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St. Mary's University, Ethiopia

ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES

**CHALLENGES AND PROSPECTS OF ESTABLISHING STOCK
MARKET IN ETHIOPIA**

BY
GETACHEW MULATU

JANUARY, 2016
ADDIS ABABA, ETHIOPIA

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**A THESIS SUBMITTED TO ST.MARY'S UNIVERSITY, SCHOOL OF
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REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS
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**JANUARY, 2016
ADDIS ABABA, ETHIOPIA**

ST.MARY'UNIVERSITY
SCHOOL OF GRADUATE STUDIES
FACULTY OF BUSINESS

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APPROVED BY BOARD OF EXAMINERS

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DECLARATION

I, the undersigned, declare that this thesis is my original work; prepared under the guidance of Dr Zenegnaw Abiye. All resources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of learning any degree.

Name

St. Mary's University, Addis Ababa

Signature

January, 2016

ENDORSEMENT

This thesis has been submitted to St.Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

Advisor

Signature

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January, 2016

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ACRONYMS AND ABBREVIATIONS

AA-CCSA	Addis Ababa Chamber of Commerce and Sectoral association
BM&FBOVESPA	Brazilian Mercantile & Futures Exchange (BM&F) and the São Paulo Stock Exchange (Bovespa).
CMA	Capital market Authority
CBE	Commercial Bank of Ethiopia
CBK	Central Bank of Kenya
CNSC	Commercial Nominees S.C.
CG	corporate Governance
DBE	Development bank of Ethiopia
DSE	Dar es Salaam Stock Exchange
EASC	East Africa Security Company
ECX	Ethiopian Commodity Exchange
EEPCO	Ethiopian Electric Power Corporation
EPAAA	Ethiopian Accountants and Auditors Association
EPS	Earning Per Share
EY	Ernst and Young
FDRE	Federal Democratic Republic of Ethiopia
FEACC	Federal Ethics and Anti-Corruptions Commission
GAAP	Generally Accepted Accounting principle
GDP	Gross Domestic Product
GoE	Government of Ethiopia
GPRS	General Packet Radio Service
HWRTSC	Hasset Wholesale and Retail Trade S.C
IAS	International Accounting Standards
IAAS	International Accounting Auditing Standards
IFC	International Financial Corporation
IFRS	International Financial Report Standards
IMF	International Monetary Fund
IPOs	Initial Public Offerings

JLSRI	Justice and Legal Systems Research Institute
JSE	Johannesburg Stock Exchange
MFI	Micro-Finance Institutes
MoFED	Ministry of Finance and Economic Development
NBE	National Bank of Ethiopia
NSE	Nairobi Stock Exchange
NYSE	New York Stock Exchange
OECD	Organization for Co-operation and Development
P	Price (the Stock Price)
PER	Price-to-Earnings Ratios
PFEA	Public Finance Enterprises Agency
POESSA	Private Organization Employee's Social Security Agency
R&D	Research and Development
SOPs	Standard Operating Procedure
SSPA	Social Security and Pension Agency
USE	Uganda Security Exchange

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ABSTRACT

Ethiopia currently does not have a stock market except treasury bills and government bonds; however, share companies including financial institutions, brewery and cement factories are being set up using equity finance raised from the public by Initial Public Offerings (IPOs). Financial institutions, including contractual saving institutions have accumulated equity capital; profitable projects are established and may establish to raise equity capital for stock market. This study aimed at identifying factors that affect the development of stock market such as macro-economic development, government reaction towards stock market investment, financial sectors development and initiate the government to establish stock market. Relevant primary data was collected by interviewing key informants drawn from eleven different organizations that directly or indirectly involved in stock market development. The discussions based on the checklist were the primary data gathering tools to assess stock market development infrastructures and provide contextual information about the stock market development within the system. Thus, separate moderated discussions were also carried out with participants drawn from sample organizations in the structures. Documents believed to be relevant had been also reviewed for the stock market development study, including, strategic objectives, indicators outputs/results, activities plan, procedures, policies rules and regulations on stock market development infrastructures, stock management, accounting, audit reports, etc. Data was then summarized based on the basic key-infrastructures needed to establish stock market in the country. Despite the presence of private share companies and contractual saving institutions in the country, result of this study indicated an authorized institution and legal infrastructure is not in place yet to operate stock market thus far. Given these findings, therefore, it is concluded that establishing stock market under the current situations of development of key institutional and legal infrastructures is unlikely in Ethiopia.

Key words: Stock market development infrastructures, financial institutions, Initial Public Offerings (IPOs). Shares, equity capital.

CHAPTER ONE: INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Share market in Ethiopia had been started during the Imperial regime which was rudimentary at that period. During that time, it was handled by the National Bank of Ethiopia, department of Share Exchange, and later on by other financial institutions and few private share dealers known under the name of “Share Dealing Group” that was engaged in facilitation of transaction of shares and other services in the share markets. The Share Dealing Group consists of National Bank of Ethiopia, Commercial Bank of Ethiopia, Development Bank of Ethiopia, Sabean Utility Corporation and Mr. Alfred Abel. The group ceased to exist in 1975 when financial institutions and large companies were nationalized and transferred into government ownership. Another important land mark in the history of Ethiopia share trading was the enactment of the commercial Code of Ethiopia in 1960 which is still an important legal document in establishing share companies.

Stock market was started in the late 1950s and was formally instituted in 1965 and was administered by the National Bank of Ethiopia, regulatory body, in the financial sector. Financial institutions including Addis Ababa Bank, Commercial Bank of Ethiopia and the Ethiopian Investment Corporation played an intermediary role in transferring and delivery of traded shares. National Bank of Ethiopia, as a regulatory body, issued a rudimentary rules and regulations for the auction market. According to Asrat (2003) the stock market was moderately successful in its pioneering efforts to provide an organized market for companies whose shares were relatively widely held. Workable trading practices and standards were developed and a smoothly operating market mechanism had been created. After the down fall of the Dergue regime, a number of efforts, notably by scholars from academia, Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA) and National Bank of Ethiopia (NBE) were made to establish stock market in the country.

According to Mohammed (2010), Ethiopia's brief history of stock exchange showed there were share and bond dealings under the sponsorship of the National Bank of Ethiopia (NBE) starting in March 1965. Later, the Addis Ababa Share Dealing Group was set up to trade in shares and government bonds with share dealings of 15 listed companies and four government bonds, and the

number of listed companies were 17 by 1966. Additionally, Ruecker (2011) showed National Bank of Ethiopia undertook a study on the —"Feasibility of Establishing Securities Exchange Market in Ethiopia" and prepared a draft Securities and Exchange proclamation which is awaiting government endorsement. Furthermore, the Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA) had produced a research on the stock Market and recommend for establishing and still awaiting approval of the government.

Besides, different seminars and studies were undertaken by different scholars which emphasized on the need to establish stock market in Ethiopia. In 1995, a group of entrepreneurs organized as the Ethiopian Share Dealing Group under the Addis Ababa Chamber of Commerce and Sectoral Associations (AACCSA) and initiated a share dealing group similar to the former Addis Ababa Share Dealing Group of 1974. The group initiated the development of a Stock Exchange rules and regulations as well as bylaws of a share dealing group, and commissioned Ernst & Young to develop an international standard rules and regulations manual(Ruecker 2011).

In 2008, the NBE launched a capital market infrastructural development study by international consultants under the Financial Sector Capacity Building Project which was financed by the World Bank (WB) based on the potential interest of the government of Ethiopia which is under review by the concerned government body (Ruecker, 2011). Ethiopian economic system had been transformed from a highly centralized economic system to an increasingly decentralized economic system and registered remarkable achievement in its financial sector development. Various private organizations in different sectors had been established and were under establishment. There were 19 banks of which 16 were private and 3 public, 17 insurance companies of which 16 were private and 1 public and 31 micro-finance institutions operating in the economy (NBE, 2014). Private commercial banks and insurances have been established through selling of shares without stock market.

Moreover, there are contractual saving institutions that accumulate funds to meet the future pension liabilities of government that is built up from contributions paid by the employer and employees. These institutions are Social Security and Pension Agency (SSPA) and Private Organization Employees' Social Security Agency (POESSA) established by the government to accumulate funds to meet future payments to employees at time of retirement. SSPA accumulated

a social security fund amounting to Br.7.2 billion as at June 2011 (SSPA, 2011) for government civil servants and military guards and POESSA accumulated a social security fund amounting to Br.1.8 billion as at June 2013 (POESSA, 2013) for private and non-government civil servant employee as per the rules and regulations of the government . These institutions can be a strong base for stock or capital market development in the country in the near future.

Financial markets are money and capital markets that facilitate the flow of short-term and long-term funds, (Gitam, 2007) from those who have excess funds to those who are in deficient to run their productive businesses. Capital market can be Primary or the New Issues Market, and Secondary Market or the Stock Exchange. While the primary market deals with Initial Public Offering (IPOs) or New Issues by Share Companies, the secondary market refers to the market for already floated securities to finance long-term productive projects. Capital markets can be defined as stock market, bond market, mortgage market, and derivative market. It can also be called securities market. These terms, viz., capital market, security market and stock market, are used interchangeably in this research work. However, the focus of this study is on Stock market.

Upon the transition from the central economic policy to the new economic policy the need for stock market development has been discussed and being studied by various groups/stakeholders and academics to initiate the establishment of Stock Markets in Ethiopia. Finally, all studies stressed the importance and the rationale behind the need for the establishment of a stock market and cite several advantages for the development of the country.

Beyond the studies conducted to initiate the need for stock market development, draft proclamation was submitted to the government through the initiation made by the Addis Ababa Chamber of Commerce and Sectoral Associations (AA-CCSA) and commissioned to Justice and Law Systems Research Institute (JLSRI) in December 2001 named Monetary Instruments and Share Market proclamation. However, the proclamation was not endorsed by the government. Consequently, the Addis Ababa Chamber of Commerce and Sectoral Association (AA-CCSA) conducted a study on Position of the Business Community on the Revision of the Commercial Code of Ethiopia (AA-CCSA, 2008). Further, Justice and Law Systems Research Institute(JLSRI) started to revise the Commercial Code of Ethiopia(1960) to make it compatible to the existing domestic and international business environment (JLSRI, 2012).Despite various studies, Ethiopia

does not have a stock exchange market until now. However, share companies had been already been formed or were under the process of formation by initial public offerings (IPOs) particularly banks and insurances.

On the other hand, African countries have established stock markets to trade in shares. In Kenya, there are stock markets and stock exchange used to sell shares in secondary market which is recognized as an overseas Stock Exchange by the London Stock Exchange in 1953 (NSE, 2006). Similarly, Uganda establishes Securities Exchange in 1996 and use stock market as an avenue for privatization and treasury issues. Tanzania had also established stock market following the establishment of Tanzania Capital Markets and Securities Authority in 1996. Likewise, emerging countries established stock markets to mobilize substantial amount of capital for the rapid industrialization whereas developed countries establish stock market as a source of corporate finance.

Finally, this study attempted to investigate the infrastructural development needed to establish stock market and mobilize funds to establish and expand productive enterprises in Ethiopia.

1.2 STATEMENT OF THE PROBLEM

In Ethiopia, several studies were conducted to assess the infrastructural development required to establish stock market by different institutions, scholars, associations and consultants including NBE (1995), Asrat (1998), EASC (1995,1999), Stamps (2010), Ruecker (2011), PFEA (2012) have recommended to establish stock market upon fulfilling requirements required to establish stock market. Previous studies including Goldsmith (1969), McKinnon (1973), Shaw (1973), Fry (1988) and more recently, King and Levine (1993) have ascertained that financial development is a prerequisite for economic growth. However, these studies did not assess the telecom infrastructure development and present equity positions of private financial sector and contractual saving institutions like pension funds which are critical prerequisites to establish a stock market.

Following the economic policy of the country, private companies such as banks, insurances, factories and others were established through sell of shares by IPOs and Commercial Nominees Share Company (CNCS) without stock market interventions where it obviously required primary

and secondary stock market. Commercial banks in the country extend loans based on collateral securities and only short-term finance whereas private companies required equity finance through selling of shares.

Ethiopia has registered a remarkable development and promising growth that required mobilizing financial resources to establish profitable enterprises through equity finance (NBE, 2014 report). The first GTP has been finalized in 2014/ 2015 and the second GTP will launch in 2015/2016 with a vision to join middle-income category by 2025. Thus, mobilizing financial resources and investing in productive enterprises will bring rapid economic development and modernizations; given the establishment of financial markets particularly stock market, if the right grounds are in place.

1.3. BASIC RESEARCH QUESTIONS

This study focuses on investigating infrastructures needed to establish stock market in the country, thereby, determines the need for establishing the stock market. Thus, the research questions in the study entertained as follows.

- What are the prerequisites to establish stock exchange?
- How is the accounting, auditing and reporting standard in Ethiopia?
- Is a legal and regulatory infrastructure in Ethiopia adequate to establish stock market?
- How is the government stand point and commitment towards stock market development?
- What is the level of telecommunication networks infrastructural development in Ethiopia?
- What are the current long-term investment finance sources in Ethiopia?

1.4. OBJECTIVE OF THE STUDY

General Objective:

The general objective of this study is to assess factors that contribute to the establishment of stock market in Ethiopia and examine the situation to establish and raise equity including the placement of adequate control system. The study provides the NBE and its stakeholders with information likely to expand business through financial market as a result of share trading.

Specific objectives are:

- To see the macroeconomic conditions that permit development of stock market,
- To see the current legal and regulatory infrastructures,
- To assess accounting, auditing and financial reporting standards and standards of accounting and auditing professionals,
- To identify forms of business organizations established in the country,
- To assess financial and non-financial sector development,
- To identify infrastructural development of the country,
- To assess current market conditions,
- To assess Government standpoint and commitment to capital market development, etc.

1.5. SIGNIFICANCE OF THE STUDY

The stock market study is an effort to identify challenges and prospects to recommend feasible options to establish stock market in Ethiopia. The information was collected through document review and interviews to identify problem areas, potential determinants and intervention options. There are several significant advantages of the study. It investigated the core elements of stock market infrastructure development, policy and legal framework, selection, rational use and support systems.

