PROBLEMS AND PROSPECTS FOR THE EMERGENCE OF A STOCK MARKET IN ETHIOPIA

Abu Girma

1. INTRODUCTION

The Ethiopian economy has recorded steadily deteriorating performance over the past two decades. Among the explanatory factors advanced, the adoption of distorted economic policy and economic management stand out as central. Economic policy was designed to grant an exclusive priority to the public sector in terms of ownership, production and employment of resources. This has resulted in a weak and marginalized private sector and a level of economic growth and development far below the country’s considerable potential. Thus the current change in approach and economic reform measures are long overdue.

Although the key policy orientation is to institute a market economy, the state has an essential role in setting appropriate economic policies and in facilitating the development of market institutions as well. Ethiopia’s new approach is, in fact, part of the larger trend in development thinking and policy orientation recently observed in Africa, Latin America and Eastern Europe. This shift is clearly toward a restricted government role in economic activities and toward the promotion of the private sector; however, shrinking the public sector is not an objective in and of itself. Rather, a properly organized and efficient public sector which can actively promote the private sector and bridge the gap between the actual capacity of that sector and the resource requirements for investment and economic growth is necessary (World Bank, 1991:131). Thus the issue becomes in essence what the optimal size and role of the reformed public sector should be to create a conducive environment for economic development (Israel, 1990:3). It is therefore the quality not the size of the state in economic affairs that matters.

One of the areas in which the realization of private sector’s potential requires policy reform is the financial sector. Without an efficient financial system the improvement in resource mobilization and its efficient allocation towards economically viable investment can be only partial. Most developing nations, including Ethiopia, have undermined the growth of the financial sector by controlling interest rates, directing credit to priority areas regardless of their economic viability, and securing inexpensive funding that is biased for the public sector alone (World Bank, 1989: 4; TGE, 1992a: 5). The objective of financial liberalization in the reforming economies is thus to eliminate this distortion within the general framework of macroeconomic adjustment.

In order to spur a market economy and unleash private productive potential, the Transitional Government of Ethiopia has launched an economic reform programme. Within the framework of the new approach to economic management, three interrelated measures that are intended to stabilize, reform and restructure the Ethiopian economy have been announced, and some of these measures have already been taken (TGE, 1992b: 3). Creation of an enabling environment requires the implementation of policies favouring market activity, including investment...
incentives, the development of physical infrastructure and market institutions, and measures to ensure macroeconomic stability. This would open the opportunity for the 'birth' of a strong private sector and the achievement of faster economic growth and development. The structural reform measures which began to lay the legal, institutional and regulatory groundwork were taken with the issuance of Investment, Credit and Interest rate, Exchange rate, Public Enterprise and Tax Codes (TGE, 1992b: p.3-5; annex). Measures related to the privatization of public enterprises and the revision of the Commercial Code are now being undertaken as well.

This paper investigates the economic rationale and options for the emergence of a stock market in Ethiopia in light of this general policy framework. In the first section, it will discuss the economic rationale for share market development. The next section concentrates on the operation of the infant share market in Ethiopia in the 1960s until it ceased operation in 1975. In section three, the specific problems and possible options for not only reincarnating Ethiopia's former stock exchange, but also paving the way for a larger, more active stock market will be examined. In the last section, some conclusions and recommendations are set forth.

2. THE RATIONALE FOR SHARE MARKETS

The achievement of sustainable economic growth demands, among other factors, considerable resources for investment and the efficient utilization of those resources. These may be generated either domestically or externally. The domestic side can be broken into two components: the public and the private sectors. Experience reveals that the public sector alone could hardly be able to generate revenues and distribute resources in an efficient way, and therefore can't finance these resource requirements by itself. External sources of funding are also problematic and cannot be channelled without domestic institutions, and are limited in size and scope. Thus the active involvement of the domestic private sector in saving and investment is critical to achieving desired levels of economic growth.

For this, not only are favourable economic policies needed, but actual institutional capacity must also be developed in order to overcome the obstacles to the generation and flow of investible resources. The mobilization of economic resources from various economic agents is a problem general to developing countries, and in fact one of their main challenges. In most cases, there is a persistent gap between the actual monetary saving and the targeted investment requirements of these countries. This phenomenal investment gap has only increased in recent years, ultimately leading many to resort to external borrowing.

Ethiopia is not an exception to this general picture of the developing countries. The problem of resource mobilization in the Ethiopian economy is at least as serious as that of most other developing countries. The level of national saving is far below the domestic investment requirement, so the system has been compelled to resort to external borrowing particularly to
finance large development projects. The details of this serious and long-standing situation are depicted in Annex I. This table also points out the need for specific adjustment measures to redress this growing gap. In this respect a strong mechanism for the efficient mobilisation of resources should be put in place so as to channel resources from disparate sources toward the investment levels required to a sustainable economic growth.

