarded as the two core African values;

(e) help improve the legal framework. Securities laws have to be more effective and courts more impartial;

(f) help create the conditions for venture capital instruments. Venture capital will go a long way to helping small- and medium-sized companies to raise capital; and

(g) encourage new stock listings to improve investors' choices.

In general, African countries need to pursue policies that would allow them to efficiently tap into global financial market integration. It is logical to deduce that initial reactions to capital inflow will largely shape the patterns of future responses. African governments on their part will have to understand that:

(a) there is wisdom to curbing lending booms associated with capital inflows while redesigning the institutional structure of the financial system;

(b) it is wise to develop a well-functioning financial system to reduce the risks of potential instability as well as to attract global portfolio investment;

(c) developing countries need to build better shock absorbers and develop mechanisms to respond to instability because they will remain highly vulnerable to external shocks for quite sometime; and

(d) international co-operation between regulators and adequate disclosure of information at all levels are increasingly important to ensuring safe and efficient markets.

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