Capital market harmonization can boost intra-African investment

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Standardisation and collaboration across equity markets are critical to achieve greater levels of cross-border investment in Africa

Africa has enjoyed more than a decade of sustained economic growth, often outstripping many other parts of the world. However, Africans are not reaping the rewards of that growth as much as they should. It will take more than the mass export of commodities to effectively facilitate the 'trickle-down' effect of wealth. Many argue that it is largely foreign companies and foreign investors instead of Africans who are benefiting most from the continent's tremendous growth.

Attracting foreign investment clearly plays an important role in helping to finance Africa's development, but it is crucial that local companies, savers and investors should also benefit. Some data suggests that this is already happening, with Intra-African investment said to be rising by more than 30% a year. However, this is heavily skewed to only a handful of markets, with South Africa accounting for 35% of this investment, followed by Kenya with 16% and Nigeria with 11.6%. Economies across the continent need to attract broader participation by all African investors.

To spread the benefits of African growth and to unlock the power of the savings culture in the burgeoning middle classes requires an environment that facilitates easy and reliable investment. In the first place, companies more used to relying on debt funding need to be persuaded of the benefits of equity capital and the risk sharing provided by a stock market listing. Once listed, they need to make good information available to investors. At the same time, the legal and regulatory frameworks which protect investment need to be robust and companies seeking investment must meet minimum levels of governance and transparency.

But just as important is the financial market infrastructure that underpins the buying and selling of securities. The right infrastructure ensures that access to financial markets is easy, transparent and robust; poor infrastructure acts as a constraint on the growth and vitality of equity markets and inhibits liquidity, due to the heightened levels of operational risk.

Many investors argue that it is the ability to trade in and out of a security easily and not stock valuations and economic climate that are likely to shape Africa's equity prospects in the coming years. Beyond a handful of markets like South Africa, Nigeria and Kenya is what many call a "liquidity cliff" – where even shares in quite large companies can be hard to buy and sell.

First class infrastructures such as central securities depositories make buying and selling easier. They reassure investors that the ownership of securities is registered correctly and efficiently at the time of sale, and that payments are cleared and transactions settled in good order. All of these unseen financial markets processes minimise risk and play a critical role in giving investors the confidence to invest in particular markets. As confidence grows, so do trading volumes and liquidity; this attracts more activity in the marketplace and convinces more companies that stock market listings are an efficient and effective way to raise growth capital.

Financial market infrastructures therefore play an essential role in creating this virtuous circle: making markets more accessible and more efficient, reducing transaction costs and eliminating settlement risks.

Currently, there are many small exchanges dotted across the African landscape. There is, of course, an important place for national stock markets, but with few listed companies, low trading volumes and manual or non-standardised clearing and settlement processes, it can be difficult to encourage higher levels of participation, particularly by investors in other African markets. This means that pension funds and other investment vehicles across Africa are not benefiting from the continent's growth as much as they should do. If small exchanges could operate in a harmonised and standardised way or interlink with each other, investors would have easier access to these markets and more companies could be persuaded to list.

Recent developments in many countries make clear the willingness of Africa's business leaders and policy makers to invest in improved securities market infrastructure; however, implementation has often proved time consuming and costly due to the challenges of collaboration and the tendency to operate in country-silos.

The next stage of evolution in African securities markets may well be the development of interoperability between the different platforms using international standards supported by companies like SWIFT. Securities markets can learn valuable lessons from the successful harmonization already under way in various regional payments markets.

The Southern African Development Community (SADC) is leading the way where payments are concerned. The third phase of SADC's SIRESS payment system went live September 2014, with almost 70 commercial banks from nine countries now participating. Transaction volumes and the daily value settled through the system continue to grow and are exceeding the expectations of all the national central banks working together on this project. In practical terms, this facilitates cross-border commercial activity which will drive economic growth in the region. Other regional blocks such as EAC (the East African Community) and ECOWAS (Economic Community of West African States) are likely to follow suit.

African securities markets do not have to reinvent the wheel – there are common standards and market practices that will help to speed and ease the process. The win-win solution is one where all stakeholders work collectively to develop Africa's capital markets to the benefit of African companies, investors and savers.

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