Presently, many private companies are established and will establish via initial public offerings (IPOs) at primary and secondary basis. These companies frequently require more equity capital to expand the businesses. Therefore the significant of the study is to:

- initiate the government to issue policies, rules and regulations on stock market development,
- initiate the government to establish regulatory and related institutions,
- create awareness to the public on the existing legal and regulatory framework, infrastructural development of communication network, economic development of the country, the existing knowledge of stock market, the present business environment and government standpoint towards establishing stock market,
- initiate the government to establish stock market,
- mobilize financial resources for economic growth,
- induce academicians to undertake further studies,
- serve as a reference material for further studies,
- provide alternative avenues to diversify investment portfolios,
- shape the existing set-up of public companies through IPOs through interested-group promoters to protect the public interest'

1.6 SCOPE OF THE STUDY

This study focused on challenges and prospects of establishing stock market in Ethiopia. Due to time limitation, data collection conducted by interviewing key informant and other interviewees (total number = 24) drawn from eleven national organizations involved in financial, legal issues and service delivery in the country (ANNEX-I). The duration of the study was limited only for two months period (February - April, 2015). Both the national organizations addressed by this study are based in Addis Ababa.

The scope of the study includes;

- Review documents like, accounting manuals; agreements, relevant government regulations and policies; and at the same time the current equity management system.
- Review the Institutional Framework and Management Capacity for the financial institutions function – structure and staffing, internal controls, and facilities for the establishment of stock market, outsourcing, and oversight. The situation analysis on stock market development (including procedures for planning, acquisition, management and approval) and fairness, open competition, and the systems supporting share trade.

- Assess the timeliness of the stock market infrastructures and effectiveness of the system followed by assessing the robustness of the entire chain and asset management.
- Evaluate the effectiveness of the control system around the stock market management system including share circulation and trading.
- Review the performance of NBE as a government agent for the establishment and management systems used hitherto share portfolio and discussion with the relevant organizations within the financial institutions on share circulations system of the stock market.

CHAPTER TWO: LITERATURE REVIEW

2.1. THEORETICAL LITERATURE

There are growing literatures on establishment of stock market by different scholars and institutions in different times and places. The establishment of stock markets in Africa is expected to boost domestic savings and increase the quantity and quality of investment. More generally, stock markets are seen as enhancing the operations of the domestic financial system in general and the capital market in particular (Kenny and Moss, 1998). Critics, however, argue that the stock market might not perform efficiently in developing countries and that it may not be feasible for all African markets to promote stock markets given the huge costs and the poor financial structures (Singh, 1999).

Many authors have different critics about stock market development. Binswanger (1999) argued that, stock market prices do not accurately reflect the underlying basics when speculative bubbles emerge in the market. In such situations, prices on the stock market are not simply determined by discounting the expected future cash flows, which according to the efficient market hypothesis should reflect all currently available information about fundamentals.

Bhide (1994) further argued that stock market liquidity may negatively influence corporate governance because very liquid stock market may encourage investor myopia. Since investors can easily sell their shares, more liquid stock markets may weaken investors' commitment and incentive to exert corporate control. In other words, instant stock market liquidity may discourage investors from having long-term commitment with firms whose shares they own and therefore create potential corporate governance problem with serious ramifications for economic growth.

On the other hand, Singh (1997) pointed out that the actual operation of the pricing and takeover mechanism in well-functioning stock markets lead to short term and lower rate of return on long term investment. It also generates stubborn incentives, rewarding managers for their success in financial engineering rather than creating new wealth through organic growth.

2.1.1 The Effect of Financial Development on Economic Growth

The theoretical basics of the relationship between financial development and economic growth can be traced back to the study of Schumpeter (1912), McKinnon (1973) and King and Levine (1993). It asserted that financial development could lead economic growth through well-developed financial system that performs several important purposes to improve the efficiency of intermediation by reducing information, transactions, and monitoring costs. Creane and Sab (2003) argued that a modern and efficient financial system mobilizes savings, promotes investment to finance feasible business opportunities, monitors the performance of managers, enables the trading, hedging and diversification of risk, and facilitates the exchange of goods and services. These functions ultimately result in a more efficient allocation of resources, a more rapid accumulation of human and physical capital, and fast technological progress, which in turn provide economic growth. Tsuru (2000) as well clearly explained the relationship between finance and growth by arguing financial development can promote economic growth through positive impact on capital productivity or efficiency of financial systems in converting financial resources into real investments’.

Further, the relationship between financial development and economic growth was in fact widely analyzed more than two decades by Goldsmith (1969), McKinnon (1973), Shaw (1973) and others. The findings confirmed strong and positive correlations between the degree of financial market development and the rate of economic growth.

Financial market development provides ways to mobilize financial resources to invest in productive projects in different sectors. It has a significant effect on economic growth and will remains strong being source of fund for further developing the economy. Najeb and Glenn (2012) reflected, there is a stable, long term equilibrium relationship between the evolution of the stock market and the economy. The same authors also confirmed that stock market and the banking sector in emerging economy are complementary rather than substitutes in providing financial services.

According to Dailami and Aktin (1990), a well-developed stock market should increase saving and efficiently allocate capital to productive investments, which leads to an increase in the rate of economic growth. Stock markets contribute to the mobilization of domestic savings by enhancing the set of financial instruments available to savers to diversify their portfolios. In doing so, they

provide an important source of investment capital at relatively low cost. However, there is a debate within this idea. On one side literatures argue that stock markets promote long-run growth. Bencivenga, et. al. (1996) and Levine (1991) have also argued that stock market liquidity i.e. the ability to trade equity easily plays a key role in economic growth though profitable investments that require long run commitment and savers also prefer not to surrender control of their savings for long periods. Without liquid markets, savers would have been less willing to invest in simultaneously allowing firms permanent access to capital that are raised through equity issues. Liquidity has also been argued to increase investor incentive to acquire information on firms and improve corporate governance (Kyle, 1984; Holmstrom and Tirole, 1993), thereby facilitating growth.

On the other hand, there are doubts on the contribution of stock markets to long-run growth. For example, the role of stock markets in improving informational asymmetries has been questioned by Stieglitz (1985) who argued stock markets reveal information through price changes rapidly, creating a free-rider problem that reduces investor incentives to conduct expensive search. Demirguc-Kunt and Levine (1996) also point out that increased liquidity may deter growth via three channels. First, it may reduce saving rates through income and substitution effects. Second, by reducing the uncertainty associated with investments, greater stock market liquidity may reduce saving rates because of the ambiguous effects of uncertainty on savings. Third, stock market liquidity encourages investor myopia, adversely affecting corporate governance and thereby reducing growth.

Recent literature has also shown that financial intermediaries facilitate the hedging, diversifying and reducing risk. Such functions improve economic growth by promoting the capital accumulation and improving the allocation of resources, selecting efficient projects, exerting corporate control, monitoring managers, mobilizing savings and easing the exchange of goods and services (Levine, 1997). Hence, companies can diversify their risk and access to new instruments to allocate capital. These in turn, monitor the corporate sector and improve managerial and organizational efficiency. Stock market is a part of financial system to trade using medium and long-term financial instruments and also assists various world economies to mobilize financial resources required and skills for growth and development (Adewuyi and Kolawole, 2011).

Stock markets and institutions also assist decision-makers in generating information i.e. allow effective managerial incentive schemes and mitigating managerial inefficiencies through the threat of takeover via capital markets to enhance efficiency at the firm level, and managerial incentives that use information in stock prices reduce shirking, leading to the alignment of managerial interest to that of shareholders (Holmstrom and Tirole, 1993).

According to Demirguc-Kunt and Levine (1993) stock market has an advantage due to lower cost of equity and the discipline imposed on corporate managers since movements of share prices reflect managers' performance, existence of mechanisms for appropriate pricing and hedging against risk and increased inflows of funds to the thriving domestic stock market. Furthermore, many authors including McKinnon (1973, 1991), Gelb (1989), Fry (1988) and Montiel (1996) stressed the positive contribution of stock market development to economic growth.

Calamanti (1983) also stated that the securities market can positively contribute to growth if supported by appropriate government policies.

2.1.2 The Stock Market Development and Economic Growth

Literatures on the area of economic growth had taken a new position, given the significance effect of stock markets on economic growth. Actually, past literatures considered financial intermediaries as the only contributing channel to economic growth, and this new phase of developmental economics has achieved much in helping us understand this unexplored channel of causation since Bagehot (1873). In fact, stock markets and banks provide services that could either be complements or substitutes for each other depending on the level of industrialization development of the country.

In principle, the establishment of stock markets is anticipated to mobilize domestic savings and increase the quantity and quality of investment to accelerate economic growth. Moreover, stock markets are seen as enhancing the operations of the domestic financial system in general and the capital marketing particular (Kenny and Moss, 1998). Researchers, however, argued that the stock market might not perform efficiently in developing countries and may not be feasible for all African markets given the huge costs and poor financial structures (Singh, 1999). The stock market is expected to by mobilizing domestic savings and increasing the quantity and the quality

of investment (Singh, 1997). It encourage savings by providing individuals with an additional financial instrument that may better meet the risk preferences and liquidity needs and further provide an avenue for growing companies to raise capital at lower cost.

Stock market also expected to assure taking-over mechanisms of efficient previous investments. Theoretically, the risk of takeover is lessening by efficient management to maximize firm value. The assumption is, if management does not maximize firm value, another economic agent may take control of the firm, replace management and gains from it. Thus, a free market incorporate in providing financial discipline expected to best guarantee of assets efficiency use. Similarly, the ability to effect changes in the management of listed companies is expected to ensure managerial resources used efficiently (Kumar, 1984).Efficient stock markets may also reduce the costs of information to reveal efficient stock prices. Reducing the costs of acquiring information is expected to facilitate and improve the acquisition of information on investment opportunities and thereby improves resource allocation.

Further, stock market liquidity is expected to reduce the downside risk and costs of low-pay-off projects investment for long-time. With a liquid market, the initial investors do not lose access to savings for the duration of the projects because it can easily, quickly, and cheaply, sell stake in the company (Bencivenga and Smith, 1991). Thus, more liquid stock markets could ease investment in long-term, potentially more profitable projects, thereby improving the allocation of capital to enhance prospects for long-term growth.

Stock markets offer an alternative channel for savings mobilization and resource allocation (N'Zué 2006).It enables savings mobilization for financing “immense works” (Hicks 1969, Greenwood and Smith 1996). More efficiently mobilized savings is a foundation for capital accumulation, which firms tap to finance large projects via equity issues that spurs economic growth (Levine and Zervos 1998; Adjasi and Biekpe 2006).

Given, liquidity, Bencivenga, et. al. (1996) and Levine (1991) argue that stock market liquidity plays a key role in economic growth. Without a liquid stock market, many profitable long-term investments would not be undertaken because savers would be reluctant to tie-up their investments for long periods of time. In contrast, a liquid equity market allows savers to sell their

shares easily, thereby permitting firms to raise equity capital on favorable terms. By facilitating longer-term, more profitable investments, a liquid market improves the allocation of capital and enhances prospects for long-term economic growth. A more developed equity market may also provide liquidity that lowers the cost of the foreign capital that is essential for development as pointed out within the works of Bencivenga et., al. (1996). Liquidity has also been argued to increase investor incentive to acquire information on firms and improve corporate governance (Kyle, 1984; Holmstrom and Tirole, 1993), thereby facilitating growth. Levine further argued that a liquid stock market complements a strong banking system, suggesting that banks and stock markets provide different bundles of financial services to the economy.

However, Demirguc-Kunt and Levine (1996) point out that increased liquidity can deter growth through at least three channels. First by increasing returns to investments, greater stock market liquidity may reduce saving rates through income and substitution effects. In case of the African subcontinent, liquidity has been a significant factor in hampering stock market development (Adjasi and Biekpe 2006) and consequently retards economic growth. A second link of stock market development on the economy is based on the premise that the presence of stock markets would mitigate the principal agent problem, thus promoting efficient resource allocation and growth (Adjasi and Biekpe 2006). Third, given that the stock price at any time is mirror of firm performance, weakening corporate governance would be reflected as a fall in share price. Management would have a disincentive to work in their personal interests if their compensation is tied to stock performance (Jensen and Murphy, 1990). Thus the emphasis is on the role of equity markets in providing proper incentives for managers to make investment decisions.

Binswanger (1999) and Yartey 2007, Bhide(1999) however argued that the above might not be true in a situation of investor myopia.

The role of equity markets in providing portfolio diversification, enabling individual firms to engage in specialized production is bound to result in efficiency gains (Acemoglu and Zilibotti, 1997). In actual fact, the presences of stock markets which provide for various vehicles for transferring risk through which investors can confidently invest. It showed that investors had the opportunity of switching from low-risk to high risk investments. Obstfeld (1994) showed international risk-sharing through internationally integrated stock markets improved resource

allocation and can accelerate growth. Certainly, stock markets had more information than financial intermediaries and usually translate in more efficient allocation and better growth (Adjasi and Biekpe 2006, Atjeand Jovanovic 1993). King and Levine(1993b) also stressed on the ability of equity markets to generate information about the innovative activity of entrepreneurs or the aggregate state of technology. Perotti and van Oijen (1999) argued that diverse equity ownership creates a constituency for political stability, which, in turn,promotes growth.

More recently, the emphasis was given to stock market indicators and economic development. Stock market development became the subject of intensive theoretical and empirical studies (Demirguc-Kunt and Levine (1996), Levine and Zervos (1993, 1996, 1998)). In theory, a well-developed stock market should increase saving and efficiently allocate capital to productive investments, which lead to an increase in the rate of economic growth and important source of investment capital at relatively low cost (Dailami and Aktin (1990)). Share ownership of stock market provides individuals with a relatively liquid means of sharing risk when investing in promising projects. Debt finance is likely to be unavailable in many countries, particularly in developing countries, where bank loans may be limited to a selected group of companies and individual investors. This limitation can also reflect constraints in credit markets (Mirakhor and Villanueva (1990)) arising from the possibility that a bank's return from lending to a specific group of borrowers.

Many Ethiopian authors including Asrat (1998), Tadewos and Araya (1995), EASC (1995),Ruecker (2011), Ernst and Young, (1999), Solomon (2008) and others (ANNEX`-II) favored the establishment of Stock Market in Ethiopia. On the contrary, Samuel (1996) argued that development of stock market is unlikely to enhance corporate growth in developing countries and Singh (1997) also argued that financial liberalization and expansion of stock markets in developing countries will hinder development rather than enhancing development of African countries. Considering the above mentioned literatures it seems that establishing Stock Market requires further study.