In the face of this critical disparity, most developing countries probably have actual saving rates far below their socially optimal rates (Baran, 1976: 132-134). One reason for this is undoubtedly the lack of effective and efficient institutions for attracting savings and directing investible resources to their most profitable use. The existence of such institutions could, in theory at least, boost saving and investment levels by increasing the return on small investments, thus altering agents' current consumption-future consumption decision. That is, if postponing current consumption could mean much higher wealth and consumption in the future, many may opt to postpone consumption of a larger share of their current wealth, and save and invest more of their current income.

In encouraging agents to raise their savings and investment rates, however, a stable and sound policy environment and the existence of effective institutions for channelling these resources is crucial. This is most likely to be realised through the private financial sector. The problem of bridging the gap between the saving potential and investment requirements is a long-standing and persistent one for developing countries and requires countervailing measures. Encouraging potential savers for higher monetary saving demands improving the relative attractiveness of this opportunity. For instance, this include conditions which favour subsistence production and discourage market exchange as well as non-monetary forms of saving like real estates, livestock investment, construction and the like. The most beneficial decisions for vast sectors of the population are also conditions which tend to reproduce themselves, resulting in low monetary savings rates. In particular, weak productivity levels, slow technological advancement, low levels of real income and demand, and an unreliable policy environment are part of this vicious circle. They also make a shift to alternative forms of saving and investment unlikely without deliberate and well-conceived countervailing measures. In particular, boosting monetary saving, which can be channeled into viable investment opportunities, will require new financial institutions and a great deal of confidence in those institutions. One form of financial intermediation which could be highly effective, given the right institutional design and economic environment, is a stock market. There is a recent discussion in policy making circles in Ethiopia which involves the establishment of a reliable capital market in the system through different options.

If the country is successful in building the institutions necessary for facilitating efficient resource allocation and in inspiring investors confidence in such an exchange, investible funds could be thereby mobilized from both domestic and external sources. However, there are a number of major economic and political challenges to be confronted before this is possible.
Problems and Prospects of Private Sector Development

Most of the reforming nations have taken a number of policy measures towards the improvement of their financial policies and sectors as part of their economic adjustment programmes. However, these measures have not been accompanied by a significant recovery in the level of private saving and investment. If these policies, which can facilitate the operation of the sector, are not designed and put in place, it may lead to inefficient mobilization and allocation of resources (Watson, 1993, p.5; Fitzgerald, 1993, p.1). First of all the private sector would show recovery in these areas if and only if there is an enabling policy environment conducive for their active operation.

In fact, liberalization of the financial sector without proper mechanisms for allocation can lead to a smaller change in savings behaviour than a country’s potential. This may lead to a possible misallocation of economic resources because the liberalization of other variables like interest, credit, prices, and the like in the system adversely affects the purchasing power of economic agents in the immediate run. The question of private sector’s saving and investment recovery would be possible only after prices get right. If so, liberalizing the financial sector without the accompanying measures in the rest of the economy would cost the system.

Ethiopia’s recently issued economic reform measures are intended to open the way for the emergence of a conducive environment for private sector development and new forms of business organizations. Among the new options and forms for business organization is the corporation. One obvious advantage of the corporation, of which there can be many owners and where the risk, or liability, of these owners is limited to their initial capital, is the possibility of raising a considerable amount of capital from a wide range of sources.

The corporation is one of the most common organizational forms in most of the advanced economies. It has, in contrast, a very insignificant role in most of the underdeveloped economies, in particular where the degree of monetization as well as the growth of the financial sector are evidently very weak. Yet the advantages of developing some form of stock market in the less developed economies has, in fact, begun to attract the attention of policy makers. This is reflected in the policies of the reforming economies (World Bank, 1989).

It is recognized that the existence of an active share market is important to the smooth operation of share companies. Where stock exchanges thrive, they are integral parts of these national economies. Indeed, the stock market is considered to be the nerve center of economic decision making process and finance and the barometer of the prosperity and adversity of an economic system. It is the catalyst by which the long-term savings of the economy can be converted into physical and other productive assets.

