Globalization and the East African Capital Markets: An Analysis of Tanzania's Performance and Potential for a Regional Bourse

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ABSTRACT

Globalisation has transformed most traditional and conventional ways of business transactions and international relations between economies of the world. As a result of globalisation, capital markets have become important instruments in attracting capital flows globally. In developing economies, capital markets are still in the early stages, i.e. emerging markets, given the pace that they are supposed to move at so as to survive the hazards of globalisation. Adequate knowledge and skills on how to develop the emerging markets are required so as to realize the benefits of regionalizing the capital markets.

The aim of this paper is to follow up on an individual country (Tanzania) capital market situation so as to be able to establish its position in the prospective regional (East African) stock market. Key informant interviews, desk review and content analysis were employed in describing and comparing the traditional and institutional characteristics of the three East African stock markets. The results showed that there are latent factors that contribute to low listing at the DSE in Tanzania, including among others, fear of dilution of ownership, fierce competition that triggers fear of disclosure and thus low incentive for listing, and the high costs of IPO.

The results further showed that the mote of the products offered in the Tanzanian market could not attract the tiny savings of Tanzanians, especially those in rural areas, as compared with the Indian case where the UTI reaches the poorest of the poor. Market capitalisation ratio (MCR) and potential investment diversification measures employing both the MCR and risk/return approaches were used as methodologies for empirical evaluation. Correlation results of both MCR and risk/return showed a poorly performing Tanzanian capital market.

Furthermore, a weak investment diversification potential was observed within the three East African capital markets signalling the need for more development of domestic capital markets so as to have viable regionalisation. The study concluded and implied that a regional market should emerge parallel with broader initiatives of regionalizing the East African economies as a political federation.

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Introduction

The end of the 20th Century has witnessed the rising importance of globalization with the formation of economic blocs like the North America Free Trade Agreement (NAFTA), the European Union (EU), and the East African Community (EAC), etc. However, the globalized world is about much more than trade or capital flows. Countries are increasingly linked together by travel, communications, trade, services and investment. Television, mobile phones and the Internet are erasing the barriers, not just between economies, but between people as well. The unavoidable transformation of businesses, international relations and world economies as a result of globalization requires that we all adapt (Shahid, 2002).

Following such transformation the world has witnessed the establishment of capital markets and securities exchanges as institutions for mobilizing domestic savings and external capital inflows. According to (Black, 1988) the development of domestic capital markets provides opportunities for greater fund mobilization, improved efficiency in resource allocation and the provision of relevant information for investment appraisal. Stock markets as operating arms of capital markets facilitate long-term financial mediation of these opportunities to investors in the market. Well-developed stock markets in particular have the potential for promoting the efficiency of investment (both local and foreign) thus suggesting that local stock markets are becoming instruments of globalization.

Tanzania, as other countries in the East African region, has separately invested in developing and modernizing its domestic capital market. Contributions of these separate markets to economic growth have not been impressive over the years; a situation that has led to consideration of regionalizing the three East African capital markets, which include the bourses as part of areas of cooperation in the EAC. This is a challenge that requires respective authorities to establish massive internal programmes for capital market development, followed by timely adoption of necessary policy and regulation changes so as to keep pace with the requirements of the regionalisation challenge. It is therefore the intention of this article to investigate these challenges in the regional markets, particularly in the Tanzanian market, with a view to establishing what is currently happening on the ground so as to determine progress towards an integrated regional market.

Organization Of The Study

The study has been organized in six sections and several sub-sections. Section one gives an introduction of the subject matter and the motivation for undertaking the study. Section two presents a review of literature both theoretical and empirical at global level as well as in emerging markets. Section three states the objectives of the study, the research questions the study intends to answer and the hypothesis it intends to test. Section four provides the methodology employed in carrying out the study to produce the research findings that are discussed in section five. Section six provides the conclusion and policy implications.