2.1.3 Factorsthat affect Financial Development

2.1.3.1 Type of Economy

Different economies request different kind of demands on their financial sectors depending on the nature of their businesses. For example, agricultural economies might have quite limited requirements, ones heavily geared to the seasonal and erratic nature of the business. Cameron (1967) suggests that different level of economies could require different level of capital depending on the nature and development of technology. Economies that are more trade and commerce orientated would be more likely to develop arm's-length financing, letters of credit, bills and acceptances, insurance provisions, and merchant banking facilities (Obstfeld, 2009; Eichengreen and Bordo, 2002).

2.1.3.2 Stages of Development

Many countries develop their growth strategies based on the level of their economic development and they further refine their financial system consistent with broader macro- economic policies and financial development. Few economies remain committed to same economic policies for a very long time. As the structure of growth changes, so do the needs of financial intermediation. Sometimes the transition between stages is gradual and sometimes it is violent.

Nevertheless, as economies move between phases of growth driven by, for example, agriculture, or trade, the nature of the demand for financial services changes. More sophisticated economies tend to require greater choice, such as for housing finance and insurance services. But the argument is by no means straightforward, and there may be occasions when an apparently “unsophisticated” system both suits the need of the economy and is perhaps the only viable option available. Goldsmith (1969) noted that in the 1945–60 periods Financial Interrelation Ratios (FIRs) were significantly higher in the United States and Britain than in Germany. However, one of the factors behind Germany’s successful postwar recovery was undoubtedly the role of the banking system and its ability to take a long-term view of financing the corporate sector. But the appropriateness of the structure will change over time. Bundesbank acknowledged that perhaps the bank-dominated system that served Germany so well in the postwar period was less well suited in an environment of much higher and more mobile capital flows (Gessler Commission (1979). Additionally, as the World Bank’s chief economist recently noted in his paper on

optimal financial structure, there exists some optimal financial structure for the economy at every stage of development (Lin, et. al., 2009).

2.1.3.3 Macroeconomic Instability

There are conditions that create economic instability including but not limited to inflation, volatile asset prices and volatile levels of growth, labour market unrest and bank lending policies. When prices are rising rapidly, firms and consumers become uncertain about future costs, prices and profitability – this uncertainty tends to reduce their willingness to invest. When inflation is very high and above interest rates, the real value of money can decline quickly causing savings to fall in value. Economic instability is linked to confidence of investment so that people save a higher percentage of their income that cause a larger fall in output and more instability. Furthermore, boom and bust creates instability because a period of high growth is followed by a recession and decline in output that leads to higher unemployment and the instability of lower incomes (Economic Instability, Tejvan Pettinger August 31, 2009).

Macroeconomic environment and the financial sector are closely interrelated. On the one hand, financial stability, which encompasses a stable banking system, plays a pivotal role in ensuring an efficient allocation of funds and in fostering economic growth. On the other hand, the macroeconomic environment affects the stability of the banking sector. Assuming that banking-sector stability depends on banks' operating environments, banks' risk exposures, and their ability to manage risks and withstand adverse outcomes. Macroeconomic factors affect the operational environment and capital buffers of banks to withstand adverse events.

Macroeconomic instability can affect banking-sector risks through two important ways: first, they affect the value and quality of assets that banks hold in their portfolio; second, they directly affect the economy and hence on banks' business performances. The interaction between prevailing financial conditions and real economic activity also runs in the opposite direction (Bikker and Metzmakers, 2002). Furthermore, savings in the economy and distributions of income, strongly affect liquidity preferences, cause currency instability, and, of course, undermine confidence generally. In addition, wars and war financing can greatly affect financial stability, and for years afterwards, they affect institutions' ability to intermediate due to constraints on their balance sheets. Sometimes new institutions are created for the purposes of facilitating public financing in the wake of the fiscal strain war can put on an economy (for example, the Caisse de Dépôts et

Consignations in France, established in 1816). Fraud can also have an impact on financial development as indicated by Murphy (1997).

When a macroeconomic instability occurred there are several channels through which its impacts are felt by households (Ferreira and Keely, 1999; Lustig and Walton, 1998). These can be traced to the different sources of household income-wages, salaries, and self-employment incomes; returns on physical goods and services.

Macroeconomic stability is the cornerstone of any successful effort to increase development and economic growth. Cross-country regressions using a large sample of countries suggest that growth, investment, and productivity are positively correlated with macroeconomic stability (Easterly and Kraay, 1999). Even though it is difficult to prove the direction of causation, these results confirm that macroeconomic instability has generally been associated with poor growth performance. Without macroeconomic stability, domestic and foreign investors will stay away and resources will be diverted elsewhere.

In fact, evidence of investment behavior indicates that in addition to conventional factors (i.e, past growth of economic activity, real interest rates, and private sector credit); investment is significantly and negatively influenced by uncertainty and macroeconomic instability (Ramey and Ramey, 1995). Finally, result suggests that growth is positively correlated with macroeconomic stability; on the other hand macroeconomic instability is a serious barrier against the economic growth of the country.

2.1.3.4 Political Pressures

According to Rajan and Zingales (2003) political forces had great influence on financial structure especially in the wake of the current financial crisis and there could be a widespread political hostile response against large parts of the financial system. This has brought forth a confusion of proposals on capital regulation, liquidity, governance, and remuneration issues and leverage controls. The economy could be command economy, with a large proportion of financing occurring via government or government-controlled institutions which include overriding of market mechanisms by state planning and bureaucracy. It determined political structure of

government or transforming from a federal structure to a more unified structure. Politics can also have an important influence in terms of ownership and objectives of financial institutions. The waves of nationalizations in a number of countries experienced at various stages were not always the result of a macroeconomic instability but rather a response to shifting political attitudes. Political factors should be seen how its reaction and subsequent regulatory and supervisory responses fundamentally affect financial structure and the behavior of borrowers and lenders.

Researchers argued that the democratic process enhances fundamental civil liberties, stable politics and an open society; promotes property rights protection and contract enforcement; discourages corruption and lawlessness and fosters economic growth (Olson, 1993).

Rajan and Zingales (1999) have also contributed to the debate over determinants of overall financial system development and specifically contrast legal and political influences and argue that not legal systems, but political context i.e. the support of financial institution growth by government and interest group that determine the course of development. Verdier (1997 and 1999) hit on similar themes but lays out a political-economic view of the development of financial systems. The authors argued that political structure, not “relative backwardness”, determines the shape of financial systems. In particular, universal banking arose in the coincident presence of two conditions: first, a segmented deposit market, dominated by non-profit and provincial banks and, second, a reliable lender of last resort facility insuring liquidity in the banking system. Furthermore, he argues, these two preconditions for universality emerged simultaneously only when state centralization was sufficient to provide a strong central bank but limited enough to permit coexistence of provincial and ‘center’ banks.

2.1.3.5 Social Factors

Access to financial services is one of the determinants to alleviating poverty and achieving sustainable economic growth. Such access can be financial inclusion or exclusion. In the past, many mutual and cooperative institutions were established and encouraged in order to provide basic saving and lending services for groups who either would not had access to the more exclusive financial facilities elsewhere in the system, or for whom such facilities were less suited to their particular small, local needs. Some countries and political systems embraced the concept of comprehensive social security systems, often operating on a pay-as-you go basis. This

arrangement would be less likely to support the growth of long-term contractual savings products which are reliable source of capital market.

Geographical factors are part of social factor for accessing financial markets. However, several research attentions have stressed the importance of geography for general economic development. It emphasized three aspects in particular. The first group is concerned with the correlation between latitude and economic development. Countries closer to the equator typically have a more tropical climate Kamarck (1976), Diamond (1997), Gallup *et al.* (1999) and Sachs (2003a, 2003b). A second strand of research relates to countries being landlocked, distant from large markets or having only limited access to coasts and rivers navigable to the ocean (Sachs and Warner, 1995a, 1995b, 1997; Easterly and Levine, 2003; Malik and Temple, 2009). The third aspect related to natural barriers to external trade and knowledge dissemination, geographic isolation and remoteness to some extent determine the scale and structure of external trade in which countries engage.

2.1.3.6 Incentives for Innovation

Incentives can be positive and negative depending on their nature. Incentive for technology innovations can be positive while negative incentives can be tightly controlled allocation of resources by government authorities but also possibly by well-established or incumbent groups. As Sundaresan (2009) noted, light-touch regulation can lead to powerful flows of innovation but also high, or even excessive, risk taking. Heavy-touch regulation may suppress innovation although it could, of course, stimulate financial intermediation outside the formal financial structure. Incentives in technological advance and innovation in other sectors may flash innovation in the financial sector. A classic example of this in the emerging world has been the growth of mobile telephone banking. Innovation needs incentives that can be tax incentives due to the presence of knowledge spillover.

Furthermore, financial innovations are more like variations on (or combinations of) existing products, e.g. rights issues, convertible debt and asset backed securities and an alternative way of selling assets to investors in the financial market. Innovation may also encourage the creation of new organizational structures, e.g. Automatic Teller Machine (ATM), and Internet only banks.

Financial innovation is good for economic growth is based on the idea that such innovations will improve the allocation of capital (Bernanke, 2007). Innovation is a crucial investment for long-term growth and national competitiveness. Innovators cannot completely prevent others from using their innovations as their inventions are being public goods and cannot fully appropriate the returns on their R&D investment that requires incentives for their work. There are policy instruments to promote incentives for innovations such as intellectual property rights, grants, and R & D tax incentives that stimulate firms to invest more in R&D and increases businesses in an economy and to be used in policy objectives (OECD, 2011a; 2011b).

2.1.3.7 Legal and Regulatory Constraints

Law and finance theory focuses on the role of legal institutions in explaining international differences in financial development (La Porta, Lopez-de-Silaanes, shleifer, and Vishny, 1997, 1998, 200a, henceforth LLSV). The first part of the law and finance theory holds that in countries where legal systems enforce private property rights, support private contractual arrangements, and protect the legal right of investors, savers are more willing to finance firms and financial markets flourish. In contrast, legal institutions that neither support private property rights nor facilitate private contractual arrangement inhibit corporate finance and financial development. The second part of the law and finance theory emphasizes that the difference legal traditions that emerged in Europe over previous centuries and were spread internationally through conquest, colonization, and imitation help explain cross-country differences in investor protection, the contracting environment, and financial development today.

Many researchers showed that the institutional environment had an important impact on the functioning of the financial sector (Tressel and Detriagiache 2008, and Demetriades and Fielding 2009). La Porta (La Porta, et al 1997 and La Porta, et al 1998) argued that legal Origin determined the level of financial development. Moreover, common law-based systems, originating from English law, were better suited for development of financial markets than civil law systems. Common law has been instrumental in protecting private property than civil law, which aims at addressing corruption in the judiciary and improving the power of the state.

A legal and regulatory system involved in protection of property rights, contract enforcement and good accounting practices has been identified as essential for financial development. La Porta *et al.* (1997, 1998) argued that the origins of the legal code significantly influence the treatment of creditors and shareholders, and the efficiency of contract enforcement. Others, such as Mayer (2001) emphasized that regulations concerning information disclosure, accounting standards, permissible banking practices, and deposit insurance do appear to have material effects on financial development. Levine, Loayza, and Beck (2000) examined whether the level of legal and regulatory determinants of financial development influences the development financial intermediary part.

La Porta, Lopez-de-Silanes, Shleifer, and Vishny (hereafter LLSV, 1997, 1998) argued that the national legal origin (whether English, French, German, or Scandinavian) strongly affects the legal and regulatory environment in financial transactions and explains cross-country differences in financial development. LLSV (1997, 1998) and Levine (1998, 2003) reflected that low levels of shareholder rights are associated with poorly developed equity markets (especially in French civil law countries). In contrast, common law countries have high levels of shareholders' rights with correspondingly high levels of equity market development (Claessens, et al., 2002 and Caprio, et al., 2003), and that greater creditor rights are positively associated with financial intermediary development.

Besides, McDonald and Schumacher (2007) pointed out that financial liberalization, stronger legal institutions, legal origin, lower inflation, and increased sharing of information as key contributing factors for financial sector development in Sub-Saharan Africa. Some studies on Asian countries considered political institutions and political party structures (Zhang 2006), rule-of-law, political stability, government effectiveness, and regulatory quality (Gani and Ngassam 2008) as main drivers for financial development.

More specifically, legal theories emphasize two inter-related mechanisms through which legal origin influences finance (Hayek, 1960). Furthermore, political mechanism holds that (a) legal traditions differ in terms of the priority they attach to private property vis-à-vis the rights of the state and the protection of private contracting rights forms the basis of financial development (LLSV, 1999). Adaptability stresses that (a) legal traditions differ in their formalism and ability to evolve with changing conditions and (b) legal traditions that adapt efficiency to minimize the gap

between the contracting needs of the economy and the legal system's capabilities will more effectively foster financial development than more rigid systems.

Whereas, legal and regulatory forces can come in many shapes and forms. Financial companies can be regulated by having their functions controlled, for example, long- versus short-term business, types of deposits they might supply, composition of portfolios they might hold, access to individual market segments restricted (for example, mortgage markets), and restrictions on the amount of loans. This meant that the supply of financial services simply could not keep pace with demand for those services (White, 1982).

2.1.3.8 Financial Infrastructure

Financial infrastructure is the set of institutions that enable effective operation of financial intermediaries which include payment systems, credit information bureaus and collateral registries. More broadly, financial infrastructure encompasses the existing legal and regulatory framework for financial sector operations. The development of local capital markets evolves in stages. Unlike bond markets, equity markets can develop even in environments with weak financial infrastructures and weak investor rights because of the returns on an equity contract that compensate for the perceived riskiness of the claim in an environment. Bonds, for which the upside is limited by the promised interest rate, require a much better financial infrastructure (including proper disclosure and reliable bond ratings) and a strong enforcement of creditor rights to attract potential investors (Herring and Chatusripitak, 2001).

Furthermore, development of local equity and government bond markets require a more developed financial infrastructure and a stronger legal framework and contract resolution, such as local currency and corporate bond markets. Corporate bond markets also differ from government bond markets in that they require a more developed private sector which is often weak in developing countries and emerging market economies. Market development begins from the fiscal side, starting with a short instrument and then moving to longer dated instruments in government securities. While local government bond markets are often created by governments to finance large deficits, the development of equity and corporate bond markets typically start as private sector initiatives, with the government influencing the development through legislation, standard setting, supervision, and the provision of a financial infrastructure (Schinasi and Smith, 1998).