The growth of the corporate organization in Ethiopia would serve as a lever in the effort for the development of the private sector. However, without an active and efficient securities market, corporations will have only a modest impact.
Abu Girnu: Prospects of Stock Market

The stock exchange can be important to corporate -- and therefore economic -- health and viability for a variety of reasons. Its main function is, of course, to serve as the nexus between disparate sources of saving and various investment outlets in the economy. In so doing, it provides a market place for the purchase and sale of securities, and the opportunity for constantly adjusting signals of corporate value and prospects as well as the economy's health. An active stock market primarily benefits the companies themselves by supplying readily large amounts of capital, and the assurance that if their own management and prospects are good, they will face a less stringent capital constraint. In theory, then, corporations would invest up to the optimal level, and funds would be allocated more in line with efficiency considerations throughout the system. Moreover, the advantages to investors of tradeable securities usually translate into a lower cost of capital to the corporation itself.

Thus one major attraction of a stock market to potential holders of securities is that stocks are reasonably liquid (Khan, 1982:234-5). That is, no investment is completely irreversible, and investors would be more likely to assume corporate risk.

The functions of providing liquidity and signalling overall investor confidence would thus allow the stock exchange to act as a barometer of the national economy and of the prospects of various corporations themselves. It is in fact the need for these functions, which is at the root of the goal to promote such exchanges.

Of course, the extent of real transferability and liquidity of shares would depend on the capacity of the market to absorb a fairly large volume of shares within a certain time span and price. That is, if a large investor wishes to disinvest quickly, then the price of those shares is most likely to fall. In an active share market with diverse shareholders, these holders could convert their shares into cash easily and quickly thereby reducing the uncertainty and difficulty of holding shares. An additional advantage is that the transferability of shares makes them a convenient form of collateral for borrowing from financial institutions. In this manner, an active market increases the attractiveness of investment in corporate forms of business organizations with fairly convertible assets for economic agents.

The emergence of this important type of market and its ongoing development, however, would require corresponding policy measures which would encourage private sector risk taking and entrepreneurial decision-making. Thus economic, political and social variables are intricately linked to the evolution of this type of enterprise and hence market.

Share-markets and companies especially in the earlier stage of their life have usually been viewed with scepticism, when actually a leap of faith is required. These are obstacles to the development of public confidence in share investment and hence in share markets which ultimately limit their ability to solve the problem of under-capacity operation in the economy. The development of stock exchanges in economies like that of Ethiopia would face a number of challenges which include: the new and unknown nature of the market, the low level of real
income and savings capacity, the impersonal links between the shareholders and the management, the tradition of secrecy in business, the weak level of accounting practice and hence reporting of the operation of these enterprises, the need for many agents to participate in order for advantages to investors to be realized, and of course the unpredictable nature of economic policy and commercial law in these countries.

The emergence of share companies and markets then require the existence of the physical and policy environment and the education of the potential investing community about the operation of these enterprises. This is very important because the system of corporate financing and investment is information intensive in most cases. It is therefore based on the accomplishment of this challenging task on the side of the policy makers and the business community that the emergence of and hence the benefits thereof could be exploited towards faster economic growth and development.

3. SHARE MARKET OPERATION: 1965-1975

If buttressed by sound financial policies, a well-functioning share market could greatly assist in mobilizing resources for economically viable investment projects, especially large and capital intensive projects where more than a few investors are required. Of course, the development of an effective share market would require implementing a number of interrelated policies on the side of the government. To understand the interplay between various policies and its potential reincarnation, it is instructive to highlight the experience of Ethiopia’s former, now defunct share market.

Stock market in Ethiopia is a recent and short-lived phenomenon, which began in the early 1960s and ceased operation with the nationalisation measures of 1975 by the Dergue regime.

The legal framework for the development of corporate forms of business organisation in Ethiopia was provided with the issuance of the Commercial Code of Ethiopia 1960 (IGE, 1960). This document set out the basic requirements for the establishment of share markets in the system. It also describes the areas of business activities in which share companies could be formed.

Most new share companies in Ethiopia at that time were financed by both private and the public sector purchase of shares. Government agencies, constituting the largest domestic investors, held shares in most of the largest share companies, but the private sector also held a significant share of these companies. The long-run public policy aims were in favour of private ownership, as the government sought to enable the eventual private takeover of these corporations and, hence, the responsibility of achieving rapid economic development (Pischke, 1968: 3). The public sector thus attempted to act as a middleman, bridging the gap between the growth of the private sector and the growth of the national economy.
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The corporate form of enterprise ownership was established in Ethiopia beginning in the 1960s and continued until the early 1970s. During this short period, a number of obstacles impeded existed to the successful development of the stock exchange, which served as the medium of share ownership transfer in the system. First, the corporate form of enterprise organization was a new phenomenon and potential investors at the beginning were reluctant to actively participate in share investment.