Theoretical Review

According to Bain (1999), theoretically, a capital market represents a wider context that covers both the primary and secondary market. The primary market as far as securities is concerned, refers to Initial Public Offer (IPO)

where the firm intending to go public upon satisfaction of the securities authority, offers the security to the public to raise the specified amount of capital in the agreed timeframe. Secondary market for securities commences after the lapse of IPO whereby the securities of a public firm are listed at a stock market of its choice as per regulations of the respective stock market. Participation in the secondary market is optional for the public firm, meaning it can decide not to list in the secondary market. Often stock markets have been wrongly referred to as capital markets because of the publicity of their activities, i.e. stock indices in world news. By definition, stock market is one where investors both large and small buy and sell securities (shares and bonds). There are usually market makers who facilitate the buying and selling of these securities, who are called stockbrokers and those brokers specializing in certain types of securities are called jobbers (Blake, 2000). Investors trade in these markets through these brokers. The fact is a stock market is the only secondary market that makes securities trading possible and thus improving their liquidity, *inter alia.*

Several phenomena have made capital markets a priority area in the development context; these include the dissatisfaction with bank-based finance which does not cater for the growing need of a more integrated approach to resource mobilization, promotion of investment and economic growth (Dailami and Atkin, 1990; Ongwumike and Omole, 1997). Reduced supply of foreign funds from previous sources has compelled governments, especially those of developing countries, to turn to capital markets as a tool that will improve domestic resource mobilization, enhance the supply of long-term capital and encourage the use of existing assets.

Capital markets also encourage good corporate governance through IPO and listing requirements which in turn brings about good corporate performance which is in short supply in less developed countries (Mc Kinnon, 1973).

The merits discussed above give capital markets added advantages over other financial institutions. Altogether they make the development of an effective capital market indispensable for any economy that is keen to allocate scarce capital resources to achieve economic growth. The issue remains of how to go about the process of establishing the desired efficient capital market. As globalisation has affected the conduct of every phenomenon, the following sub-topics review empirical literature on globalisation in capital markets from different regions of the world. Moreover, regionalisation has been referred to as a globalization phenomenon as it tends to bring nations together with different initiatives. Furthermore, Africa has been singled out from among the emerging capital markets, particularly because of the existence of an initiative that aims at integrating the African capital markets, which the case study, Tanzania, is a participant.

Empirical Review of Developed Capital Markets in the Globalisation Context

As a result of diminishing opportunities in the developed world, stock exchanges have been actively participating in discussing alliances, mergers and joint ventures, both domestically[2]

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[2] It is possible to have more than one stock exchange, a feature that is not common in most emerging capital markets in Africa. For example, there are three stock exchanges in the USA. The Over The Counter (OTC) NASDAQ, American Stock Exchange, the famous New York Stock Exchange (NYSE) and several other regional exchanges.

and internationally. In Europe, there have been several alliances and mergers. The first cross-border merger proposal between Deutsche Bourse and the London Stock Exchange was initiated but failed as a result of an unsuccessful takeover bid from the Sweden OM Exchange. Success stories include the formation of Euronext (Paris, Brussels and Amsterdam exchanges), the merger of Swiss Exchange and Tradepoint to form Virt-X and the Global Equity Market (GEM) was formed in mid-2000, which comprises NYSE and nine other developed and emerging markets to mention a few. Thus, these types of alliances by the developed stock markets suggest that the world is not likely to move to a single consolidated market, but rather a collection of diverse markets, some strictly domestic, while others with a more global reach (Shahid, 2002).

Empirical Review of Globalisation Perspective of African Capital Markets

There is a school of thought claiming that many countries in Africa undertook setting up of capital market authorities and stock markets in the 1990's primarily for the purpose of facilitating the privatisation of state-owned enterprises, and also as a precondition for the introduction of market economies. The legal frameworks in many African countries were not designed to provide incentives to other market transactions that are often associated with securities exchanges. Consequently, the design of the regulatory framework for public distribution of securities in many African countries has often resulted from a hurried and rushed translation of political and economic decisions into legal ordering (Mwenda, 2003). This runs contrary to the stock markets in other developed markets, which are designed to play two vital and inter-linked roles: to enable government and industry to raise capital with comparative ease; and to provide a secondary market where existing investors can sell and where prospective investors can buy.

