The Past, Present and Future of Stock Exchange Operations in Ghana

Ghana Stock Exchange 25th Anniversary Public Lecture

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THE PAST

We want to review the lessons of the past and harness them for a better future.

Stock exchanges have long been viewed as important catalysts of economic growth. They provide an organized market for the trading of securities to individuals and organizations seeking to invest their saving or excess funds through the purchase of securities. A fair and efficient performance of a stock exchange is of substantial benefit to the public. The stock exchange provides liquidity and price discovery that facilitates efficient raising of capital for businesses. The movement of share prices and in general the stock indexes can be a good indicator of the general trend in the economy. Although the stock exchange is one of a number of institutions that make up the capital market, it cannot be studied in isolation as its operations are inextricably linked with the wider market which includes investment banks, market operators, issuers, investors, regulators and service providers such as registrars and trustees.

Interest in establishing a securities market in Ghana goes back to the colonial period. In July 1954, the transitional Government of the Gold Coast led by Dr. Kwame Nkrumah as leader of Government Business and Prime Minister issued the first ever Treasury Bill in the then Gold Coast when an amount of £500,000 of a three-month tenor was issued at 3/8th of 1%. As Minister of Finance, Mr. K.A. Gbedemah made it very clear in his accompanying statement that the sole purpose of the issue was to create a local market for government securities. Unlike today, it was not meant to fund any Government deficit as the Government accounts in those days were in substantial surplus. Gbedemah’s plans to create a securities market however were aborted in the political and economic turbulence of the immediate post-independence era as the country navigated a difficult socialist path.

In the 1960s, an effort was made to establish a stock exchange reflected in the establishment of the Accra Securities Market Limited which was never made operational. In 1971, the Government of Dr. Busia passed the Stock Exchange Act to give legal backing to the establishment of the Ghana Stock Exchange. This occurred at a time when only six African countries had stock exchanges: Nigeria (1960), Zimbabwe (1946), South Africa (1887) Kenya (1954) Egypt (1883) and Morocco (1929). That Ghana was contemplating the establishment of a stock Exchange was a tribute to the far sightedness of the government of the day.

Unfortunately, Dr. Busia government was overthrown in 1972 and the dream of establishing a stock exchange vanished for another 18 years or so. In the meantime, the Acheampong government passed the Investment Policy Implementation Decree which mandated the conversion into public companies of some 18 companies, owned primarily by foreign shareholders, with partial sale of shares to local investors through an OTC market operated by National Trust Holding Company. It was not until 1989 that the dream of establishing a stock exchange was realized, following the establishment of a nine-member Committee chaired by the then Governor of Bank of Ghana to take charge and consolidate all previous work connected with the stock exchange project as well as take
the necessary measures towards the exchanges actual establishment. The Committee was able to
draw up a successful program that culminated in the formation of the GSE on July 25, 1989, with the
exchange opening its floor for trading on November 12, 1990.

The establishment of the Ghana Stock Exchange in 1990 was part of a wave of stock exchange
development given impetus through structural reforms across Africa supervised by the International
Monetary Fund (IMF) and the World Bank. The so-called “Washington Consensus” framework
included financial liberalization, competitive exchange rates, liberalization of inward foreign
exchange, privatization of state enterprises, abolition of regulations that impeded market entry or
restricted competition and legal security for property rights.

Given that many of the structural adjustment policies fitted nicely with the existence of formal
capital markets, many donors, taking their cue from the IMF, provided financial support and
technical assistance for the establishment of stock exchanges. Ghana’s entry into a ERP/SAP in the
1980s created a fertile environment for reactivating the stock exchange project.

In addition to the standard economic justifications for establishing stock exchanges Todd Moss, in his
book “Adventure Capitalism”, has identified other non-economic reasons for the widespread
establishment of stock exchanges in Africa in the 1990s. First, the stock exchange was A Badge of
Inclusion. As a symbol of international legitimacy, the stock exchange was ideal. It was a highly
visible symbol of the free enterprise credentials of a country. Presidents and Prime Ministers have
found it appealing to stress the modernity of their economies by showcasing their stock exchanges
in investment promotion speeches around the world. Secondly, the stock exchange was a good
Populist Symbol: Governments had been searching for ways of “democratizing” the ownership of
wealth in the economy. Popular ownership of shares was appealing, particularly as a means of
deflecting criticisms of privatization drives. Privatization through stock exchanges was seen as
transparent and fair as well as a means of supporting a narrowing of the income gap. Stock
exchanges could also be used as tools for indigenization, especially in cases where there was
widespread discontent about foreign ownership in the economy.