The government gave the responsibility to the Central Bank of Ethiopia for administering the exchange. The intention was to stimulate trading and investment in shares of the newly established corporations through a Department of Share Exchange, which formed the basis for the establishment of the new share market in Ethiopia in 1959. The objective was to encourage widespread public investment in shares and other securities. To achieve this, the unit was governed by rules and regulations which basically emphasised the requirements that a company should meet in order to participate in the market. These requirements included legal establishment and reporting on the operation of the company to the group and to the shareholders on a regular basis. Only listed shares and bonds of companies which fulfilled certain minimum requirements were traded at the weekly meeting of the Department.

By the mid-1960s, the department found it difficult to effectively accommodate the growing needs of the share transactions for the period. The demand of the economy for additional investment greatly improved and the department which was assigned to the operation and dealing of shares became a stumbling block for its expansion. To this effect, the National Bank of Ethiopia formed a group of the main financial institutions and a few private share dealers entitled Share Dealing Group. The Group was established to facilitate the transaction of shares and other securities in the market by involving the shares of those companies which fulfilled the requirement set by the National Bank. The Group was also involved in the transfer and delivery of traded shares, which had to take place within three days after the trade. To implement the share transfer objectives, Addis Ababa Bank, the Commercial Bank of Ethiopia and the Ethiopian Investment Corporations provided over-the-counter share dealing services in Addis Ababa.

Options for investing in shares grew and the investing community developed the needed confidence in these institutions to invest in the newly established share companies. This institutional framework encouraged the investing community to take the risk of such stock investments.

The share-holding public was expanding at a fast rate, from a trading volume of Birr 852,300 in 1959 to Birr 1,159,090 in 1963 (SBE, 1963:15). There was a general trend of excess of sales to the public over purchases from the public indicating the growing interest of private savers to invest in shares. The potential buyer of shares began to develop confidence in share investment. This fast growth, coupled with the provision of a number of new share issues, raised the need
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to have a stronger market which could accommodate the growing demand in the system. By 1965, it became obvious that the narrow exchange unit could hardly handle the growing demand for faster transaction in the market. This necessitated the formation of a new form of market arrangement and led to the establishment of the Share Dealing Group in 1965.

The Share Dealing Group managed to attract the confidence of the financial community. The Group was dealing in share transactions actively on its weekly meetings to the tune ranging from Birr 8,000 to 45,000 per week. This amounted to the average annual sales of shares to the public around Birr 1.9 million (Pischke, 1968: 37). This is considerable relative to this small and infant share market in an economy like that of Ethiopia.

Though significant relative to the time period and the state of the economy, there were a number of challenges to the development of the stock exchange in the system. The main problems could be classified into two main categories: internal and external. With respect to the exogenous factors, mention can be made to the relative attractiveness of alternative forms of investment that compete with the share market for the aggregate capital in the system, the performance of the listed share companies and the availability of information concerning their performance, the rate of formation of new companies, the level of national saving and the competitiveness of the share companies whose shares were floating in the market (Pischke, 1968: 50). In addition to these variables there were internal factors which hindered the operation of the infant share market in the system. These include a relatively low publicity of the new form of investment in shares in the system, the information flow from the corporations to the shareholders and the Group, the size and organizational problems that face the Group in handling weekly quotation of share prices. The external factors, nonetheless, assumed more hinderance to the operation and expansion of the share dealing group. In spite of all these factors, the Group attracted wide public confidence and stable market for the shares of the listed companies in its short period of operation. No crises in the public confidence occurred. This made possible to have a relatively large number of shareholders from virtually all walks of life.

The operation of share market in Ethiopia came to an abrupt end with the promulgation of Nationalization of private economic undertakings in 1975. This unfortunate measure abandoned the infant share market before it reached its take-off stage. The whole vigour to mobilize resources for investment purpose and the faster economic growth related to that also became fruitless.

With respect to share companies, the nationalization of the main industrial activities has had precarious repercussions on the national economy. These companies were owned by the government, foreign investors, and domestic national private investors. In this portfolio of share companies in Ethiopia, the nationalization measure had different impacts on different economic agents. This is an important element to closely analyze in the following paragraphs.
The role of the government in share companies ownership was significant in most cases. The approach pursued by the Imperial Government was to create a conducive environment and confidence of the private sector to make investment in share and eventually take over the share of the government (Paschke, 1968: 3).

The serious impact of nationalization of share companies was reflected on foreign investors and the private domestic investors. These shareholders entirely lost their investment in shares. The reaction of the government and the investing community in this broad grouping could be treated separately. The foreign investors managed to have at least partial compensation of their share investment. Even for the remainder, they make every effort to put on the agenda for any negotiation between the Ethiopian government and their government. Some of them considered the issue of compensation within the framework of technical assistance to Ethiopia and paid their nationals out of the fund allotted for this purpose.