The other school blames over protectionist behaviors in setting up and operating capital markets as a root cause of the failure of African countries to effectively and efficient participate in the securities business (Senyo, 2004; Alemayehu (2000). This situation has impeded large and multinational portfolios among other investors from participating in these stock markets, who refer to stock markets in Africa as too small and illiquid with the exception of South Africa.[3] Some African stock markets have been among the world's top performers[4] (in turnover) but that has not been enough to attract foreign investors, who still put the bulk of their money into Africa in the form of private equity through conventional FDI (Aryeetey *et. al.*, 1994).

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[3] The Johannesburg Stock Exchange (JSE) is Africa's largest and most vibrant stock market accounting for over 90 per cent of the total market capitalisation of Sub-Saharan Africa and over 76 per cent for the entire continent.

[4] Egypt was included in MSCI free indices as one of the top 10 emerging markets and the United Kingdom has also identified Egypt as one of the top 10 emerging markets. In 1994, IFC named NSE the best performing stock market in the world. Other countries that have gone into the top ten stock markets are as follows; Nigeria (2001), Botswana, Malawi (2002), Ghana, Kenya and Uganda in 2003 while Egypt and Ghana were strong contenders for inclusion among the ten best performing markets of 2004.

Factors Underlying the African Capital Markets

General observation, drawn from arguments in the two schools, reveals, that the securities markets have delayed taking appropriately prioritized measures to adjust to the dynamics of capital market roles that suit the prevailing needs of African economies. As most African capital markets discuss regionalisation and other forms of alliance in the securities industry, there is the possibility of external influence, including that of multinationals. Reports by Fischer, (2004)[5] ; and Alemayehu, (2000) suggest that consolidation of Africa's 21 exchanges is needed so as to give the markets more depth to overcome the constraints imposed on them by their small size.

When such arguments have been swiftly put into action, the results have been white-washed tombs that African has been expert in creating. In Senyo (2004) it is reported that the world's first regional bourse, the stock exchange in Abidjan, Cote D'Ivoire, that represents eight (8) francophone West African countries, has actually made very little impact on the individual economies it is supposed to represent. It suffers from the same problems other markets have on the continent, such as low liquidity and small capitalisation. In fact the markets in Ghana and Nigeria also in West Africa are bigger in terms of capitalisation and listings than the regional bourse.

Regionalisation rather provides a secondary step towards a solution for the markets' inefficiency, after the first course of action i.e. domestic resources mobilization has been optimally attained. Ndi Okereke-Onyiuke (2004)[6] reports that there cannot be a merger of what does not exist, suggesting that before consolidating Africa's desperate exchanges, individual African countries have to first develop the culture of operating efficient individual stock markets that are free from their structural problems.

A deeper understanding of the problems is crucial so as to prepare for a comprehensive tailor-made solution that will cater for sustainable efficiency of the stock markets. Soyode (1991) reported that low liquidity is the critical problem of the African markets which is largely due to:

- Low number of securities which are floated;
- Low participation of citizens and limitations put on foreign participation;
- Small capitalization of individually listed companies; and
- Poor regulatory and policy environment that constrains the creation of vibrant fund management industries[7] leading to increased liquidity risks in Africa.

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[5] Stanley Fischer was then President of Citigroup International and Deputy Chairman of Citigroup.

[6] She is the head of the African Stock Exchanges Association and Director General of the Nigeria Stock Exchange. She has been trying to put pressure on the Nigerian government to get oil exploration companies listed on the country's stock exchange: their massive assets would greatly boost the size of the market to attract much bigger domestic and foreign investors.

[7] Fund management industries are different specialized services in the securities business, e.g. fund managers who manage unit trusts and their corresponding collective investment schemes, credit-rating agencies to evaluate debt-related instruments etc. Companies that seek capital from the public by (IPOs) and later in the secondary market do require this specialized service.

