

Can Ethiopia's Capital Market Deliver Wealth for the Masses?



The formal capital market holds the potential to bridge the financing needs of businesses that are facing difficulties in accessing bank loans. However, addressing challenges such as capacity building, legal frameworks, and trust issues is crucial.



Despite Ethiopia's vast size and potential, the penetration of bank loans remains woefully limited, with only approximately 0.3% of the population having availed themselves of this

financial resource. For a nation boasting a population of over 105 million and ranking as the 59th largest economy in the world by nominal GDP, the underperformance of banks in driving economic growth and fostering financial inclusion raises a pertinent question: What truly drives Ethiopia's economy and shapes its unique economic landscape?

To ensure effective and meaningful efforts in addressing this disparity, several key factors must be considered. These encompass the vibrant informal economy, the pivotal role of agriculture, the impact of remittances, and the strategic



investments made by the government. Taking these factors into account will enable any plan, intervention, or effort to avoid reproducing the limited impact observed in the banking sector and to genuinely contribute to bridging the economic gap in Ethiopia.

The introduction of capital markets in Ethiopia holds the promise of addressing this gap. The government has made significant strides in establishing these markets, starting with the Capital Markets Proclamation (No. 1248/2021) enacted by the House of Peoples Representatives on June 10, 2021. Previous efforts, such as the "Addis Ababa Share Dealing Group" during the Imperial period, had minimal impact and were eventually dismantled. However, the establishment of a formal capital market has been a recurring subject of discussion, underscoring the importance of creating a regulated and thriving market in Ethiopia.

Capital markets play a vital role in economies worldwide, acting as engines of economic growth and facilitating capital mobilization. Developed countries like the United States, United Kingdom, Japan, and Germany have strictly regulated stock markets that drive investment, innovation, and job creation. Across the African continent, capital markets have also played a pivotal role in driving economic growth and development, as seen in nations like Nigeria, South Africa, and Kenya, where vibrant markets have substantially contributed to their economies.

The introduction of the Ethiopian capital market evokes the anticipation reminiscent of 1994 when the local private sector first accessed the banking sector. Nonetheless, past experiences underscore the imperative to ensure the successful realization of the promised advancements in access to finance. As Hernando de Soto eloquently stated in his book [The Mystery of Capital](#), the

effectiveness of capitalism and its instruments is often evident in the West but faces challenges elsewhere, Ethiopia included.

The Rise of Shareholding Culture: Lessons from the Banking Sector

Since 1994, Ethiopia's shareholding and exchanging culture have witnessed significant participation, particularly in private banks leading the market. Their suitability for the share company approach, as distinct from the family-owned or solely operated businesses prevalent in Ethiopia, sets them apart. Pioneering banks like Awash International Bank, Dashen Bank, Bank of Abyssinia, and others have amassed considerable numbers of shareholders.

Recent developments demonstrate growing enthusiasm for share ownership, with successful share sales by banks like Ahadu Bank, Amhara Bank, Gadaa Bank, and Tsedey Bank, attracting thousands of shareholders. Additionally, the Ethiopian banking sector is poised for further growth with the expected entry of foreign banks. This surge in shareholder numbers reflects the increasing interest and engagement of Ethiopians in shareholding and trading activities, highlighting a thriving share market with potential for further expansion.

Currently, the exchange of shares among individuals occurs informally, often at prices higher than the original share price.

This informal market is facilitated by 'online brokers' who provide investment advice and set varying percentages, some as high as 60% for different banks.

The emergence of a share market with such potential has captured the curiosity of private companies, especially those in the lucrative real estate sector, offering enticing returns to shareholders within a reasonable timeframe. The introduction of the Capital Market serves as a catalyst to formalize, regulate, and secure this emerging market, ensuring the safety and interests of investors, companies, and the government.

Currently, the exchange of shares among individuals occurs informally, often at prices higher than the original share price. This informal market is facilitated by 'online brokers' who provide investment advice and set varying percentages, some as high as 60% for different banks.

Offers of the Capital Market: Opportunities and Challenges for Private Companies

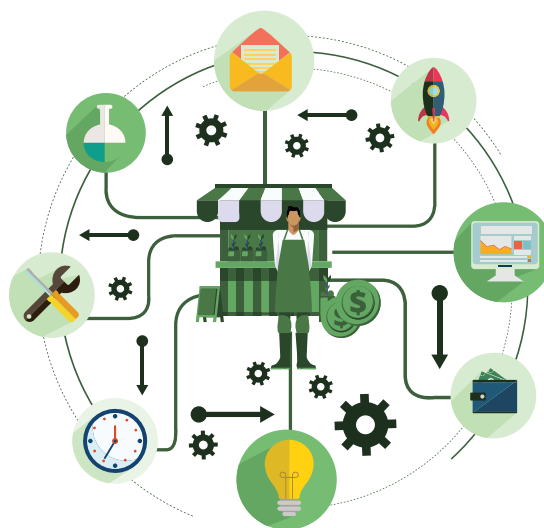


For private companies, the capital market presents an attractive alternative avenue for accessing capital, distinct from traditional banking channels. However, many private sector companies, including Micro, Small, and Medium Enterprises (MSMEs), have yet to fully embrace the vast opportunities that this new frontier offers. This reluctance is compounded by the double-edged task faced by MSMEs, navigating both risks and opportunities in their pursuit of growth and financial stability.

Shifting the perception of institutional and retail investors is a primary hurdle. Emphasizing that MSMEs listed on exchanges are as reliable as banks or conglomerates is crucial, instilling

confidence that they can yield positive outcomes. Furthermore, it is essential to dispel the misconception that establishing a share company equates to loss of control, encouraging entrepreneurs and business owners to seize this opportunity.