2.1.3.9 Access to Global Capital

Financial globalization is investing in another country in the form of foreign direct investment (FDI), portfolio investment in other emerging countries for profit rather than as a means to encourage development of financial markets in the receiving countries. Nevertheless, the flood of capital from developed countries into North and South America and parts of Asia did enhance growth and the development of financial centers. Conversely, sudden stops in capital flows also had severe effects in sparking and compounding banking and financial crises (Eichengreen and Bordo, 2002).

However, massive capital in-flows may also lead to excessive money supply changes and consequent pressures on prices and the exchange rate, and deterioration in the current account balance. There may be other associated dangers of foreign investment: currency appreciation, reduced scope for independent macroeconomic policy actions, greater exposure to external shocks, demands for protection in local markets, some loss of control of foreign-owned domestic industry, disruption of national capital markets, asset inflation, increased volatility in financial and exchange markets, high sterilization costs, etc. (WB, 1995).

In the context of today's emerging world, there is probably a greater realization on the part of governments that access to foreign investors, be it through banking flows, portfolio flows, or foreign direct investment flows can be of substantial economic benefit. It can stimulate the economic development of the country in which the relevant investment is made, creating both benefits for local industry and a more conducive environment for the investor and create jobs and increase employment in the target country. In addition it will enable resource transfer, and other exchanges of knowledge whereby different countries are given access to new skills and technologies that can increase the productivity of the workforce in the target country (Reid, 2010).

But, in general, there probably is also a greater awareness now of the potential negative effects of fostering large-scale inward investment both in terms of unbalanced growth and often unequal distribution of this capital, and in terms of conflicts between short-term and longer-term objectives. Foreign capital focuses on resources (natural resources and labour), affects exchange

rates, and is being capital intensive. Whereas, rules of investment may affect the investing country and further investment in certain areas is banned in foreign markets.

2.1.3.10 Fiscal and Exchange Rate Regimes

A number of developed and emerging economies are considering that the existence of well-organized capital markets and financial structures can greatly assist in meeting their objectives with regard to their fiscal policies and exchange rate regimes (Eichengreen and Bordo, 2002). Chen, et. al. (2009) emphasized the need to think carefully about the sequencing of financial reforms as part of a liberalization process, particularly in connection with exchange rate and tax policies. The author highlighted the experience of financial liberalization demonstrates that the sequencing of financial reforms, internally and externally, on the route to financial liberalization is of the utmost importance in determining macroeconomic performance.

The stock market at initial stage is of course more complex has also been directed towards improving the communications interface between all levels. Accuracy of data is required to decision-makers where a comprehensive, detailed information documents and reports are submitted from all levels in time. Very few financial intuitions may have the facilities to implement stock market. The infrastructure of financial institutions was observed poor or unacceptable condition across facilities as compared to the neighboring countries' operations capacity.

NBE is mandated to determine, and issue guidelines based on available data and recurrent development throughout bank, insurance and MFIs operations. Stakeholders need to establish clear roles and responsibilities for NBE at each level of the system readiness for full planning integration and implementation.

Every stock is a function of two inputs, performance and valuation. True, in the very long-run, stock prices do tend to follow performance but extreme cases of valuation can distort this relationship for many years.

2.2. RATIONALS OF STOCK MARKET

Stock market provides a number of benefits to borrowers and investors, including governments for risk sharing and efficient allocation of capital sake. In addition, it improves the implementation of fiscal, monetary, and exchange rate policy. These advantages take place through a number of financing instruments that complement each.

First, local bond used by the governments to finance large financial deficits without having an option to financial control or foreign borrowing. In reality, the drive for the development of local bond markets naturally came from the government to facilitate the financing of large deficits (Turner, 2002). Financing deficits through financial control by forcing local banks to hold government paper, slow down the development of the domestic banking sector and foreign borrowing in hard currency exposes countries to exchange rate risk.

Second, the development of money and bond markets supports the behavior of monetary policy. Money and bond markets provide instruments needed for the implementation of monetary policy and improve the transmission mechanism of monetary policy (IMF, 2004). Long term bonds also facilitate sterilization operations by the central bank because sterilization that relies exclusively on short-term instruments tends to drive up short-term interest rates and encourage further inflows into such instruments. Long-term bond markets give valuable information for the behavior of monetary policy, including expectations about macroeconomic developments and reactions to monetary policy changes, and thus help the operation of monetary policy.

Third, the development of stock markets can develop the availability of long term financing, allowing individuals and firms to better manage interest rate and maturity risk associated with long-term investments (such as investments in equipment, machinery, land and buildings) by allowing for a better match between the duration of financial assets and liabilities. This benefit applies foremost to the development of a local bond market and the development of equity markets can also improve firms' access to long-term capital.

Fourth, the development of local capital markets encourages access to long term- financing. Bond markets can offer local investors, such as retail and institutional investors, a way to borrow or invest in local currency and better manage inflation and exchange rate risk. It also provide a safe

alternative investment to local bank deposit and foreign currency markets can make the country less vulnerable to sudden stops and exchange rate shocks (Gormley et al., 2008). Governments are major sponsors of local bond markets because it allows financing fiscal deficits by borrowing from domestic markets without exchange rate risk.

Fifth, stock markets allow for financial support alongside the development of banking markets, improving the efficiency of capital allocation in the economy. Bond finance provides healthy competition to bank loans and offers relatively cheap financing to large, reputable firms that have the scale and credentials to tap long-term capital markets. Further, the discipline of the stock market will improve the quality and disclosure of information that firms provide to markets and firm performance.

Sixth, capital markets, when opened to foreign investments, increase financial integration by attracting foreign capital, which can lower the cost of capital for local firms and individuals and improve risk sharing across countries. It further improve market access and relieve credit constraints on small and medium-sized enterprises (Eichengreen, Borensztein, and Panizza, 2006). However, the liberalization of financial markets can also result in the migration of trading to international financial sectors, hampering domestic market development. High-quality firms may try to escape local markets, lowering the average quality of local issuances (De la Torre, Gozzi, and Schmukler, 2006) or local listing or disclosure requirements may be relaxed to prevent trading activity from moving abroad, with negative implications for investor protection.

Finally, the development of stock markets can improve financial stability by enhancing the ability of financial institutions to manage risk. Moreover, a more diverse financial system that includes capital markets alongside banking markets tends to be more stable and better able to absorb shocks. Bond markets can act as a “spare tire” to bank finance in case of banking crises, thus helping to absorb the shock of bank distress. However, it is generally only large firms (Gormley, Johnson, and Rhee, 2008). Equity markets provide portfolio diversification, enabling individual firms to engage in specialized production is bound to result in efficiency gains (Acemoglu and Zilibotti, 1997). These benefits are not mutually exclusive and tend to reinforce each other. The development of local currency markets, by providing for safe assets in local currency, can

enhance economic stability both directly by improving the ability of investors to manage exchange rate shocks but also indirectly enhancing the stability of the financial market.

2.3. CHALLENGES OF STOCK MARKETS DEVELOPMENT

The development of stock market is not without challenge, especially in developing economies like Ethiopia where a small market size, weak institutions, and unstable macroeconomic policies frequently get in the way of providing an enabling environment for stock markets. The proper functioning of capital market requires several preconditions that can generally be categorized into sound macroeconomic policy, strong institutional and legal setting, and a well-functioning financial infrastructure. Exclusive of such preconditions, government efforts to develop capital markets are bound to fail, resulting in shallow markets and duped investors, and it is advisable such conditions are sufficiently in place before local capital markets are established.

2.3.1 Macroeconomic Stability

A stable macroeconomic environment in all countries is crucial for the development of the stock market to invest in profitable project. On the other hand macroeconomic instability deteriorate the problem of informational asymmetries and becomes asource of susceptibility to the financial system. Low and predictable rates of inflation are more likely to contribute to stock market development and economic growth. Both domestic and foreign investors will be unwilling to invest in the stock market where there are expectations of high inflation. Garcia and Liu (1999) found sound macroeconomic environments and sufficiently high income levels—GDP per capita, domestic savings, and domestic investments—are important determinants of stock market development.

2.3.2 Strong legal and institutional environment

Strong institutions and a well-functioning legal system are also critical for the development of stock markets because they provide the basis for the protection of investor rights, including minority interests, to attract mutual interest from investors and ensure that creditors are repaid in an arranged manner.

Burger and Warnock (2006) and Burger, Warnock, and Warnock (2012) found that countries with creditor-friendly laws (i.e., strong creditor rights) and stable macroeconomic policies have more developed local bond markets. Similarly, Eichengreen and Luengnaruemitchai (2006) found that Asian capital markets, where creditor and investor rights tend to be stronger and contract enforcement less costly, tend to be more developed than those in Latin America. More generally, economies with investor-friendly laws tend to have deeper capital markets (LaPorta, Lopez-de-Silanes, Shleifer, and Vishny, 1997, 1998) and the firms in such economies be inclined to gain higher stock market valuations (LaPorta, Lopez-de-Silanes, Shleifer, and Robert Vishny, 2002). Besides, Demirguc-Kunt and Maksimovic (1998) showed that firms in countries with high ratings for the effectiveness of their legal systems are able to grow faster by relying more on external finance.

Investor-friendly laws can exist across a variety of legal systems. Whereas La Porta et al. (1997, 1998) found that over the period 1980-2000, common law countries tended to offer more legal protection for investors and that these countries had larger capital markets. Rajan and Zingales (2003) showed that in 1913 French civil law countries tended to have more developed capital markets than their common law counterparts. This implies that while the legal protection of investors has an important bearing on capital market development.

Securities laws stay alive to reduce the “promoter’s problem” in security issuance, which is the risk that corporate issuers sell bad securities to the public (Mahoney, 1995). However, there exist different views about the need for securities market regulation. Early researchers argued that securities markets should be left unregulated (Grossman and Hart, 1980; Grossman, 1981), with the market mandating optimal disclosure and monitoring compliance to facilitate trading (Benston, 1973; Fischel and Grossman, 1984) depending on auditors and underwriters certifying the quality of securities being offered (Chammanur and Fulghieri, 1994; De Long, 1991). Recent researchers argued that regulation is needed to standardize the private contracting framework and prevent investors from being duped, with laws mandating the disclosure of information for issuances and specifying the liability standards facing issuers and financial intermediaries in case investors seek payment for damages when information is inaccurate or material information is withheld (Easterbrook and Fischel, 1984; LaPorta et al., 2006). It is now widely acknowledged that securities laws are critically important for the development of securities markets.

2.3.3 Financial infrastructure

Financial infrastructure refers to the physical foundation for a financial market exchange, including trading platform and trading system, as well as the regulatory apparatus and industry to process, evaluate, and validate the information being produced and used by the market. The trading platform could be physical or electronic. The regulatory framework consist securities market regulator, together with any self-regulation forced by the market itself to issue and enforce public regulations and promote the private disclosure of information and enforcement of rules.

The efficiency and security with which securities issues can be listed and traded on the exchange together with the quality and flow of information to value securities will to a large extent determine the market's success.

Moreover, the quality of information disclosed to investors is frequently required. In principle, reputational concerns should provide incentives to issuers to disclose accurate information in a timely manner and to their auditors to verify such information for accuracy. Corporate governance in the issuing firms may be weak or there may be conflicts of interests between issuers, rating agencies, and auditors. This is particularly problematic for the development of bond markets which requires reliable, publicly disclosed information.

Greenstone, Oyer, and Vissing-Jorgenson (2006) found that firms whose stocks are traded over the counter enjoyed positive abnormal returns following the 1964 amendments to the US Securities Act which extended the mandatory disclosure requirements that had applied to listed firms also to firms traded over the counter.

The establishment of a well-functioning financial infrastructure is not without difficulty. It evolves in stages, with the development of equity markets and government bond markets preceding those markets that require a more developed financial infrastructure and a stronger legal framework and contract resolution, such as local currency and corporate bond markets. Market development begins from the fiscal side, starting with a short instrument and then moving to longer dated instruments in government securities. Government bond markets are frequently handle by governments to finance large deficits, the development of equity and corporate bond markets typically start as private sector initiatives, with the government influencing the development through legislation, standard setting, supervision, and the provision of a financial

infrastructure (Schinasi and Smith, 1998). Bonds, for which the advantage is limited by the promised interest rate, require a much better financial infrastructure (including proper disclosure and reliable bond ratings) and a strong enforcement of creditor rights to attract potential investors (Herring and Chatusripitak, 2001).

2.3.4 Banking Sector Development

Financial services from the banking system contribute significantly to the development of the stock market. Accordingly, liquid inter-bank markets, largely supported by an efficient banking system, are important for the development of the stock market. On the other hand, a weak-banking system can limit the development of the stock market. On the empirical front, Demirguc-Kunt and Levine (1996) found that most stock market indicators are highly correlated with banking sector development. Countries with well-developed stock markets tend to have well developed financial intermediaries. Yartey (2007b) found that a percentage point increase banking sector development increases stock market development in Africa by 0.59 percentage point controlling for macroeconomic stability, economic development and the quality of legal and political institutions.

2.3.5 Market size

To date, in the absence of institutional, legal, and technological barriers, local markets in many emerging economies frequently lack the critical mass of investors needed to provide for market depth and liquidity (Eichengreen, Borensztein, and Panizza, 2006). Governments in such economies can jump-start market development by opening up to foreign investors (though this has to be carefully weighed against the risks of financial integration).

The growth of pension institutions funds can provide another drive to stock market development, especially bond markets (Giannetti and Laeven, 2009). Pension funds need to invest in longer date instruments for asset-liability management purposes and therefore can provide a stable market base for bond and equity markets (Cifuentes, Desormeaux, and Gonzalez, 2002).

Furthermore, the creation of an institutional investor base will have positive externalities for the development of capital markets by stimulating financial innovation and the efficient functioning of these markets. Institutional investors will put forth pressures for better accounting and auditing standards as well as for a more accurate and timely disclosure of information to investors.

They will also encourage improved broking and trading arrangements and will help establish more efficient and reliable clearing and settlement facilities. Additionally, they can improve corporate sector performance by facilitating the privatization process and by promoting sound corporate governance and the dispersion of corporate ownership (Vittas, 1992).

