

**The dynamics of market
integration: African stock
exchanges in the new
millennium**

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For my parents

About the author

Before joining the World Bank, Dr. Kenneth Kaoma Mwenda served as a full-time law lecturer at a top UK law school, the University of Warwick. A Rhodes Scholar, Dr. Mwenda holds doctorate degrees in law and business administration, respectively, and is a graduate of, *inter alia*, the Universities of Oxford, Warwick, Hull and Zambia. Dr. Mwenda has worked in three different continents. He has also been recipient of a prestigious fellowship from Yale Law School and has taught law in the University of Zambia. Dr. Mwenda's works appear in leading academic and professional journals worldwide. He is author of four other books on banking law and corporate finance law, and is listed in the following prestigious biographical publications: International Who's Who of Professionals, the 1999 and 2000 directories; and Marquis Who's Who in the World, the 2000 directory.

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Preface

This book looks at contemporary issues facing financial markets in Eastern and Southern Africa. The book addresses strategies for capital market integration and development on a region-wide basis. An argument is made that the establishment of a regional stock exchange and the promotion of multiple listings and cross-border trade in securities would stimulate increased liquidity on national stock exchanges in Eastern and Southern Africa. Lessons of experience are drawn from other regions and a case is made against transplanting models of a regional stock exchange from one region to another. The book argues that African countries may, however, use lessons of experience from other regions as points of reference, while pursuing their own discourse of self-determination. Each case is unique and is thus surrounded by different variables. The book covers developments in regions such as the European Union, francophone West Africa and Eastern and Southern Africa. Indeed, an international and comparative perspective is provided. The interpretations and conclusions expressed in the book are entirely those of the author. They do not necessarily represent the views of the World Bank, its executive directors, or the countries they represent.

The law is stated on the basis of materials available to me as at August 11, 2000.

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Chapter 1

Introduction

This book examines the question of whether the legal framework for public distribution of securities in Zambia, adopted in 1993, has facilitated the development of a competitive stock exchange.¹ Based on a six years study of African stock markets, the book is a sequel to the author's earlier works on Africa's emerging stock markets.²

¹ No attempt is made in the book to look at futures and options markets. Such a discussion falls outside the scope of this work.

² See for example some of the works cited in this book. See also K.K. Mwenda, *An Analysis of Corporate Finance in Emerging Markets in Africa*, [published] Occasional Paper No. 13, Spring 2000, Center for Advanced Study in International Development (CASID), Michigan State University, Lansing, Michigan, USA; K.K. Mwenda, *Regulation of Foreign Direct Investment in Zambia*, [published] Occasional Paper No. 14, Spring 2000, Center for Advanced Study in International Development (CASID), Michigan State University, Lansing, Michigan, USA; K.K. Mwenda, "Multiple Listings And The Setting Up Of A Regional Stock Exchange As Means to Stimulating Increased Liquidity On Stock Markets In Eastern and Southern Africa," unpublished seminar paper, Michigan State University, African Studies Centre, Lansing, Michigan, USA, 17th November 1999; and K.K. Mwenda, "Theoretical Issues

Closely related to arguments in this book is evidence I have presented elsewhere³ on the market capitalisation and market performance of a number of African stock exchanges. In that study, and in related works too, I have demonstrated how constraints such as inadequate liquidity and poorly drafted legislation have affected the growth of African stock markets.⁴ The analysis in the said works will not be repeated here. Suffice it to say, in the present work the primary objective is to set out a legal and policy framework for addressing some of these constraints. In so doing, some proposals are set out on how Africa's emerging markets can strategi-

Underpinning Corporate Finance Law In Emerging Markets: A Case For The Attractiveness of Emerging Stock Markets," unpublished seminar paper, Michigan State University, Centre for Advanced Study of International Development, Lansing, Michigan, USA, 18th November 1999.

³ See K.K. Mwenda, *Contemporary Issues in Corporate Finance and Investment Law*, (Washington DC: Penn Press, 2000), pp. 86-147.

⁴ See K.K. Mwenda, *Legal Aspects of Corporate Capital and Finance*, (Washington DC: Penn Press, 1999), pp. 102-156. See also K.K. Mwenda and G.N. Muuka, "Prospects and Constraints To Capital Markets Integration In Eastern and Southern Africa," *Journal of African Business*, Vol. 2, No. 1, 1999; K.K. Mwenda, "Securities Regulation and Emerging Markets: Legal and Institutional Issues for Southern and Eastern Africa," *Murdoch University Electronic Journal of Law*, Vol. 7, No. 1, March 2000, at the following web page: <<<http://www.murdoch.edu.au/elaw/issues/v7n1/mwenda71nf.html>>>

cally position themselves in order to stimulate increased liquidity. The correlation between the efficacy of the legal framework and the development of a stock exchange cannot be over-looked. Taking Zambia as an example, I have argued below that the legal framework for public distribution of securities has not provided adequate incentives to stimulate increased liquidity and market development of the Lusaka Stock Exchange.⁵ To overcome such constraints, it is proposed that a regional stock exchange must be set up in Eastern and Southern Africa. The setting up of the regional exchange should be complemented by the promotion of multiple listings and cross-border trade in securities.

In general, the legal framework for public distribution of securities in Zambia consists of various levels at which securities regulation is conducted. These levels, which constitute the backbone of the regulatory framework,⁶ comprise the following:

⁵ See also K.K. Mwenda, *Zambia's Stock Exchange And Privatisation Programme: Corporate Finance Law in Emerging Markets*, (forthcoming, 2001).