The potency of these non-economic factors and the ERP/SAP provided the impetus for the creation
of many stock exchange’s in Africa. Ghana’s Financial Sector Adjustment Program (FINSAP) which ran
from 1988-1992 provided financial backing for the preparatory work towards the establishment of
the Ghana Stock Exchange. In the 1990s, the World Bank supported FINSAC II and the Non-Bank
Financial Institutions Credit provided resources to the Ghana Stock Exchange for important
development activities such as public education, training of market operators, the upgrading of the
exchange’s processes and the establishment of an appropriate regulatory regime. CIDA also
supported the development and implementation of a market training program.

It is indeed fitting that the then Minister of Finance, Dr. Kwesi Botchwey who championed the
FINSAP reforms and the reactivation of the stock exchange project is in the chair for today’s 25th
Anniversary event. Dr. Botchwey, your child has grown into an iconic economic and financial
institution within Ghana which you can be proud of. The market and the country are grateful.

The GSE started operations in November 1990. The set-up was modest:

1. Three stockbrokers
2. 11 equity listings

3. 1 Commemorative bond

The processes were mostly manual. Trading was based on a call over system that was conducted three times each week to fix the price of each listed security. Clearing and settlement was manual. The three days a week was later expanded to daily price fixing. After that the call-over was replaced by continuous trading, still manual with traders posting their orders on whiteboards.

THE PRESENT

Mr. Chairman, distinguished ladies and gentlemen, let me briefly recount the achievements of the GSE and where it stands today in pursuit of the objectives that led to its establishment. In other words, after all that history, where do we stand now?

The present operations of the GSE are in stark contrast to how the GSE started. Today the GSE can boast of the following:

1. 38 Listed equities (compared to 11 listed companies at inception)
2. There are 21 Licensed Dealing Members compared to 3 at inception.
3. 97 Government bonds
4. A fully automated trading system
5. A Central securities depository
6. The Alternative Market (GAX) for SMEs which has attracted 3 listings within a year
7. Ghana Fixed Income Market has been established as a specialized platform for fixed income securities.
8. A total of GHS 2.1 billion in equity finance has been raised through the GSE.

Mr. Chairman, despite these results the exchange has faced a number of difficult challenges and disappointments. The GSE is no exception to the common afflictions of frontier capital markets.

The first is Low liquidity: Market liquidity refers to the ability of buyers and sellers of securities to transact efficiently and is measured by the speed with which large purchases and sales can be executed and the transaction costs incurred in doing so. The GSE’s liquidity as measured by the market turnover ratio is well below key African markets such as Botswana, Nigeria, Kenya and South Africa. Low liquidity increases volatility thus creating additional risk for investors. If there are many potential buyers and sellers and they can transact quickly, easily, and cheaply, then price movements tend to be smoother as news events are factored into prices quickly based on the market consensus about their significance. The high volatility of the market is reflected is exemplified by the fact that, in the five-year period 2011 and 2015, returns on the GSE Composite Index ranged between 78.81% in 2013 and -12.69% in 2015. Such volatility drives away investors.
A second problem is the **Limited number of listings**: Since inception, the GSE has gone from 11 listings to 38 listed companies, an average of on new listing every year.

Next we have a Limited number of instruments – the GSE is primarily an equity market. There is limited trading activity in bonds.

Finally we have **Limited investor participation**: The CSD reports 80,000 equity accounts as at the end of 2014.

Mr. Chairman, these disappointments and challenges also contain a rich set of lessons: First, we have learnt that the GSE can only grow in partnership with the government. To date this partnership has been reflected in financial support as well an attractive enabling environment. Government has put in tax incentives such as the exemption of capital gains on listed securities from tax, a 3% tax rebate for the first three years of listing, the exemption of the Ghana Stock Exchange from taxation the tax free status of mutual funds.