The remainder of the confiscated shares of the public were held by the domestic private investors. Even if relatively weak in share-holding at that period, the potential of the private sector in share investment was promising and significant. At the rate of growth of the purchase of shares by the investing community, one can tell the possible strength of the sector in the absence of that unfortunate measure of confiscation of share companies. Unlike the beginning period when the community looked share investment with scepticism, an encouraging development of public confidence in making investment in share companies was observed. The middle class and the trading community was the potential and some people from the low income strata were also participating in this investment opportunity. The development of confidence in the public for investment in shares was exhibited by the fact that the Share Dealing Group turned out to be the net seller of shares to the community (SBE, 1963: 9; Pischke, 1968: 6-7). The nationalisation measure was taken just before the share market reached a take-off stage and that destroyed the infant development potential of the system. Then onwards, the private sector became the victim of a number of policies adopted by the Dergue regime and nowadays one can hardly consider the existence of the private sector in the economy.

4. OPTIONS FOR SHARE-MARKET REINCARNATION

Having explored the operation of the infant share market in Ethiopia in the 1960s and the unfortunate and abrupt end of its operation in 1975, the next issues that demand closer investigation are: Is there a conducive environment for the re-emergence of the share market in the foreseeable future in the economy? Is reincarnation a visible possibility in the present economic policy environment of Ethiopia? What challenges and options are available for the reincarnation of the stock exchange in Ethiopia?

The emergence of stock exchange is a necessity in the present economic policy environment of Ethiopia for financing business organizations. This is so because of a number of reasons
including: the individual private sectors capacity to finance medium and large scale establishments is very limited; the advantage of economies of scale that could be derived out of these large scale enterprises attracts the new corporate forms of business organisation; the limited liability nature of these enterprises would also have significant advantage to the business community; a form of co-ownership in a certain form of business organisation encourages especially the middle-income group; the share investment would widen the assets portfolio of households making them less vulnerable to different shocks in their employment and income situations; and to some extent to the contribution towards the national economic development effort of the system. These objectives would serve as the driving forces towards investment in corporations through the purchase of shares.

The experience of the 1970s, however, left a black spot on the confidence of the investing public. This coupled with no counteracting measures to date has made it difficult to recover the public confidence in share investment. The Commercial Code which is in operation since 1960 has not been changed so far even if it is known recently that the Code is under revision. This assumes the main constraint in the development of share market in Ethiopia in the absence of counteracting measures. In addition to this, there are organizational, economic and institutional constraints to the birth and development of share market in the system.

It would be a prudent approach to observe the options for the birth of share companies whose shares are to freely float in stock market into two main categories. These options involve those enterprises to be newly formed in the form of share companies and existing public enterprises which could be converted into share companies by sale of share to the investing public.

4.1 The Establishment of New Share Companies

Since the early period of the 1990s, Ethiopia has been going through certain forms of economic policy reform. March 1990 could be considered the starting point in the questioning of the economic policy adopted by the then system. The need to reform and liberalise government excessive control over economic variables has been in line with the contemporary economic doctrine of the world, namely the Structural Adjustment Programme (SAP).

The policy orientation of the Transitional Government tends to promote the private sector by limiting the intervention of the public sector. Pursuant to this central objective, different proclamations and laws have been issued and some of them are under the process of amendment.

One of the laws which was amended to encourage the private sector is the Investment Code. The Code intends to provide incentives to investors in areas of activities which the private sector is allowed to operate. Investors who can make investment beyond a capital of Birr 250,000 would be eligible for different incentives. To coordinate and smoothen the investment activities of investors, the Investment Office of Ethiopia has been reorganized in light of the new developments. A lot of improvement in the procedure of investment has been made relative to
the earlier period. Nonetheless, a lot remains to be desired in this exercise so as to ease the investment efforts of potential investors.

In addition to this, the investors could form different forms of business organizations including share companies provided that some conditionalities are fulfilled. These conditionalities mainly include factors like a minimum amount of Birr 50,000 of capital, making a deposit of at least a quarter of the stated capital under blocked account, the submission of project appraisal document to the Office and confinement in areas which are allowed to the private sector involvement (TGE, 1992c). The restriction of the areas of operation for the private sector would have its own side effects on the magnitude and form of private sector participation in the economy.

The responsiveness of the private sector so far in terms of making investment in the productive sectors has been far below expectation. The records of the Central Register of companies reveals that a total of 127 companies were formed with a capital of Birr 72.4 million worth of capital after the issuance of the new investment code. Of these enterprises, 119 are formed as private limited companies. These companies have small capital investment which on average is Birr 440,630.70. The main form of ownership in these companies is confined within a family or friendship circle to ensure the close follow-up of the operation of the enterprise. In the form of Partnership, only two companies with capital investment of Birr 525,652 were established. These companies have no direct impact on the formation of share markets because they have shares with restricted circulation in the economy. They have non-transferable shares and are relatively less risky because the controlling hand of the owner on the business is strong. These are activities which are concentrated in trading and hotel service with little involvement in the productive sectors of the economy.