2.3.6 Public knowledge on stock market

Increasing public knowledge about the functioning of the stock market could promote the development of the stock market in developing countries. Knowledge about stock market activity can be improved through regular and intensive education programs. Educating the public about the role of the stock market can help increase the investor based and improve the liquidity of the stock market. Being new financial systems in most of Sub-Saharan Africa, stock markets would not appeal automatically to economic agents. Education about stock markets must be at the firm and individual level. At the firm level, it is important to allay the fears of firms by educating them strongly and regularly on the benefits of listing. Firms in Africa have an array of reasons why they would not list on stock markets. Apart from the lack of knowledge about how stock markets work, there are other reasons such as high listing requirements and fear of losing control over family businesses. A study on the Ghana Stock Exchange (Yartey, 2005) revealed that 33 percent of firms surveyed were unwilling to list on the stock exchange because of fear of losing control. At the individual level, African markets could tap into potentially large amounts of financial wealth which exists outside of the financial system, by pursuing vigorous and consistent educational campaigns about stock markets at various levels of society.

2.4. Empirical Evidence

Different scholars studied the challenges and prospects of establishing stock market in Ethiopia. Asrat (2003) clearly identified challenges such as low level of public awareness about securities markets, lack of public confidence in share investment, lack of institutional capacity to facilitate securities trading and underdeveloped state of the bond (debt) market. Besides, the same author stated that low level of private sector development and a low level of market orientation in the economy, easy access to loans by wealthy Ethiopians and problems with the supply and demand for securities market in Ethiopia are other problems of establishing stock market.

W/Senbet (2008), also recognized macro-economic and political stability with respect to rates of inflation, the levels of domestic saving and investment, quality of institutions such as law and order, democratic accountability, the rate of changes in government policies that could affect the development of stock market. Further, he explained the depreciation and wide fluctuations in the values of African currencies and the crisis of international confidence which stems from images of war, famine, massive corruption, failed projects, undisciplined governance and gross violation of human rights.

Furthermore, Solomon (2011) had identified some of the likely challenges in establishing stock market in Ethiopia as: companies being too young to be judged for their profitability; companies' reluctance to go public and restrict their ownership; owner managers; financial inexperience; lack of accounting/auditing professional expertise; investment regime which support individual ownership than portfolio investment; non existence of investment banks; low income and saving capacity of individuals; non-conducive political and macro-economic environment; NBE's lack of supervisory knowhow and discouraging tax regime.

On the other hand, Teklehaimanot (2014), after studying the potential beddings and constraints in the establishment of stock exchange markets in Ethiopia, had indicated economic growth, privatization scale-up, increasing capital inflow, negative real interest rate, inclination to incorporated enterprises, the establishment of Ethiopian Commodity Exchange (ECX) and energy expansion as some of the motivating matters for the establishment of stock exchanges in Ethiopia. He had also mentioned government's reluctance; the underdeveloped infrastructure, like the legal and regulatory frameworks, media, ICT; immature financial sector, uninformed and small base investors and shortage of professionals were constraints to establish stock market.

To establish an efficiently operating stock exchange market in Ethiopia, the factors that need to get the necessary attention are government commitment, policies and laws; availability of market participants; the legal and regulatory framework that protects the rights and interests of interests of shareholders; macroeconomic conditions such as GDP growth, FDI, inflation rate, devaluation of currency, the level of domestic savings; awareness and trust of the public towards stock markets; financial literacy, the development of accounting and auditing standards and infrastructural development should get due regard(Alemneh (2015).

According to the world development indicator of the World Bank, the United States of America has the biggest stock market measured in terms of their market capitalization, followed by China, Japan and UK including South Africa, which stood seventeenth (World Bank, 2014) in the top twenty stock market performing countries in the world.

To enhance the current level of economic growth and encourage both domestic and foreign investment in the continent, Africa needs to rapidly expand, develop and modernise its financial markets to develop its economic growth like other developed countries. Empirical economic studies proposed that deeper, broader, and better functioning financial markets can encourage economic growth (Ndikumana, 2001).

In 1980, Africa had only 8 active stock markets, (Ndikumana, 2001). But in 2014, the number had risen to more than twenty (Lemma, 2008). African stock markets were highly illiquid, with very low trading and turnover ratios. The low liquidity indicated limited opportunities for the transformation of illiquid assets into liquid assets, which limit economic activity (Ndikumana, 2001). African stock markets were also highly volatile due to low economic base, high country-specific risk and weak external position (Ndikumana, 2001). On the other hand, there were some African Stock markets which were highly profitable, like Egyptian, Kenyan and Nigerian stock exchange markets (Ventures Africa, 2014).

According to Levine (1997), over the past two decades, stock market liquidity had been a catalyst for long-run growth in developing countries. He argued that without a liquid stock market, many profitable long-term investments would not be undertaken because savers would be reluctant to tie up their investments for long periods of time. On the other hand, a liquid equity market allowed savers to sell their shares easily, thereby permitting firms to raise equity capital on favorable terms. By facilitating longer-term, more profitable investments, a liquid market improves the allocation of capital and enhances prospects for long-term economic growth.

.Having recognized the importance of stock markets in economic development, several African countries launched stock exchanges. Rapid expansion of stock exchanges in the continent contributed to economic development in facilitating the privatization process, diversifying the financial services, facilitating long term capital mobilization, provision of alternative investment

opportunities, attracting foreign capital inflows and serving as a signal of overall macroeconomic performance (Kumo, 2008). Furthermore, he showed stage of development and challenges like political instability, high volatility in economic growth, macroeconomic uncertainty, liquidity constraints, limited domestic investor base, underdeveloped trading and settlement structures, and limited market information were challenges for the development of stock market.

Charles Amo Yarety et al (2007), should that sound macroeconomic environment, well developed banking sector, transparent and accountable institutions, and shareholder protection are some of the challenges stock markets in the Sub Saharan African countries. Recommendations like the need to increase automation, demutualization of exchanges, regional integration of exchanges, promotion of institutional investors, regulatory and supervisory improvements, involvement of foreigner investors, and educational programs were forwarded.

Massele et al (2013), studied the challenges faced by the Daressalam Stock exchange market and pointed out lack of desirable characteristics of the stock market in terms of liquidity, availability of information that leads to market efficiency, high price sensitivity to new information, small price sensitivity, narrow price spread as factors having impacted the market. He also indicated lack of public awareness and knowledge about stock market, few market participants, lack of ICT and technology support for trading sessions and settlement of transactions, macro-economic instability from the point of view of inflation, currency depreciation, unemployment, population increase and poverty as some of the challenges. Lack of competent experts in the financial sector was also emphasized like stock analysts, financial analysts, lawyers, licensed brokers and professional financial advisors.

Bohnstedt et al (2000) had also investigated the potentials and challenges of the Ugandan Stock exchange market and identified those factors that need to be improved to enable an efficient market in Uganda. An enabling environment which provides macroeconomic stability, prudential financial sector regulation, active government support, an improved tax regime and tax incentives, installing clearing and settlement system and strengthening the accounting profession were identified as important measures.

Josiah et al (2012) have studied the elements of stock market development of Nairobi Stock Exchange (NSE) by using secondary data from 2005-2009 and found that institutional quality

represented by law and order and bureaucratic quality, democratic accountability and corruption indices as important determinants of stock market development because they enhance the viability of external finance. On the other hand, the regression analysis between stock market development and macroeconomic stability- in terms of inflation and private capital flows showed no significant relationship.

The arguments for stock market development were supported by various empirical studies, Levine and Zervos (1993), Atje and Jovanovic (1993), Levine and Zervos (1998) which emphasized the importance of stock market development in the growth process. On the other hand, Rousseau and Wachtel (2000) and Beck and Levine (2003) showed that stock market development is strongly correlated with growth rates of real GDP per capita. More significantly, the stock market liquidity and banking development both predict the future growth rate of economy when both enter the growth regression.

Using data on 49 countries from 1976 to 1993, Ross Levine and Sara Zervos (1996), investigated whether measures of stock market liquidity, size, volatility, and integration in world capital markets predict future rates of economic growth, capital accumulation, productivity improvements, and private savings. Finally, it found that stock market liquidity-as measured by stock trading relative to the size of the market and economy - is positively and significantly correlated with current and future rates of economic growth, capital accumulation, and productivity, growth, even after controlling for economic and political factor.

Researchers including Spears (1991), Pardy (1992), Atje and Jovanovic (1993) showed that stock market development is strongly correlated with growth rates of real GDP per capita. In addition, it found that stock market liquidity predict the future growth rate of economy. Levine and Zervos (1998), Filer et al. (1999), Rousseau and Wachtel (2000) and Tuncer and Alovzat (2001) examined stock market-growth nexus and exhibited positive casual correlation between stock market development and economic activity. Subsequent research, with larger panel sets and longer time series attempted to attend to the earlier criticisms.

Beck, and Levine(2003) for instance, investigated the impact of stock markets and banks oneconomic growth using a panel data and found that stock markets and banks positively

influence economic growth. Chen et al (2004), Paudel (2005) and Love and Zicchino (2006) also acknowledged that stock markets, due to their liquidity, enable firms to attain much needed capital quickly, hence facilitating capital allocation, investment and growth. Alam and Hasan (2003) for the case of the US also found a significant positive impact of stock market development on economic growth. Bahadur and Neupane (2006) concluded that stock markets fluctuations predicted the future growth of an economy and causality is found only in real variables. Recent studies have employed models, however most are country specific studies including research in Ghana (NZué 2006), Pakistan (Shahbaz, Ahmed and Ali 2008) and India (Agrawalla and Tuteja 2007).

Recent empirical research has identified macroeconomic stability, robust economic growth, well developed banking sector, and good quality institutions as important for stock market development. Garcia and Liu (1999) found income level, banking sector development, domestic savings and investment, and stock market liquidity as important determinants of stock market development in emerging markets. Yartey (2007b) also found that a percentage point increase in financial intermediary sector development increases stock market development in Africa by 0.597 percentage points controlling for macroeconomic stability, the level of economic development, and the quality of legal and political institutions. It also found that good quality institutions such as law and order, democratic accountability and limited corruption as important determinants of stock market development because they reduce political risk and enhance the viability.

Given the basics, the long-term capital is deemed crucial for economic development as evidenced by the positive relationship between long-term capital and economic growth (Demirguc and Levine, 1996). A study conducted by Atje and Jovanovich (1996) concluded that stock market contribute to economic development. Furthermore, Levine and Zervos (1996) had conducted an empirical study and found a strong correlation between stock market development and long-term economic growth. The authors indicated between 1985 and 1995 the rise of world stock market capitalization from \$4.7 trillion to \$15.2 trillion, and emerging market capitalization jumped from less than 4 percent to almost 13 percent of total world capitalization.

2.4. MARKET CAPITALIZATION

Market capitalization is the total market value of all company's outstanding shares and that is calculated by multiplying a company's shares outstanding by the current market price of one share. Investors use this figure to determine a company's size, profitability, risk and performance, good governance and future prospects before buying stocks.

Market Capitalization frequently referred as “Market Cap” can be classified as large-cap, mid-cap, and small-cap, respectively depending to the level of market capitalization of the company (The Economic Times, 2015). Investment professionals have differences in definition of Market capitalization but the current approximate categories of market capitalization are: Large Cap: \$10 billion plus and include the companies with the largest market capitalization, mid cap: \$2 billion to \$10 billion and Small Cap: less than \$2 billion.

As per World Bank Report (WB, 2014) market Capitalization in the world shows substantial movements in share market in all levels of the economy that include United State reached to \$18.7 trillion, Japan \$3.7 trillion, China \$3.7 trillion, United Kingdom \$3.02, Canada \$2.02, France \$1.8 trillion, German\$1.5 trillion, in India \$1.3 trillion. Whereas in Africa, many countries has a market capitalization of \$844.9 billion (ANNEX III) which include East African Countries like Kenya that has established stock market, stock exchange and capital market authority. Kenya has a market capitalization of \$14.8 billion. Similarly Uganda has established Stock Market, Uganda Security Exchange (USE) and Capital Market Authority (CMA) and accumulated a market capitalization amount of \$7.3 billion and further Tanzania has same stock market, Stock exchange and capital market authority and has a market capitalization amount of \$1.8 billion. But there is no securities market, other than government treasury bills and government bonds in the financial market in Ethiopia; rather there is a Commodity Exchange, Ethiopian Commodity Exchange (ECX) established in 2008 which is the first in Africa.

However, in Ethiopia, as a sample, private share companies like banks, insurance, brewery, and cement and real estate companies are established through sell of shares by IPOs (ANNEX IV) A-C) without stock market in the country. Private banks and insurance share companies sold 88.4 million shares in different par values and accumulated Br.11.7 billion (paid-in shares) and others brewery, cement and real estate share companies taken as a sample sold 2.0 million shares at different par values and accumulated Br. 2.0 billion. Out of companies established in the country,

nineteen (19) companies sold their shares through Commercial Nominees Share Companies (CNSC) upon presenting their prospectus. These companies mobilize resources, create employments and pay taxes to the government.

The aforementioned evidences reflected that there are benefits that could be derived from stock market to mobilize resources to raise equity capital for productive sectors towards accelerating the economic growth.

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY

3.1 SAMPLE DESIGN AND DATA COLLECTION INSTRUMENTS

The sampling frame of the organizations for this study was selected systematically, based on the list of specific functions expected to generate information. For this purpose, respondents were drawn from different level, National Bank of Ethiopia (NBE), Addis Ababa Chamber of Commerce and Sectoral Associations (AA-CCASA), Ministry of Finance and Economic Development (MoFED), Ethio-Telecom (ET), Ethiopia Accountants and Auditors Association (EPAAA), Justice and Legal Systems research Institute (JLSRI), Ernst and Young (EY), Public Finance Enterprises agency (PFEA), Commercial nominees S.C. (CNSC), Hasset Wholesale and retail S.C. and Habasha Capital PLC found in Addis Ababa are included (ANNEX V).

3.1.1. Qualitative Study

The primary data gathering tools to assess stock market development infrastructures were the discussions based on the checklist to provide contextual information about the stock market development infrastructures within the system. The respondents were drawn from different organizations at different level, principal persons and respective staffs.

3.1.2. Document Review

Document review was the second data gathering tools on requirements of stock market infrastructure development. The researcher had reviewed documents believed to be relevant, including but limited to strategic objectives, indicators outputs/results, activities plan, procedures, policies, rules and regulations, stock management, internal/external audit reports, etc.