Second, it is also clear that it takes a significant amount of time to build an equity culture both from an issuer and investor perspective. Supply side equity culture requires local businesses to look to the stock exchange as a major source of long-term capital. This is obviously not the case now given the limited use of the stock market by domestic companies as a source of capital. Local entrepreneurs are yet to appreciate the benefits of sharing ownership in return for equity capital to grow their firms. On the demand side, the development of the market requires a high level of financial literacy as well as a critical mass of institutional investors. Although some progress has been made, the GSE is in competition with the microfinance companies such as Trust Jesus Microfinance and DKM which in a short space of time created a deposit base of GHS100 million. The individuals who own shares do not trade them, thus exacerbating the liquidity problem. Retreat from the equity market has also been fuelled by excessive market volatility which makes it difficult to earn consistent returns.

Third, the market is dynamic. New technology is changing the speed with which trading, clearing and settlement are done. The GSE has to keep up with the technology and this requires an exchange that is financially strong with the requisite resources.

**THE FUTURE**

The GSE has come a long way. But there is a longer journey ahead. Today, I will focus on a number of trends that are likely to significantly change the way the stock exchange will operate in the next five years or so. These are demutualization, globalization, regional integration and the enabling environment.

Traditionally, the ownership structure of a stock exchange was a mutually held organization. Members enjoy rights of ownership, decision-making (one-member, one vote) and trading. Demutualization is the term that denotes the change in the legal status of a stock exchange from a mutual association with one-vote per member (and usually consensus based decision-making) to a company limited by shares with one vote per share with majority decision making. It involves the separation of trading rights and ownership, i.e. you can pay for the right to trade without being a member of the exchange.
In 1993, the Stockholm Stock Exchange became the first exchange to demutualize. While privately owned and self-listed exchanges are now widespread across the Americas, Europe, and some parts of Asia, even 15 years ago, this scenario would have been unimaginable. Today, only 12% of the largest stock markets that are members of the World Federation of Exchanges are organized as associations with mutual members.

The GSE is organized as a company limited by guarantee which is the incorporation model for non-profit organizations. In this model, the company is constituted by its members. The membership was categorized into Licensed Dealing Members (LDMs) and Associate members. LDMs were members who were eligible to trade on the exchange. Associate members were corporate entities and individuals who supported the goals of the Exchange.

What are the benefits of demutualization?

1. **Improved Governance**: With the separation of ownership and trading privileges, an exchange will achieve greater independence from its members with respect to its regulatory functions.

2. **Investor Participation**: Unlike a mutual structure where often only broker-dealers may be members, a demutualized exchange affords both institutional investors and retail investors the opportunity to become shareholders.

3. **Resources for Capital Investment**: One key rationale for demutualization is to give the exchange the ability to raise through various means including private or public offerings to a wide range of investors.

4. **Unlocking Stock Exchange Value**: Demutualization provides an opportunity to unlock the value of a stock exchange though the realization of the value will ultimately depend on the listing of the exchange.

The global trend towards demutualization has not been lost on African exchanges. A few exchanges such as JSE, Mauritius and BRVM have been demutualized. More recently, Kenya demutualized and Nigerian is at an advanced stage of demutualization. Indeed the demutualization of the Nigerian Stock Exchange will mean that Ghana would be the only stock exchange in the region which is non-profit. However, progress is being made on the demutualization of the GSE. A Committee has been set up to advance the process.

However, demutualization will bring a significant change to the operations of the GSE. Demutualization signifies that an exchange has become a for-profit firm in a competitive financial markets environment. It has more potential for profit, and also for failure, than before and like any business, it must stand alone for its financing. The GSE will need to operate profitably as shareholders will be looking for a competitive market return on their investment. In addition the support from government and donors is likely to fade away. This will mean a more commercial orientation. I am not expecting the transition from a non-profit culture to a commercial culture to be easy as it involves a major paradigm shift of corporate culture.

An argument often made in the context of demutualization concerns the regulatory function of exchanges. Historically, most exchanges globally have operated as self-regulatory organizations. The
self-regulatory functions of exchanges typically consist of setting and enforcing rules for trading, conducting surveillance, overseeing the trading system to prevent abuses, and establishing rules to govern the conduct of members. A concern expressed by regulators is that attempts to maximize profits and shareholder value by demutualized or privatized exchanges will come at the expense of self-regulation and supervision. Thus, the architecture of the capital market will need to adapt. The regulatory environment will have to adapt to the regulation of a for-profit institution.