The formation of share companies so far has been very limited for various reasons. The common justification for forming corporate forms of business organization is the need to have huge amount of capital for the undertaking. This implies the scale of activities of the investment project demands the contribution of investment resources from a wide range of sources. This has partial limitation in Ethiopia for the government has identified these types of companies to be run and owned by the state. Since the reorganization of the investment code, for instance, it is only 6 share companies until October 1993 which were formed and registered in the Central Commercial Register. These companies had an initial registered capital of Birr 19.4 million and most of them are operating in areas of commercial agriculture and trading activities which are not within the domain of activities of the government.

Recently, the government announced the possibility of private nationals to involve in commercial banking and insurance companies. The conditionalities for the involvement include company form of organization, minimum capital and the level of maximum share-holding ceiling of share holders. This means that the form of business organization in these industries is going to be
share-company which would increase the need to have an effective and efficient primary and secondary share market in the system. The market would provide to the investing community not only of the framework for transaction of shares but mainly also to provide an up-to-date and reliable information on the operation of the share companies which is needed for decision making process of the investing community.

The corporate forms of business organizations could serve as spring board for the formation of share markets without which the companies hardly manage to efficiently operate. But a closer examination of the articles and memorandum of associations of the companies reveals that they have restricted transferability of shares. So far, no free floating of shares has been observed in the system. All the same, these companies could serve as the potential pool for the emergence of share market in Ethiopia.

There are also some institutional, policy, economic and organizational obstacles for the emergence of share companies. The lack of confidence of the potential investors in making investment in shares should be addressed in time. The impacts of the measures taken by the Dergue regime have left a bad lesson on the private sector, which has not shown much confidence on policy measures taken so far or to be taken in due time. There are also important issues in the limbo which constrain the investment decision of the private sector.

There are still some options for the development of new share especially if the government keeps on relaxing the policy of restricting the private sector from participation in certain economic activities which are usually run by corporate forms of business organization like banking and insurance, communication mining and public utilities, and companies which require huge amount of investment for their operation. In this respect, there seems consensus on the side of the government to relax the restriction of the private sector in commercial banking and insurance industries (TGE, 1993:5; TGE, 1994a; TGE, 1994b). These industries by their own nature require a large lump-sum capital which could hardly be generated by individual domestic capitalists. The minimum capital requirement of the commercial banking industry shall not be less than the greater of Birr 10 million or 8% of the bank’s risk weighted assets in terms of the most recent annual balance sheet (TGE, 1994a:250). For operation in the insurance industry on the other hand, a minimum capital requirement was set at Birr 3 million for general insurance and Birr 4 million for long term insurance business or Birr 7 million if the business is both general and long-term insurance (TGE, 1994b:278). In both cases, the corporate form of business organization is put as conditionality to be eligible for getting license from the National Bank of Ethiopia which is the responsible authority. The provisions also indicate that it is only Ethiopians who can involve in the establishment of these banking and insurance industries. Moreover, no person can hold more than 20% of the company’s share jointly or severally with his spouse and/or with a person who is below the age of 21 and related to him consanguineously in the first degree relationship (TGE, 1994; TGE, 1994b). This necessitates the existence of an effective stock-exchange which can accommodate the smooth operation and the accounting of the operation of the share companies to the investing community. This widens the options and
the pool for the emergence of share markets through which investment in shares is to be effected. This is therefore indicative of the optimal time to put in place the institutional and policy framework for the emergence of stock exchange in the system as soon as possible.

4.2 The Formation of Share Companies through Privatization

The recent economic reform measures of most of the former socialist countries and the underdeveloped nations emphasized the promotion of the private sector in economic activities and the limitation of the public sector to its areas of relative efficiency. One of the forms to improve the efficiency of the enterprises is supposed to be through privatization of public enterprises. A number of the reforming economies have adopted the policy of privatization though the pace is different in different economies (Sachs, 1991: 17). Privatization itself has different modalities including public offering of shares, management contract, sales of shares to the employees of the enterprise, or even divestiture. The actual course of action depends, nonetheless, on economic, political and social variables that prevail in the system under consideration.

One of the forms of privatization is disposing public enterprises through initial public offering. This approach demands the existence of an institutional arrangement in which the identification and valuation of the enterprises to be privatized is made. The valuation of public enterprises is one of the prerequisites in this method of privatization. Those economies which adopt this method of privatization confronted the same problem of timely and realistic valuation of the firms. This raises the need to have accountable and competent valuation groups in the system which is in short supply in most of the reforming economies. This approach might lead to unfair expropriation of public assets in favour of those who manage to buy shares of these companies (Sachs, 1991:26-27).