3.2 DATA COLLECTION

The study employed two types of data collection instruments, most widely used standard tools i.e. checklist and discussions developed by the researcher. These tools exercised from higher to lower level in a various meetings, where each question in the checklist were reviewed and discussed to better reflect the views. Furthermore, the discussions with 24 senior and middle officials were done at various levels to ensure accountability requirements of stock market development in the country and quality of data collection at lower levels.

A multi-stage used for each level for the analysis. Moreover, representative samples were taken into considerations to meet study objectives. Thus, secondary data were collected from the reports. Topics of the interview were focused on (1) economic development of Ethiopia, (2) forms of Ethiopian private companies (3) accounting and audit standards (4) Ethiopian legal systems and issues of corporate governance, (5) development of financial and non-financial institutions (6) existing practices on floating shares in Ethiopia (7) business environment in Ethiopia, (8) government standpoint and commitment to support stock market development. Please the detail in Annex VI.

3.3 DATA ENTRY AND ANALYSIS

Checklists to collect data were prepared to interviewees in the selected organizations. After discussions, all opinions collected from informants are categorized based on the nature of opinions in relation to legal and regulatory framework, economic development, stock market knowledge, business environment and government commitment towards stock market establishment.

Following the data collection, information entry format was designed. Finally, all variables in the check-lists were summarized, labeled and data entered into the document; editing and each variable in the discussions to check the consistency followed by presentation of the relevant information on the basic key-infrastructures needed to establish stock market in Ethiopia.

CHAPTER FOUR: RESULT AND DISCUSSIONS

4.1. LEGAL AND REGULATORY INFRASTRUCTURES

Establishing a well-functioning stock market requires legal and regulatory frameworks. Among these the regulator and securities enforcement, adequacy of judicial system, accounting and auditing standards, Corporate Governance (CG), acquisition and merger regulation, and bankruptcy and insolvency law are essential. Based on this understanding the collected data was analyzed, discussed and presented as follows.

The study provides a descriptive and qualitative analysis on requirements of legal and regulatory frameworks together with providing a complete picture to establish a well-functioning stock market system in Ethiopia. The results provide information on current financial system including but not limited to regulatory and securities enforcement, adequacy of judicial system, accounting and auditing standards, Corporate Governance (CG), acquisition and merger regulation, essential law on bankruptcy and insolvency on financial system function as a baseline for future review. The presentations in the following sections offer the results of the study.

4.1.1 The Regulatory and Securities Enforcement

There is no specific regulation of capital market and related activities in the country to date. Thus, no assessment of strengths and weaknesses with emphasis on the regulator's independence, objectivity, integrity, and enforcement capacity made to rectify the existing scenario.

As confirmed by respondents, to establish a fair, orderly, transparent, and well-regulated capital market in which investors will be willing to place confidence, it is absolutely necessary establishing regulatory authority. Furthermore, all respondents of the assessment reflected that there is no an independent regulatory authority like Capital Market Authority, Stock Exchange and other related institutions that could facilitate stock market in Ethiopia.

The research also described that NBE had purchased bills from banks and CBE also purchased corporate bonds from EEPKO, Regional Governments, DBE, City government of Addis Ababa and Railway Corporation but there is no interbank money market. Moreover, shares are sold by

IPOs promoters to establish share companies without primary and secondary stock market circulations that may have unforeseen risks as all respondents stress.

The research result also clearly reflected, Ethiopia first credit rating was given in May 2014, with Standard & Poor's and Fitch assigning a 'B' rating and Moody's giving a 'B1' based on Economic Strength, Institutional Strength, Fiscal Strength and Susceptibility to Event Risk. Following this, Ethiopia made its first Sovereign-debt offering in December 2014, selling US\$1 billion of 10-year Eurobonds at 6.625% to European and American investors.

Strongly enough, NBE had issued two Directives to establish one-Reinsurance Company and Fixation of Daily Foreign Exchange Cash Notes and Transaction Rates and is expected to issue a directive to establish secondary market for government bonds except treasury bills. Unlike Ethiopia's situation, some other east African countries like Kenya, Uganda and Tanzania have established stock market, stock exchange and capital market authorities.

4.1.2 Commercial Code of Ethiopia

All respondents confirmed that the most important provisions that are required to establish stock market which reflect the current business development and the global trend to establish and expand share companies were not well-arranged yet. Respondents also confirmed that various institutions had studied to update the commercial laws and presented the draft proclamation to the government which is not endorsed thus far. Pursuant to this, there is no dedicated authority in the system of civil courts to handle and persecute securities cases. There are also no specific training programs to educate prosecutors and judges towards capital market regulation.

Through the assessment, it found that Justice and Law Systems Research Institute (JLSRI) have started to revise the Commercial Code of Ethiopia (1960), and policy documents of Ethiopian Commercial Law (JLSRI, 2012) to update, endorsement and not yet materialized that necessities for subsequent launchings. Experience of other countries, like Kenya, Tanzania and Uganda indicated that they have company laws that regulate stock market for years to actively participate into the international financial market.

4.1.3 Acquisition, Merger, Bankruptcy and Insolvency Laws

Respondents had confirmed that there is no Acquisition, Merge, Bankruptcy and Insolvency legislation that covers acquisition bids and /or merger in the country. However, bankruptcy/insolvency process permits some resolution of creditors claims. Furthermore, it confirmed, there is no system of civil courts where securities can be persecute courtyard towards acquisitions, merger, and bankruptcy and insolvency disadvantages.

4.1.4. Accounting and Auditing standards

Respondent stressed that reliable and relevant accounting information is critical for making investment decisions. It was confirmed that accounting auditing and reporting standards are low in the country where as stock market required international financial reporting standards.

The respondent also confirmed that there is no adopted/ developed national accounting, auditing and reporting standards from international practices perspective. Absence of sophisticated internal and external users of financial statements precluded the investment flow towards the country. In addition, there is no ethical and professional code that directs accountants and auditors responsible and accountable for standardization of report and reflection of predetermined related material weakness.

Respondents' further stated that banks demanded audited financial statements for loans request of more than Br. Five million to assess the borrowing capacity of the applicant. As a result of sub-standardization and ethics concern, no supervisory authority in charge to supervise, monitor and evaluate accountants' and auditors' report towards taking any remedial actions in time. Thus, defaults in the preparation and presentation of financial reports standards were observed and substantiated. Respondents also stated that NBE had issued many directives on financial reporting standards for banks, insurances and micro-finance institutions to monitor and evaluate the performances to assure compliance to the rules and regulations.

Recently, the Ethiopian Government has issued a Regulation No.332/2014, Federal Negarit Gazette No.22, January 14, 2015 to regulate the Establishment and Determination of procedures of Accounting and Auditing Board of Ethiopia. The regulation aims to promote high quality reporting of financial statements and related information of reporting entities at highest

professional standards by auditors and accountants. The main objective of the regulation is to ascertain the quality of accounting and auditing services, and develop accounting profession for the interest of the public to maintain professional independence of accountants and auditors. Presently, the board had started to register auditors and accountants.

4.1.5 Corporate Governance

All respondents stated that corporate governance of Ethiopia is low due to non-existence/adoption of corporate governance code and absence of adopted/developed accounting and auditing standards and lack of institutions that have the capacity to monitor public companies and lack of legal enforcement of filing requirements of annual reports that disclose basic financial information to the public. They also confirmed that the level of corruptions and absence of corporate governance code in the country make corporate governance weak. Respondent also stated that at present NBE is preparing a Corporate Governance Directive for all banks and insurance institutions to maintain the safety and soundness of financial systems in general.

Whereas, OECD (2004) advises that presence of corporate governance, promotes transparency, efficient market, protects and facilitates shareholder rights and ensures the timely and accurate disclosure of all material matters regarding corporations. Furthermore corporate governance should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the boards' accountability to the company and the shareholders.

4.1.6. Corruption in Ethiopia

All Respondents substantiated the existence of corruption in all sector organizations particularly in land distribution and administration, Ethiopian Revenue and Customs Authority, judiciary and public procurements even though a legislative framework against corruption exists in Ethiopia. The findings of this assessment are in line with World Bank report conducted in the country.

Respondents also cited that there are corrupt police officials in the mining sectors. As a result, private companies have been requested to pay bribes to public authorities. Parallel to this, intermediary of forced-in-nature payments to officials are commonly practiced by contractors to speed up in facilitation of payments to meet the commitments. Obviously, the public procurement process has definitely depicted lack of transparency.

The Federal Ethics and Anti-Corruption Commission (FEACC) has a threefold mandate to prevent, investigate and prosecute corruption in the public sectors. It also has powers to investigate corruption in the private sectors as long as the issues are related to question of concerns to public officials, such as public-private collusions perspective.

4.2 ECONOMIC DEVELOPMENT OF THE COUNTRY

4.2.1. Country Review

All respondents verified that there is an economic development in the country for the last consecutive years in all sectors of the economy including service, agriculture, industry and infrastructure (road and rail way), electric power generations, telecom expansion and in real estate sectors. NBE (2014) also confirmed that the country's economy had registered remarkable growth in the fiscal year ended 2013/14. Real GDP had expanded by 10.3% of which service sector constitutes 51.7%, agriculture sector 21.9%, industrial sector 26.4% had contributed to GDP growth. Nominal GDP per capita grow up to USD 631.5 and similarly real per capita GDP growth by 7.5 % and reached to USD 377.1. In addition NBE report stated Real GDP of the country had reached to Br.626.6 billion in the fiscal year ended. Furthermore, IMF (2014) also verified that Ethiopian economy continues to grow fast in 2013/14 on the heels of very strong real GDP growth in 2012/13 and projects the economic growth in the 8.0–8.5% range in 2013/14 and 2014/15. Inflation had also remained in the single digits throughout the year and was 8.5 % in June 2014. Finally, respondent ascertained that the government is committed to maintain stable fiscal and monetary policies for sustainable development.

4.2.2 Financial Sector Development

In Ethiopia, at present, there are government and private owned banks, insurances and microfinance institutions operating in the country. State owned banks were established through initial capital raised by government whereas private banks were through sell of shares to the public by IPOs without stock market. In the present banking industry state banks accounted to 46 percent and private banks 54 percent of the paid capital. This showed private banks accounted higher amount due to sell of shares from the day of establishment up to the fiscal period ended June 2014. Further all banks showed an increment of 12.5 percent as compared to the previous year capital position.

Out of the total capital raise including micro-finance institutions, the share of micro-finance institutions contribute 18 percent which is minimal in relation to all banks in the country. This capital position of micro-finance institutions will stay for long to enable to grow to bank. In general, capital position of all banks and micro-finance institutions increased by 14.5 percent in the fiscal period. This resulted due to expansion of branch network of banks to mobilize deposits. Similarly, capital position of all banks and micro-finance institutions depicted an increment of 14.5 percent.

State-owned banks mobilize 69.3 percent and the rest 30.7 percent by private sector of the total deposit mobilized in the industry that resulted a lion share of state owned banks. Out of state-owned banks Commercial Bank of Ethiopia took 95 percent of the deposit due to deposit of government enterprises. This also urge private banks to mobilize more through branch network and product development to reach to better competitive position. Beyond this, banks and micro-finance institutions mobilizes 96 and 4 percent respectively and total deposit showed an increment of 24.4 percent from the preceding year.

All banks extend loans and advances to different sectors to establish and expand their business. Out of the loans granted 68 percent is extended by government banks and 32 percent by private banks. It showed that government banks hold a leading position to finance the economy. In total, outstanding loans and advances showed 23.9 percent increment from the previous same year. Contribution of micro-finance also showed a minimal share i.e. 9 percent out of the loans and advances granted and overall outstanding loans and advances increased by 24.6 percent.

Insurance companies which comprises state-owned and private were operating in the economy. Out all insurance companies the highest amount of capital is registered by private companies which accounted to 78.7 percent whereas state owned insurance company accounted to 21.3 percent. The highest capital registered by private companies is due their capital base through sell of shares to the public periodically. These companies are expected source of funds to buy shares in the stock market. Their capital is by now increased by 82.7 percent due to sell of shares to the public (NBE and Commercial Banks report, 2014).

The assessment result indicated that there is development in financial sectors in the country but it is low in relation to neighboring countries like Kenya, Tanzania and Uganda. Payment systems of banks are also found to be slow; automatic payment systems were not in place and use few banking products. Extending credit is based on collateral strength. It was also found that if financial sector is opened for foreign investors local banks will not be able to compete in due to lack of technology, knowhow, capital and branch network. Furthermore, number of financial institutions in Ethiopia was less than neighboring countries.

As clearly stated by the respondent, financial institutions are monitored through different directives in ensuring sound practices, stability and long-term institutional success in financial system in general and banking and insurance sectors in particular. Ascertaining the public confidence in the financial system, among other things, on whether financial institutions are owned and managed by persons who are fit and proper are needed to enhance effectiveness of governance of institutions. Further they explain that NBE through its given mandate by the government, set minimum requirements and considerations to appoint directors, chief executives officer and senior executive offices for all financial institutions.

4.3 CAPITAL MARKET KNOWLEDGE

The research result reflected, there is low level of skill in the country to start stock market. Some respondent pointed out the experience of ECX which is engaged in commodity exchange can be a starting base. Knowledge about Security trading, capital raising, Initial Public Offerings (IPO) processing and investing are highly required. Moreover, how to provide services and promote capital market financing and practical knowledge and experience is required. Respondents stated that knowledge on ethics and compliance, financial analysis, investor protection and services for investors are also critically essential.

Some respondents advised to exploit Diaspora experience to handle the market, other country's exchange operators or institutions funded/supported by International Financial Corporation/ World Bank. However, presently shares are sold by IPOs promoters without adequate share trade management knowledge which may result in unforeseen risks.

4.4 PRESENT BUSINESS ENVIRONMENT

Respondents stressed that contract implementation in construction sector, transferring of ownership, getting property registration/title deed and paying taxes took long bureaucratic processes. It also stated that most big businesses are owned and run by the government and party affiliated companies with a better access to credit and foreign exchange permits. Similarly, World Bank (2015) confirmed that Ethiopia ranks 132 out of 189 countries in doing business. Detailed ranks showed starting business 168, doing with construction permits 28, getting electricity 82, registering property, 104, getting credit 165, paying taxes 112, and enforcing contracts 50, trading across borders,168, investor protection 154. Stock market require favorable business environment for all participants in the market. Thus, such business environments will not give a firm ground to establish stock market in the country.