⁶ A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," *Virginia Journal of International Law*, 39 (1999), 607, at pp. 613-614, observes that the legal framework that governs securities activities in a country plays an important role in determining the efficiency of that capital market. A. Guzman, *Ibid.*, pp. 613-614, argues that: "A disclosure based regime, for example, is designed to solve the asymmetric information problem that exists between an issuer and potential investors. In other words, the issuer and its insiders know the value of the security better than

- (i) the role of the Securities and Exchange Commission as the competent authority for authorising the conduct of securities business and trade in Zambia;⁷
- (ii) the power of the Minister to close down a stock exchange;⁸
- (iii) the role of the Securities and Exchange Commission in scrutinising applications for the registration of securities;⁹
- (iv) the role of the Securities and Exchange Commission in regulating financial intermediaries, such as securities dealers, brokers and collective investment schemes;¹⁰
- (v) the role of the Securities and Exchange Commission, in collaboration with the Lusaka Stock Exchange, in identifying and prosecuting market abusers such as insider dealers;¹¹

other investors. The issuer has an incentive to disclose some of the inside information it possess in order to increase the price investors will be willing to pay. The issuer and insiders, however, may have only a limited incentive to release information and may, as a result, release too little. On the other hand, a regulatory regime that demands too much disclosure may impose costs on issuers that exceed the value of the disclosure. If there is too little disclosure in the market, investors will take this into account and reduce the cost of issuing securities. In either case, the disclosure dilemma will increase the cost of capital in the market. As a result, investors will overlook some of the valuable projects and seek other vehicles for their funds.”

⁷ See generally Part II of the Securities Act 1993.

⁸ Securities Act 1993, sec. 12(1).

⁹ See generally Part II of the Securities Act 1993. See also Securities (Registration of Securities) Rules 1993.

¹⁰ See generally Part II of the Securities Act 1993.

¹¹ See *Ibid.*

- (vi) the role of the Lusaka Stock Exchange in vetting of information in securities advertisements, prospectuses, and listing particulars;¹²
- (vii) the role of the Lusaka Stock Exchange's central depository system, plus that of a prompt and timely deal settlement system;¹³ and
- (viii) the role of the Lusaka Stock Exchange in listing and de-listing securities.¹⁴

Generally, there are a number of constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. Among the constraints, the issue of inadequate liquidity and that of poorly drafted statutory provisions are prominent.¹⁵ The conclusion reached in this work is that the legal framework has not provided adequate incentives to stimulate increased liquidity and market development of the Lusaka Stock Exchange.¹⁶ Supporting the above argument are a number of material facts. As explained below, the main reason behind this view is that the Lusaka Stock Exchange and the regulatory framework for public distribution of securities in Zambia were designed primarily to facilitate the privatisation of state owned enterprises. In setting up the exchange and establishing the regulatory framework, other interests in

¹² See *Ibid.*

¹³ See *Ibid.*

¹⁴ See *Ibid.* See also generally Lusaka Stock Exchange Listing Rules 1993; and Securities (Transitional) Rules 1993 r.3(2).

¹⁵ As evidenced by results of a 1996/97 field study, conducted by this author, in Zambia.

¹⁶ *Ibid.*

the market, such as those that do not relate to privatisation, were not a determinant variable. This feature explains why other market interests were not provided with the same incentives as the privatisation programme.¹⁷ Guzman observes:

“In order to attract capital, it is necessary to have a set of substantive legal rules in place that meets a set of clear, well functioning, and reliable securities laws. These rules can take many forms. Indeed, in some markets, the best set of rules may allow parties to define their own obligations through contract.¹⁸ Such rules must not only be clear and predictable, the interested parties must also perceive that the rules are stable over time. Rules that are expected to change with each new government or with each crisis offer no comfort to would-be issuers and investors.”¹⁹

¹⁷ Ibid.

¹⁸ Cf. Coase theorem. For an elaborate discussion on the Coase theorem, see S. G. Medema, *The Coase Theorem*, Working Paper, (Denver, Colorado: CRESPP, Center for Research on Economic and Social Policy, University of Colorado at Denver, 1995); I. R. Segal, *Contracting with externalities*, Working Paper, (Berkeley, California: University of California at Berkeley, Dept. of Economics, 1997); and P.V. Goldberg, *The Coase Theorem and some puzzles on the tort/contract boundary*, Working Paper, (New York, N.Y: Center for Law and Economic Studies, Columbia University School of Law, 1995).

¹⁹ A. Guzman, “Capital Market Regulation in Developing Countries: A Proposal,” *op. cit.*, p. 618.

In Zambia, the highest priority of the government on the privatisation of state owned enterprise underpins the idea of setting up the legal framework for public distribution of securities in Zambia. Indeed, shortcomings such as inadequate liquidity and poorly drafted statutory provisions serve only to support the view that the Lusaka Stock Exchange and the regulatory framework were hurriedly set up to deal with the privatisation programme.²⁰ But then, as it transpired later not all securities in state owned enterprises were off-loaded on the Lusaka Stock Exchange.²¹ In addition, the absence of a well articulated and pro-active strategy to deal with post-privatisation investments on the Lusaka Stock Exchange is another factor contributing to the underdeveloped state of the Lusaka Stock Exchange.²² To overcome such problems, this work proposes that a regional stock exchange could be set up in Eastern and Southern Africa. The setting up of the regional exchange should be complemented by the promotion of multiple listings and cross-border trade in securities.

This work is divided into five main chapters. The second chapter explains the context in which the performance of the Lusaka Stock Exchange, its background and operations may be understood. Research findings on the performance of the exchange are analysed. The third chapter exam-

²⁰ As evidenced by results of a 1996/97 field study, conducted by this author, in Zambia.

²¹ Ibid.

²² Ibid.