Globalization

Mr. Chairman, permit me to touch briefly on globalization and its likely impact on the GSE. The wave of excitement that led to the establishment of several stock markets in Africa in the 1990s did not fully anticipate the rapidity with which financial globalization would spread across the world in the ensuing decade. The liberalization of financial markets, removal of capital account restrictions and technological changes that have drastically speeded up information flows are increasingly turning the world into one huge pool of capital. Companies that hitherto had relied on domestic markets are now able to tap into larger international markets at lower cost.

Many issuers in Africa are issuing in markets outside Africa. What this suggests is that African issuers are finding foreign markets more attractive than African markets. This has added a competitiveness dimension to the challenge of developing stock exchanges in Africa. In Africa, this is most evident in South Africa where a number of large companies have transferred their primary listing to major international exchanges such as the London Stock Exchange. However, secondary listing of Zambian company Zambeef on London’s Alternative Investment Market (AIM) indicates that large local companies can also tap into the global capital pool.1 Zenith Bank in Nigeria has listed on the London Stock Exchange and ACCESS Bank will soon follow. Thus, African stock exchanges which are already handicapped by size and liquidity have to compete with markets in developing countries to attract listings. One possible solution to the size and liquidity problem is regional integration.

The Challenge of Regional Integration

Regional integration of markets has been proposed as a framework for addressing many of the challenges facing African stock exchanges. The advantages of having a regionally integrated market include: (a) deeper capital markets as reflected in the volumes of issuance and trading; (b) a single pool of liquidity; (c) a more efficient financial system and increased output; (d) a lower cost of capital for businesses and economies of scale; and (e) lower transaction costs. In short, a regional securities market would create a large pool of liquidity to enable regional markets to be globally competitive.

Integration requires that market infrastructure should be integrated and operated seamlessly across a large number of countries.

Progress has been made in the ECOWAS region through the formation of the West African Capital Markets Integration Council (WACMIC), comprising regulators, stock exchanges and market operators of the three exchanges in the region – Nigeria, Ghana and the Regional Stock Exchange of Abidjan. Already a sponsored access system has been established such that brokers within the

1 In June 2011 Zambeef raised $55 million via a listing on AIM to fund the acquisition of ETC Bio-Energy Limited.
member countries can trade and settle in markets other than theirs, through local brokers in other member jurisdictions.

However, exchange linkages are fraught with dangers. To achieve the seamlessness and the large pool of liquidity that is desired, there will be pressures to merge especially when all three exchanges become demutualized. This will of course be at the cost of individual exchange identity but may be the optimal response to the globalization of stock markets.

**The Enabling Environment**

Recent developments indicate that we cannot take the enabling environment for granted. Future growth of the stock exchange will require macroeconomic stability and a robust regulatory framework. The current high interest rate environment has dealt a big blow to the equity market as investible funds have moved out of the stock markets to alternative instruments such as the fixed deposits of Non-Bank Financial Institutions (including microfinance)

We have noted earlier that the GSE as we see it today is really a development partnership with Government. Unfortunately, recent developments indicate that we cannot take Government support for granted. For example, the provisions of the 2015 Income Tax Act (Act 896) has abolished the following incentives for capital market development:

1. 3% rebate on income taxes for listed companies during their first three years of their listing on the stock exchange

2. The tax exemption of capital gains on the shares of listed companies. The imposition of a capital gains tax will make Ghana the only market in the region that has a capital gains tax on listed securities and will deal a competitive blow to the GSE. We about the see foreign investors flee Ghana’s equity markets.

3. The exemption of mutual funds and unit trust from taxes

4. The tax exemption of the Ghana Stock Exchange

These developments suggest that the stakeholders of the capital market need to work harder with government to sustain the enabling environment that has brought us this far.

**Conclusion**

It is obvious that there is rich history behind the establishment of the GSE. A lot has been achieved but the exchange has also weathered a lot of challenges, some of which still persist. However, we can look at the future with confidence. It is heartening to see that the exchange is putting into place the structures for the next 25 years. I see on the horizon a demutualized and profitable stock exchange tied to the global capital market. I see a market that is fully integrated with the Nigerian Stock Exchange and the Regional stock exchange in Ivory Coast and possibly evolving in the longer run into a single ECOWAS stock market. I see a stock exchange that is technology driven. However, there is work to be done on the core objectives of attracting more issuers and investors.
I would like once again to extend my congratulations to the Ghana Stock Exchange for what stands out as significant achievements in the face of many challenges. We wish you greater success in the next 25 years and beyond.

Thank you.