The issue of privatization is widely discussed in the community and the policy making circle. The government has set up a Privatization Agency whose main task is to carry out the process of privatizing public enterprises in an orderly and efficient manner (TGE, 1994c). The Agency has the responsibility of screening out, in light of the New Economic Policy of the Transitional Period, those enterprises which are going to be privatized and which are to remain under public ownership. The committee has forwarded some proposals as to the status of enterprises in terms of their ultimate fate. Out of the enterprises which are going to be privatized, one of the modalities of privatization is the conversion of organizations into share companies.

The conversion process demands proper valuation of these companies, getting an institution which would under-write the values of the companies and issue share to the public for sale, keeping share registration of share-holders and forming an institutional set up which would report on the overall operation of the companies under consideration.

These two aforementioned options of forming share companies would open the door for the
establishment of share market in Ethiopia. The existence of active share markets is necessary for the efficient operation of share companies. The attractiveness of investment in shares would be contingent on the efficiency of share markets which can ease the transferability of shares into liquid cash in fairly short time.

The development of share companies and hence markets in Ethiopia, nonetheless, have a number of problems that should be addressed immediately. Since this form of business organization is a very recent phenomenon in the economy and had a very short life span even at its infant status, increasing public awareness about the importance of corporate forms of business organization is important and timely. Moreover, to develop public confidence various measures need to be taken. The measures may range from developing a scheme of compensation for shareholders whose shares were confiscated by nationalization in 1975. These measures with the setting up of an institution which will be responsible for the development of share market in Ethiopia based on the experience of the country and other developing nations is necessary. The next issue would be which group of the population would be the participant of share markets in the Ethiopia. In this connection, the civil servants, the trading community which registered a relatively fast growth rate in the system, at least partially middle income peasants and even foreigners and the government through its financial institutions could be served by the stock market. This task in turn demands the existence of regulatory mechanisms to the proper operation of business organizations in the system. A scheme of broader participation is required because the majority of the population have little saving capacity. In this respect, the experience of the 1960s which provided the civil servants long-term loan arrangement to purchase shares from different companies could be adopted.

Given the importance of share companies and market in the resource mobilization drive of Ethiopia, every effort should be made to put in place sound policies and institutions to the development of these important devices to investment activities. In this respect, the economic policy reform measures can create a conducive environment to the greater involvement of the private sector in economic affairs. This, coupled with the liberalization of the financial sector in the economy, would make the formation of share companies less complex. The development of sophisticated stock-exchange may require long time but it is high time to put the groundwork for the formation of share market. It is only under this condition that the system could realize the potential of the private sector at a higher level and mobilize investment resources to finance development activities from virtually all walks of life.

5. CONCLUSIONS AND RECOMMENDATIONS

The new economic environment intends to favour the private sector even if the existence of the public sector at least for the foreseeable future is desirable. The creation of an enabling environment for the operation of the private sector is an important factor for realization of the potential of the private sector.
The private sector in Ethiopia could improve its actual saving provided that the necessary policy and institutional measures are taken. The present state of operation exhibits the prevalence of a phenomenal saving-investment gap. This urges the need to encourage the private sector through sound economic policies and incentives to save and invest more in the system.

This in turn demands the use of various mechanisms and modalities of mobilising investable resources from different economic agents. One of the widely used mechanisms in this regard is the formation of share companies by selling shares to the investing community. This would allow even the low-income group to opt for investment in shares out of their limited income. The nexus between the saving and investing economic agents would be assumed by share markets.

In Ethiopia, this share market has been effective at least for a decade in the 1960s and 1970s. This was the period in which the economy was relatively performing well and achieving growth. This infant share market came to an end with the nationalization of private establishments in 1975. This was made without any compensation measure to the bulk of shareholders. The whole effort came to an end with the confiscation of investment in shares and no counteracting measures have been taken so far.

In the context of the present economic environment of Ethiopia, some measures have to be taken in due time to develop companies in order to realise the potential of the private sector at a higher level. In this endeavour, the role of the stock market is evident. In this connection, however, one cannot escape the issue of compensation and should be considered seriously to nurture public confidence in shares investment and markets. Schemes of full or at least partial compensation could be developed and international financial institutions could be approached for financing contribution.

Since the market is not familiar in our economy, educating the potential investors through communication media about the essence, importance, workings, and characteristics of share companies and markets is important. In addition to this, the training of experts to properly screen the enterprises, whose shares to float in the market, is required. Public awareness, coupled with proper screening mechanism of companies whose shares are to freely float in the market, would foster involvement in share investment.