While addressing these challenges, it is imperative to ensure that **MSMEs are equipped with the knowledge, skills, and resources** to thrive in the capital market. Capacity building initiatives, comprehensive training programs, mentorship opportunities, and access to financial expertise will enable them to compete effectively alongside larger entities.



A robust **legal framework and regulations** are equally vital to ensure fair practices, protect investor interests, and promote transparency. Such measures will foster trust and confidence among investors, encouraging their active engagement and contribution to market growth.



ESX's holistic and integrated approach

In light of the workshop held on July 6, 2023, which involved the Economic Commission for Africa (ECA), Ethiopian Investment Holdings (EIH), Ethiopian Securities Exchange (ESX), and FSD Africa, the significance of the ESX in Ethiopia's capital market development was emphasized. The ESX's adoption of a state-of-

the-art electronic trading platform and an innovative alternative market for SMEs showcased promising strides.

To foster the robust growth of MSMEs, an integrated approach is paramount to ensure inclusion and sustainability within the mainstream capital market. A cohesive and inclusive ecosystem should be established to provide equal opportunities for all market participants, regardless of their size or stage of development. This can be achieved through promoting collaboration, knowledge-sharing, and equal opportunities, thus ensuring that the true potential of the securities exchange is unlocked, contributing to Ethiopia's socio-economic development and prosperity.

In conclusion, addressing capacity building, legal structures, and trust is essential for the success of the securities exchange in Ethiopia. By nurturing an environment of inclusivity, trust, and fair competition, the capital market can empower MSMEs and contribute to the overall vibrancy and prosperity of Ethiopia's economy. Embracing inclusive economic policies and recognizing the need to capacitate MSMEs will serve as catalysts for sustainable development and shared prosperity. Developing countries, Ethiopia included, must confront these challenges head-on to unlock the true potential of their economies and create a more equitable distribution of economic benefits.

ACE Insight – WHAT'S NEXT?

To capitalize on the opportunity and potential of capital market to deliver through MSMEs, it becomes essential to look into the following key aspects.

1. Prioritizing Support and Capacity Building Initiatives

Equipping all market participants, particularly SMEs, with the necessary knowledge, skills, and resources to thrive in the capital market is crucial. This can be accomplished through comprehensive **training programs, mentorship opportunities, investment readiness incubation and access to financial expertise**. By empowering SMEs and enhancing their capabilities, they can effectively compete alongside larger entities.

2. Establishing Robust Legal Frameworks and Regulations

Ensuring fair practices, **protecting investor interests**, and promoting transparency within the market are essential. These legal structures should emphasize accountability, discourage fraudulent activities, safeguard investor interests, maintain market integrity and provide a level playing field for all participants. By strengthening the foundations of the securities exchange, instilling transparent reporting standards and effective enforcement mechanisms, trust and confidence among investors can be fostered, encouraging their active engagement and contribution to market growth.

3. Integrating ESG considerations

Ethical and sustainable investing (ESG considerations) has gained prominence globally, with investors increasingly seeking companies that prioritize environmental, social, and governance (ESG) practices. Ethiopia can align its capital market development with sustainability principles, encouraging companies to adopt responsible business practices and rewarding them with increased investor interest. By **integrating ESG considerations** into its capital market, Ethiopia can attract socially responsible investors and contribute to long-term sustainable development.

4. Addressing Inherent Trust Issues through Financial Literacy and Public Awareness

Addressing inherent trust issues within the capital market through **financial literacy and public awareness** is paramount. The perception of an exclusive market for MSMEs risks perpetuating disparities and hindering their growth potential. Instead, fostering an integrated and inclusive ecosystem that bridges the gap between MSMEs and larger entities is essential. Successful capital markets have emphasized public awareness campaigns and financial literacy programs. This can be achieved through promoting collaboration, knowledge-sharing and information dissemination, educational initiatives. By creating a dynamic market with well-informed players will benefit all stakeholders, mitigate wealth concentration, and realize the full potential of MSMEs.

In conclusion, the success of the securities exchange in Ethiopia and the broader global south hinges on our collective efforts to confront capacity building, legal structures, and trust issues. While recognizing the importance of supporting MSMEs, it is imperative to strive for an inclusive capital market that empowers MSMEs, addresses disparities, and ensures shared prosperity. By adopting a holistic and integrated approach, the true potential of the securities exchange can be unlocked, contributing to the socio-economic development of Ethiopia and the global south as a whole.

Final Words: Empowering MSMEs for Inclusive Economic Growth

Developing countries face significant challenges in fostering economic prosperity for ordinary people. The presence of

informal and localized ownership structures, coupled with obsolete and inaccessible legal systems, hampers individuals' ability to monetize their ideas and fully participate in the formal economy. This exclusion perpetuates a cycle where wealth creation remains limited, and the benefits of economic growth primarily circulate among established entities. Ethiopia's history of limited loan uptake by its citizens exemplifies this issue. And we need to avoid a repeat.

To overcome these challenges, it is crucial to identify and rectify the shortcomings in legal structures, streamline administrative procedures, and ensure that every MSME is capacitated, recognized, easily traceable, and held accountable. By doing so, individuals will have the confidence to buy shares of these MSMEs and engage in entrepreneurial activities themselves.

This transformation can lead to broader wealth creation, improved livelihoods, and a more equitable distribution of economic benefits. Embracing inclusive economic policies, recognizing the need for capacity building of MSMEs, and establishing trustworthy information systems that enable the swift enforcement of laws will serve as catalysts for long-term sustainable development and prosperity.