4.4.1 Formation of Business Enterprises

All respondents confirmed that most business enterprises are family owned as sole and private limited companies while others are politically affiliated companies owned by political parties as private limited companies. It was also confirmed that big business enterprises are fully owned by the government. There were also share companies established by IPOs through selling of shares. Moreover, majority of shares are owned by party affiliated companies. Some respondent indicated such groups will obviously diminish when stock market is established.

4.4.2 Potential Players in the Stock Market

All respondents confirmed that potential players in the stock market will be banks, insurances, and Social Security Agencies (Private Organizations' Employee Social Security Agency (POESSA) and Pension and Social Security Agency (PSSA). Social Security Agencies observed have a better capacity to buy shares from the public companies due to managing of accumulated funds. Banks, insurances and social security fund agencies have liquid money power to buy and sell shares to the society. At present social security policy is under discussion, if endorsed by the government, the establishment of stock market development will anchor on a fertile ground. Thus far, results have further ascertained that Pension and Social Security Agencies in Ethiopia have enormous and rapidly growing funds for investment. However, the government restricted to utilize available funds to invest in potentially profitable businesses other than purchase of treasury bills from NBE.

4.5 TELECOM INFRASTRUCTURE DEVELOPMENT

Respondents stated the only national telecom provider, Ethio-telecom, offers mobile, fixed line, internet, data, broadband, narrowband and General Packet Radio Service (GPRS) and data centre infrastructure in a secured root. Wireless service reached at 85% coverage of the country and broad band services reached in all main towns and industrial parks. Furthermore, they stated that at present Ethio-telecom had reached at a strong stand to handle all telecom services at international level. Similarly, it started to build strong back-up power. A telecom university is focused on technical, operational, services and leadership training for the company's employees. Whereas, respondent stressed that Ethio-telecom lacks data warehouse storage at country level and legal framework for electronic trading, transactions, payments and disclosure. Furthermore, it ascertained that damages on fiber optic cables and power interruptions are among the challenges to the service provider to expand and maintain network quality effort. Respondents also confirmed that a development in Ethio-telecom services is observed although power interruptions have been frequently happened.

The current information communication in the world is highly moved ahead through different forms of ownership, whilst the government solely owned the telecom services in Ethiopia. The telecom services included fixed, mobile, internet and data communications that limited innovations and technology advancements. The government invested huge amount resources in telecoms services. It is, heavily regulated and completely controlled over networks with virtually unlimited access to call records of phone and internet users. It is observed that the mobile penetration growth is strong and potentially rising. Likewise, the country's broad band services have reflected massive improvements in international bandwidth, national fiber backbone infrastructure and 3G mobile broadband services.

4.6 GOVERNMENT COMMITMENT TO ESTABLISH STOCK MARKET

Respondents stated that the government had positive interest towards establishing stock market. Recently, NBE is on preparation to launch Secondary Market for government bonds to the public and issued Sovereign Eurobond to foreign investors after securing credit ratings by foreign credit rating agencies.

The government had also issued a proclamation to establish a regulatory board to direct, certify and control public accountants' and auditors' work and further started to revise the commercial code of Ethiopia. Further to note, recently the government by its initiative has started to study the feasibility of establishing stock market in Ethiopia. The document is at a draft level for subsequent approval. Parallel to the study, NBE is prepared to issue corporate governance directive to all financial institutions. Besides, it ascertained that first credit rating was given to Ethiopia in 2013/14 with Standard and Poor's and Fitch assigning a 'B' rating and Moody's giving a 'B1'. Respondent also explained that the government is in the process to launch Social Security Policy as a ground for social security fund agencies to buy shares in the market.

4.7 PROSPECTS TO ESTABLISH STOCK MARKET IN ETHIOPIA

Despite many challenges to establish stock market in Ethiopia at the moment, there are opportunities that could be a ground-break through to establish. The following are summarized list of opportunities identified by the key informants during data collection in this study. Thus, the nation has:

1. availability of immense natural resources including fertile land and mineral resources (gold, platinum, tantalum, soda ash, potash and natural gas, etc.).
2. population size for potential market (over 81 million people -second in sub-Saharan Africa)
3. potential players to sell shares to the public (including banks, insurances, Public/ Private Social Security agencies)
4. improvements in telecom infrastructure development
5. the GTP II (2015/16 -2020/21) plan that requires huge source of finance in all sectors of the economy
6. the existence of Accounting and Auditing Registration Board to register and certify accounting and auditing standards.
7. experience of ECX in commodity trading and CNSC in selling shares on behalf of companies under establishment.
8. public awareness in bank and insurance share trading.

4.8 PRE-CONDITIONS TO ESTABLISH STOCK MARKET

Many factors play the ability to adapt and strength in the financial marketing perspective. The most important of these may well be of the feedback and support received from the participants. Many participants in the discussions are waiting the realization of the new provisions on the market. While these reviews are valuable, it's perhaps even more critical to let know how roles of the players are faring. The study then reviewed in particular needs timing attempt to learn stock market practices, polices and preferences. Thus, ongoing feedback combined with thorough situational assessment and formal appraisals to establish stock market can minimize errors in sound economic gain.

Whilst of reviewing performance in critical areas, suggestion proposed by most are improvements to minimize the chance of minor issues will become major problems to compete with basic responsibilities to the work environment. Prior to the actual launch of the system, the process of identifying costs and possible drawbacks are critical. Areas of potential costs are clear. Financial systems to the stock market do not routinely studied in perspective to incorporate in this document. Thus, potential pre-conditions will need to most of the followings:

- Lay down adequate infrastructures and commitments of the government to capital market development.
- Significant macroeconomic development of the country.
- Ease of doing business environment.
- Legal and regulatory frameworks, enforcements, accounting/auditing standards, corporate governance.
- Focuses on value of business/current market where it determines the current significance and financial viability, market and other market related issues may affect the development of capital market.
- Identify potential capital market players (issuers versus investors) across many determinants.
- Financial literacy – awareness of many players about stock market to minimize potential problems.
- Provision of overall benefit to the country with enhancement of the interest of players in both the long and short term and financial accountability.

CHAPTER FIVE: SUMMARY OF FINDINGS AND RECOMMENDATIONS

The basic theme of this study is to assess the infrastructures needed and identify factors to establish stock market in the country. Opinions on challenges and prospects of sample organizations were collected. Effective stock market is critical for improving the availability of quality financial and equity to frontline services delivery points and beneficiaries at all levels, given, the infrastructures needed allowed to do. Based on the results obtained from the respondents the following conclusions and recommendations are drawn.

5.1 SUMMARY OF FINDINGS

There have been a number of discussions, which have reflected opinions for the establishment of stock market. Across the discussions the following summary of findings were found.

- a) Currently there is no regulatory authority and other related institutions to trade in stock in the Ethiopian market. Instead NBE issues Treasury-Bills, DBE manages Great Renaissance Dam Bond, NBE purchases bills from banks and similarly CBE purchases corporate bonds from government institutions and DBE. On the other hand, shares are sold by IPOs promoters and government has sold Sovereign-bonds without stock market in the country. Besides NBE is ready to establish secondary market for government bond other than treasury bills.
- b) The 1960 Commercial code of Ethiopia is not up-to-dated to trade in shares, however, the draft proclamation named Monetary Instruments and Share Market proclamation was submitted to the government, however, it is not endorsed yet. Moreover, there is no Acquisitions and Merger law and Bankruptcy and Insolvency rules. The Commercial Code of Ethiopia (1960) is under revision, policy documents of Commercial Law and Road Map of the financial system is understudy.
- c) Basic principles and policies governing share circulation management were not anchored at a sufficiently high juridical level of the law, with an effect on the level of transparency and clarity of the regulations, and it has made enforcement difficult.
- d) A multiplicity of legal instruments regulating different aspects of share trading constitutes a source of confusion with the risk of overlapping jurisdiction, and the lack of clarity in important policy and procedural requirements.

- e) Absence of a single agency with a mandate for formulation of stock market policy, and monitoring compliance in ensuring clear and enforcement mechanisms.
- f) Accountants and auditors in the country use different accounting and auditing standards (GAAP, IAS, IAAS and IFRS). This is due to the absence of adopted/ developed national accounting and auditing and reporting standards, sophisticated users, ethical and professional code and above all, there is no supervisory authority. Very recently, the government has issued regulations to accountants and auditors to generate professional and quality financial report standards.
- g) Corporate governance of Ethiopia has not given due attention to the adoption of corporate governance code, adopted/developed accounting and auditing standards, lack of institutions to monitor public companies, legal enforcement of filing requirements on annual reports and level of corruptions.
- h) The economic development of the country observed for the last consecutive years in all sectors including service, agriculture, industry and infrastructure (road and rail way), electric power generations, telecom and real estate sectors. The inflation has remained in single digit and the government is committed to maintain stable fiscal and monetary policies for sustainable development.
- i) Financial institutions in the country are also growing but at lower pace compared to other countries like Kenya, Tanzania and Uganda. However, having banking products and are also slow in payment system. It will face a challenge if and only if foreign banks are entering into the local market. This is due to lack of technology, knowhow, adequate capital and branches' network. As such, there is no practical knowledge in stock market other than ECX experience where it actively operates commodity exchange.
- j) In Ethiopia there are long bureaucratic processes in contract implementation for construction sector, transferring of ownership, getting property registrations and paying taxes. Most big businesses are owned and run by the government and party affiliated companies have a better access to credit and foreign exchange permits. In most cases, share companies are owned by shareholders comprising of individuals, private companies and party affiliated companies. However, share companies like financial institutions and contractual saving agencies could be potential players in stock market.
- k) Among the essential infrastructure in the country, Ethio-telecom, offers mobile, fixed line, internet, data, broadband, narrowband. GPRS and data centre infrastructure in a secured root

with wide area coverage. It has strong stand to handle all telecom services at international level and build strong back-up services. A telecom university is also focused on technical, operational, service and leadership trainings towards strengthening the capacity of Ethio-telecom staff. Presently, the Ethio-telecom services often lack data warehouse at country level and there is no legal framework to electronic transactions. Similarly, frequent damages on fiber optic cables and power interruptions disrupted the required services.

- l) Lack of qualified human resources to exert stock market and related financial matters.

Finally, it can be said that Ethiopian government is interested positively towards establishing stock market in the country due to the fact that (1) secondary market for government bonds will certainly launching, (2) the new accountants and auditors regulatory board may direct, certify and control to follow the standardization, (3) revision of commercial codes are on the pipe-line (4) feasibility study on establishment of stock market is on process. Thus, the establishment of the stock market will assist then not only the esteem players but also the social security agencies to utilize the accumulated funds for fore-front market transactions.

5.2. RECOMMENDATIONS

The formation and evolution of securities markets and its institutions is certainly a process, influenced by a large number of factors and complex relationships between these. There are, yet, obviously critical issues within the process of the development of securities markets and institutions.

Although it does not seem very likely at the moment, the most significant step to express the commitment of the GoE to undertake most valuable measure to establish a stock market. This is due to the fact that the stock market provision most importantly required the appropriate studies and lay-down legal foundation to promoting, regulating and facilitating the participation of the players. However, the following essential recommendations to fulfill in establishment of stock market are forwarded to the Government of Ethiopia as prerequisites to:

- finalize the revision of the Country's Commercial Code (JLSRI) related to Accounting and Auditing Registrations (MoFED) and develop a Corporate Governance Code (NBE). The revision and registration should be comprehensive leading towards the development of stock market in the country.

- establish Stock market and other related institutions with the technical assistance (training, manuals, expertise service, etc) of International Finance Corporation and World Bank.
- improve the legal framework by enacting a stock market law, embodying the basic principles and policies in clear and unequivocal standard (NBE).
- set-up appropriate institution(Capital Market Authority, Security Registration Offices,etc.) for proper implementations of the provisions and issue clear directives to reduce unnecessary bureaucratic processes. Simultaneously, the government should strength its capacity to implement the proposed laws and regulations.
- develop stock market Standard operating procedures (SOPs) which clearly outline the stock market system. To enforce, SOPs will require routine and consistent supervision at all levels. IT-controlled stock market management systems are required move closer to players that will eventually be optimized information networks and decisions in the on-going operations. The IT development requires huge investments to improve the capacity of stock market management. Suitable training programs directed towards different user groups accompanied by hands-on manual to ensure compatibility and commitment critically fundamental.
- finalize the social security policy and issue directive to allow Pension Fund agencies to buy shares (GoE).
- educate the public about the costs and benefits of a stock market, revise the existing financial syllabuses of the country's business school and conduct public awareness program through establishing appropriate entity (NBE and related ministries).
- privatize state-owned enterprises with full consideration of absorbing capacity of the stock market (GoE).
- strengthen government's commitment to create and maintain stable macro-economic management system to implement stock market infrastructures (GoE).
- establish local rating agencies to extend credits based on corporate financial soundness diversify banking products and implement up-to-date technologies (NBE).
- establish and improve secondary share circulation Management System, in turn, requires the identification of challenges associated with effective management systems. The present stock market development study is an effort to identify the challenges so that

feasible options can be recommended for further strengthening as well as the share circulation and control systems surrounding stock markets potential (NBE).

- employ common approaches to stock market development indicator assessments and an in-depth situational analysis of the current stock market practices in other countries at central levels (NBE).
- address the core elements of stock market development and management: policy and legal framework, selection, rational use, and management support systems. The legal institutional framework for stock market policy and internal control environment; and key factors determining stock market (NBE).
- coordinate various funding inputs, mechanisms and delivery schedules, between NBE, new proposed stock market institution and development partners to strengthen the capacity of funding and continuous management system . Finally, all key stakeholders should be involved in the quantification of requirements to identify the funding needs and funding gaps to fill-in.
- develop; introduce customized training for senior officials, program directorates and banking practitioners on regular basis. Training need to cover the principles of stock market, rules and procedures of stock market, requirements of international financial institutions, ethics and anti-corruption, technical specifications and evaluation; legal aspects- handling disputes, record keeping, standard reports, etc.
- The role the media plays in promoting the stock exchange market is highly recognized. Therefore, the country's media should do more in giving more coverage for business and financial matters

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ANNEXES

ANNEX-I: Name of institutes and position of interviewees

S.No.	Name of institute	Position of the interviewee		
1	Ministry of Finance and Economic Development	Director	Director	-
2	National Bank of Ethiopia	Director	Senior Advisor	Senior Expert
3	Addis Ababa Chamber of Commerce and Sectoral Associations	Board Chairman And General manager	Director	Ex-Board chairman and Board chairman in other place
4	Public Finance Enterprise Agency	General Director	Director	-
5	Ethiopian Public Accountants and Audit Association	Board Chairman	Senior Auditor	-
6	Ethio-Telecom/ET/	Director	Expert	-
7	Ernst and Young	Director	Senior Auditor	Ass. Director
8	Commercial Nominees S.C	Experts	Expert	-
9	Habesha Capital Plc	General Manager	Director	-
10	Justice and Legal Research Institute	General director	Expert	-
11	Hasset Wholesale and retail Trade S.C.	Board director		-

ANNEX-II: Studies Conducted on Stock Market Development in Ethiopia.