The development of sound legal framework for the formation and proper operation of the newly established companies or the would be converted state enterprises is important. The progress of operation of these companies should be reported to the investing public so as to attract the investment in these organizations. Mechanisms to control fraudulent acts should be developed and implemented in the new system.

To involve a larger sector the population in the purchase of shares, various schemes should be developed especially for government employees through long-term loan and other attractive
arrangement. The authority should make sure that those enterprises whose shares are to be freely float in the market are operating under viable economic conditions so that the investing community does not lose its confidence.

With the recovery of public confidence, the establishment of an independent and competent institution would be necessary. In this respect, the authority should be staffed with competent and experienced experts. This would render the authority the opportunity to develop an efficient customers service in share registration, transfer and dealing to attract potential investors in share investment. The institution would enable the investing public to get information related to the operation of share companies and the market. These tasks could hardly be handled by a small unit under a certain financial institution as was the case in the 1970s. For the development of the overall organization of the authority at the earlier stage of its development, bilateral and multilateral organizations could be approached for technical and financial assistance. The policy making circle should consider the issue of share companies and markets in broader and longer-term perspective. It is in this context that the stock market could contribute a lot in the resource mobilization effort of the system and to achieve faster economic growth and development.

REFERENCES


Abu Girma: Prospects of Stock Market


Annex I

Ethiopia: Basic Indicators of Investment and Saving

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment Ratio (I/GDP)</th>
<th>National Saving</th>
<th>Domestic Saving &amp; Ratio (S/GDP)</th>
<th>Resource Gap Ratio ((1-S)/GDP)</th>
<th>Government Saving &amp; Ratio: Sg (Sg/GDP)</th>
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<td>1975</td>
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<td>577.9</td>
<td>583.6</td>
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<td>528.6</td>
<td>485.6</td>
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<td>1978</td>
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<td>1993*</td>
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<td>13.2</td>
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Note: * refers to projection of the investment and saving ratios.

Annex II

Ethiopia: Profile of Share Companies whose shares were floating in the market by ownership, capital, and par share value by 1968

<table>
<thead>
<tr>
<th>Year of Estab.</th>
<th>Name of the Company</th>
<th>Percentage Share Portfolio by Ownership</th>
<th>Capital (Mil. Birr)</th>
<th>Par Value of Shares (in Birr)</th>
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<td>Gov’t</td>
<td>Prtv. Nat.</td>
<td>Foreign</td>
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<td>51.0</td>
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<td>The Bottling Company of Ethio. S.Co.</td>
<td>2.7</td>
<td>96.3</td>
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<td>1960</td>
<td>Cottonificio Barratto</td>
<td>0</td>
<td>na</td>
<td>na</td>
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<td>1965</td>
<td>Cotton Company of Ethiopia S.Co.</td>
<td>na</td>
<td>25.0</td>
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<td>1963</td>
<td>The Ethiopian Drug Manufact. S.Co.</td>
<td>68.8</td>
<td>31.2</td>
<td>8.0</td>
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<tr>
<td>1942</td>
<td>The Sabean Utility Corporation S.Co.</td>
<td>47.0</td>
<td>na</td>
<td>na</td>
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<td>1966</td>
<td>Ethiopian fabrics Share Company</td>
<td>0</td>
<td>27.2</td>
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<td>1950</td>
<td>General Ethiopian Transport S.Co.</td>
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<td>1958</td>
<td>HVA-Ethiopia</td>
<td>11.1</td>
<td>8.9</td>
<td>0.8</td>
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<td>1957</td>
<td>Indio-Ethiopian Textiles S. Company</td>
<td>43.9</td>
<td>31.4</td>
<td>24.7</td>
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<tr>
<td>1962</td>
<td>Manifattura Sacchi Asmara</td>
<td>na</td>
<td>na</td>
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<td>1962</td>
<td>National Meat Corp. of Ethio. S.Co.</td>
<td>55.6</td>
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<td>1948</td>
<td>Ras Hotels Share Company</td>
<td>na</td>
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<td>1964</td>
<td>The Rubber and Canvas Shoe S.Co.</td>
<td>80.5</td>
<td>3.9</td>
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<td>Sabean Utility Corporation S.Co.</td>
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<td>1961</td>
<td>Societe du Tedj d’Ethiopia Saba</td>
<td>0</td>
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<td>1961</td>
<td>Tendaho Plantations Share Company</td>
<td>6.7</td>
<td>31.1</td>
<td>62.2</td>
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</table>

Source: Author’s computation from different documents of share companies in Ethiopia during the 1960s and 1970s.