No.	Title	Author	Date
1	Feasibility of Establishing of Securities Exchange Market	NBE	1995
2	Prospects and Challenges for developing securities Market in Ethiopia: An Analytical Review	Prof.AsratTessema	1998
3	Proceedings of the National Seminar Towards Promoting Capital market in Ethiopia	MekeleUniversity	2001
4	Towards the development of Capital market in Ethiopia	Tadewosharege-Work and Araya Debessay	1995

5	A study on the Feasibility of Securities Exchange market in Ethiopia	East Africa Securities Company	1995
6	Proposal for the Formation of a Share Market in Ethiopia	East Africa Securities company	1999
7	The Addis Ababa Stock Exchange Rules & Regulations Manual-Volumes 1 and 2	Ernst & Young	1999
8	IFC/Conceptor-Mission	Conceptor	2001
9	Capital Market Infrastructure Development	Maxwell Stamp(UK)	2010
10	Market Potential Assessment and Road Map Development for the Establishment of Capital market in Ethiopia	Ruecker	2011
11	Should Ethiopia promote the development of a stock market? lessons from Kenya, Tanzania, Uganda and some transition economies	Solomon Gizaw Kebede	2008
12	Developing securities markets in Ethiopia	Public Financial Enterprises Agency	2012

ANNEX-III: Stock Market Capitalization of African Countries.

Name of country	2010	2011	2012
Botswana	4,075,950,000	4,106,891,988	4,587,518,585
Cote d'Ivoire	7,099,215,729	6,288,000,000	7,828,691,788
Egypt, Arab Rep.	82,494,762,437	48,682,635,301	58,008,000,056
Ethiopia	0	0	0
Ghana	3,531,487,214	3,096,953,399	3,464,538,689
Kenya	14,460,867,410	10,202,603,924	14,790,720,930
Malawi	1,363,072,568	1,384,213,000	753,551,700
Morocco	69,152,529,878	60,088,236,612	52,633,705,236
Namibia	1,176,283,868	1,152,426,487	1,305,046,760
Nigeria	50,882,966,531	39,269,936,739	56,389,263,863
South Africa	635,349,230,978	522,974,990,085	612,308,406,964
Tanzania	1,264,000,000	1,538,748,000	1,803,030,000
Tunisia	10,681,708,314	9,661,719,481	8,886,882,497

Name of country	2010	2011	2012
Uganda	1,787,863,326	7,727,269,981	7,294,133,434
Zambia	2,816,725,382	4,009,000,000	3,003,880,000
Zimbabwe	11,476,483,244	10,902,845,012	11,816,165,408
Sum	897,613,148,889	731,086,472,020	844,873,537,922

Annex IV-A: List of Banks established through sell of shares (paid- in share)

No.	Banks in Ethiopia(Private banks)	No. of Shares sold	Accumulated paid-up capital (in Br.)
1	Awash international bank S.C.	1,394,066	1,394, 066, 531
2	Dashen Bank S.C	1,064,118	1,064,118,000
3	Bank of Abyssina S.C	36,958,856	923,971,393
4	Wegagen Bank S.C	1,341,291	1,341,291,000
5	United Bank S.C	8,982,757	898, 275, 709
6	NIB International Bank S.C.	4,000,000	1,201,027,500
7	Cooperative Bank of Oromia S.C.	6,321,383	632,183,300
8	Lion International Bank S.C.	17,873,330	446,833,287
9	Zemen Bank S.C.	449,575	449,576,000
10	Oromia International Bank S.C.	540,499	540 ,499,430
11	Berhan international Bank S.C.	435,532	435,532,329
12	Bunna International Bank S.C.	<u>4,174,459</u>	<u>417,445,903</u>
13	Abay Bank S.C.	5,770	288,507,143
14	Addis International Bank S.C.	261,644	261, 644, 000
15	Debub Global Bank S.C.	177,271	177,271,425
16	Enat Bank S.C.	261,672	261,671,660
	Total	84,242,223	10,733,914,610

ANNEX: IV- B: List of Insurances established through sell of shares (paid-in-share).

No.	Insurance Company	Number of shares	Accumulated (paid-Shares) in Birr
1	National Insurance Company S.C	45,284	45,284,000
2	Africa Insurance S.C.	66,769	66,769,000
3	Lucy Insurance S.C.	15,529	15,529,0000
4	Oromia International Insurance S.C	25,998	25,998,0000
5	Berhan International Insurance S.C.*	17,442	17,442,457
6	Nile insurance S.C.	100,000	100,000,000
7	Ethio-Life General insurance S.C.	7,500	7,500,000
8	Awash international insurance S.C.	160,000	80,000,000
9	Global Insurance S.C.	86,340	43,170,000
10	Nyala Insurance S.C.	125,000	35,000,000
11	Tsehay Insurance S.C.	29,693	29,693,250
12	United Insurance S.C.*	174,726	174,726,000
13	NIB Insurance S.C*	370,848	185,424,000
14	Lion Insurance S.C. *	2,460,120	61,503,000
15	Abay Insurance S.C. *	263,552	65,888,000
16	Berhan Insurance S.C.*	30,220	30,220,000
17	Bunna Insurance S.C.*	178,510	17,851,000
	Total	4,157,531	1,001,997,707

*As at 31/12/2014

ANNEX-IV-C: List of sample share companies established through sell of shares (paid-in share)

No.	Name of the Share Company	Number of Shares	Paid-up capital (Share paid) in Birr
1	Habesha Cement Factory S.C	746,108	746,108,220
2	Habesha Brewery S.C	549,868	549,868,746
3	Habesha Building Materials and Development S. C.	53,507	53,507,268
4	Raya Brewery factory S.C.	600,000.	600,000,000
	Total	1,949,483	1,949,484,234

ANNEX: IV-D: List of Companies whose shares are sold through CNSC

NO,	Name of Companies	Number	Name of Companies
1	Hiber Sugar S.C	11	Raya Brewery S.C.
2	Alliance Transport Service S.C.	12	Thruway Parents School S.C.
3	Zebidar Multi-industry S.C.	13	Timeret Agro-Industry S.C.
4	Habasha Sugar S.C.	14	Habasha Construction materials and Development S.C.
5	Habasha Brewery S.C.	15	CFI Capital Services S.C.
6	Sogad Resort S.C.	16	Ambo Tower S.C.
7	Silvia Punk rest School S.C.	17	Habasha Cement S.C.
8	Dehub Global bank S.C.	18	Jacaranda Integrated S.C.
9	Hawassa Bank S.C.	19	Ardie International Logistics S.C.
10	Blue Nile Micro Enterprise S.C.		

ANNEX-VII-A: Present Capital of banks.

Name of bank	2012/2013	2013/2014
Commercial Bank of Ethiopia	9,027.0	9,045.0
Construction & Business Bank	465.0	642.1
Development Bank of Ethiopia	2,554.0	2,134.8
Awash International Bank	1,628.0	1,979.3
Dashen Bank	1,493.0	1,994.1
Abyssinia Bank	909.0	1,326.0
Wegagen Bank	1,570.0	1,825.8
United Bank	951.0	1,334.4
Nib International Bank	1,453.0	1,731.3
Cooperative Bank of Oromiya	549.0	739.9
Lion International Bank	415.0	514.3
Oromia International Bank	490.0	594.3
Zemen Bank	400.0	529.1
Buna International Bank	321.0	446.6
Berhan International Bank	340.0	488.7
Abay Bank	300.0	395.0
Addis International Bank	205.0	277.9
Dehub Global Bank	114.0	177.3
Enat Bank	162.0	261.6
Grand Total Banks	22,865.00	25,721.00

*As at 30/06/2014

ANNEX VII- B: Outstanding Deposit of Banks.

Deposits	2012/13	2013/14
Demand	116,143.6	128,788.1
Savings	106,288.6	145,824.3
Time	14,769.2	18235.4
Total	237,201.3	292,847.9

As at 30/06/2014

ANNEX-VII-C: Outstanding Loans and Advances granted by banks.

S.No.	Banks	2012/13	2013/14
1.	Commercial bank of Ethiopia	70,432.3	89,665.2
2	Construction & business bank s.c	1,792.7	2,332.0
3	Development bank of Ethiopia	18,948.5	22,666.8
4	Awash international bank	7737.1	9176.4 5
5	Dashen bank	8836.6	9569.7
6	Bank of Abyssinia	4675.9	5153.5
7	Wegagen bank	4689.9	4604.4
8	United bank	4710.8	5069.6
9	Nib international bank	4542.8	5521.6
10	Cooperative bank of orormia	1941.0	3718.4
11	Lion international bank	1318.1	1562.0
12	Oromia international bank	1621.2	1430.0
13	Zemen bank	1369.7	2551.6
14	Berhan international bank	967.6	1184.4
15	Bunna international bank	948.4	1339.4
16	Abay bank	864.9	1516.7
17	addis international bank	328.0	511.0
18	Dehub global bank	98.5	270.4
19	Enat bank	6.0	511.9
	Grand total	135,829.9 /151,204.0	168,355.1 / 181,327.4

As at 30/06/2014

ANNEX-VII-D: Present Capital of Insurance Companies

	Capital	(2012/2013) In millions of Birr	2013/2014
1.	Ethiopian Ins. Cor.	376.00	434.4
2	Awash Ins.Com.S.C	145.7	182.9
3	Africa Ins.Com S.C	106.5	134.9
4	National Ins. Co. of Eth.	54.9	72.6
5	United Ins.Com. S.C	88.9	203.1
6	Global Ins. Com.S.C	44.2	6.1
7	Nile Ins.Com.S.C	158.9	182.00
8	NyalaIns.Com.S.C	163.0	206.3
9	Nib Ins. Com.S.C	151.8	207.3
10	Lion Ins. Com.S.C	52.7	83.4
11	Ethio-Life Ins.Com.S.c	25.9	20.3
12	Oromia Ins.Com.S.c	76.6	119.2
13	Abay Insurance Company S.C	12.1	48.5
14	Berhan insurance S.C	15.5	22.4
15	Tsehay Insurance S.C	7.9	24.3
16	Lucy INSURANCE COMPANY	8.4	16.8
17	Bunna Insurance S.C	0.00	8.6
18	Total	2,034.1	1,113

As at 30/06/2014 (NBE)

ANNEX-VII-E: Capital, Deposits and Credit of Microfinance Institutions

	2012/13	2013/14	% change
Total capital	4,536,577.6	5,652,005.7	24.6
Saving	7,611,397.0	11,784,059.6	54.8
Credit	12,781,816.6	16,855,556.8	31.9

As at 30/06/2014

ANNEX VIII: Check Lists - Discussions with Target Organizations

The checklists are prepared for each target organizations (listed from 1 to 8), based on area of involvement subject to directly or indirectly interrelated to establish stock market.

1. Government commitment

- Rewarding and appropriate economic policies and monetary policy
- Establish legal and/or regulatory infrastructure to establish a capital market
- Establishing financial services authority (*responsible for capital market regulation, assuring market confidence, financial stability, consumer protection and the reduction of financial crime*).
- Strategy for the establishment of capital markets
- Corporate governance /information disclosure, transparency/
- Law that permit social security funds to invest in productive enterprises
- Credit rating and credit rating institution
- Tax incentives for security market participants

2. Macroeconomic conditions,

- Country economic conditions of the country
- Inflation rates in the past consecutive years
- Economic growth
- Existing exchange rates.
- Current GDP growth
- Current unemployment rate
- Current human resource development
- GTP I implementation and GTP II projections

3. Financial sector Development

- Financial and non-financial sector development
- Capital base and liquidity of banks to provide long-term loans and settle debts, appropriate branch net-work, efficient in service delivery, different financing products, inter-bank lending, use efficient technology to provide services, efficient and experienced staffs

- Long-term financing sources: NBE, Commercial Banks, Insurances, Pension Institutions
 - Banking service products, outreach and money markets instruments
 - Current market conditions (share and bond market)
 - level of saving and financial literacy
4. Corruption and Transparency
- Preparation and presentation of annual accounting report of public companies
 - Level of corruption
 - Areas of corruptions in the country.
 - Existing anti-corruption laws
5. Business Environment
- Business Environment in Ethiopia: (*start business, employing workers, enforcing contracts, registering property, getting credit, protecting investors, paying taxes, closing business and good governance*)
 - Forms of business organizations established in Ethiopia
 - Foreign investors interest in Ethiopia
 - Ownership of business enterprises
 - Availability of credits and foreign exchange
6. Legal and regulatory infrastructure
- The regulator and securities enforcement
 - Accounting, auditing and reporting standards of Ethiopia vs. International Standard
 - Acquisition , Merger, Bankruptcy and Insolvency laws
 - Legal System that protect investors' and stakeholder' interest in share trading
 - Arbitration, Litigation and Negotiation of cases
 - Arbitration, Litigation and Negotiation of cases.
 - Dispute settlement among investors
 - standards for accounting and auditing profession and Code of Profession
 - Accounting, auditing and reporting standards of Ethiopia vs. International Standard
7. Infrastructure development
- Infrastructural development of the country(road, transport, water and light)

- State-of-art communication network facilitates networking
 - Electronic trading and settlement infrastructure
 - Real-time availability of market information.
 - Area coverage (net work capacity)
8. Current market conditions.
- Stock market in Ethiopia
 - tax incentives for security market participants
 - Initial Public Offerings (IPOs) promoters
 - Potential key actors for the establishment of a stock market
 - Bond/stock market investors: pension funds and insurance companies