It is therefore observed that low liquidity stems from the actual situation in individual countries and so regionalisation cannot solve the inherent problems of low participation of citizens in securities business and small capitalizations of individual companies. The solution to this could partly emerge from the report by Senyo (2004) that, if the rural segment of the population has no access to the market, a meaningful market in the African context cannot exist. In other parts of the developing world, Collective Investment Schemes (CIS) have been instrumental in stimulating capital markets by their ability to channel the resources of rural dwellers who account for about eighty (80) percent of the population in LDCs. A good example of this is the Unit Trust of India (UTI) that has developed tailor-made products/schemes that suit the needs of the beneficiaries, ranging from rural infrastructure to personalized needs such as buying gifts during the festival seasons. CIS, along with debt-related products such as municipal bonds, are instrumental in boosting market capitalization of the securities markets, leading to a situation where pension funds, insurance companies and other large savings deposit holders would participate in bigger numbers (Applegarth, 2004). Such initiatives empower both the citizenry by offering portfolio investment avenues and also stimulate the securities market, increasing its capitalisation and its contribution to economic development.

Regionalisation benefits are best realized where there exists greater investment diversification potential between individual markets (Houthakker, 1996). This is important in choosing the level and type of alliance, i.e. from a mere cross-listing of securities among members to having a single regional stock market. As the diversification potential increases, a deeper alliance is recommended to take advantage of the opportunities that arise from a bigger market. Regionalisation can help in solving some structural problems, such as the availability of expensive fund management industries like credit rating agencies[8] for debt-related securities. Bearing in mind the lack of funds for individual bourses in LDCs, such an agency would be expensive to establish and run. Regional efforts at any level would be essential and would give African countries more presence in the international bond markets as some African countries have a good record of managing conventional debt (Fischer, 2004).

Lessons from the discussions above point to the importance of both domestic and regional capital market development. In the African context, efforts should be put, first and foremost, into domestic capital market development to attain optimally functioning individual securities markets which, upon their regionalisation, would create a viable regional securities market which could spread economic development to weaker parts of the region.

Borrowing from the lessons above, the study reviewed the following methodologies in examining the case of the East African capital markets. It started by looking at the situation on the ground of the respective country's capital market as was also reported in (Samuels *et. al.* 1990 and Soyode, 1991). The model by Pardy and Dong-He (1992) has been employed in measuring the efficiency of stock markets as reported in Fama, (1991) and Osei, (1998) for the assessment of stock markets in Nigeria and Ghana respectively. Furthermore the Market

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[8] United Nations Development Program runs an initiative, championed by former UN secretary-general Kofi Annan, which is sponsoring a number of countries to get rated.

Capitalisation Ratio (MCR), which measures the market's ability to mobilise resources and diversify risks in the economy, is reviewed as reported on by Derming-Kunt and Levin (1995).

Objectives of the Study

Based on the lessons and findings of the above review, this study was guided by the following objectives:

- To identify and comment on past, current and future issues within the Tanzanian capital market.
- To describe and make a qualitative comparative analysis of the institutional and traditional characteristics of the stock markets in East Africa.
- To establish if there is an investment diversification potential in the three East African stock markets.

Research Questions

- What are the past, current and future issues in the Tanzanian capital markets and how are they being operationalised?
- What are the institutional and traditional characteristics of the capital markets in East Africa and how are they being operationalised?
- How different from each other are the institutional and traditional characteristics of the East African stock markets?

Hypothesis

Null Hypothesis

- There is an investment diversification potential with a united East African stock market.

Alternative Hypothesis

- There is no investment diversification potential with a united East African stock market.

Methodology

Desk Review, Key Informant Interview and Content Analysis

There was a desk review of literature available about the Capital Market and Security Authority (CMSA), Dar es Salaam Stock Exchange (DSE), Unit Trust of Tanzania (UTT), National Investment Company (NICO), Uganda Securities Exchange (USE), and Nairobi Stock Exchange (NSE). Annual reports, prospectuses and brochures for different institutions were the sources of information, along with scholarly journals and the Internet. Key informant interviews with officials at the DSE, UTT and NICO were held. Registered Brokers and Registered Investment Advisors were also interviewed. A checklist of guiding questions was prepared to help in conducting the interviews.

The researcher then conducted a content analysis by matching theory and findings from other previous studies with findings of this study to add value to the study. Based on the findings from the literature review, comparable variables were compared qualitatively and quantitatively to determine the difference between the same variable from different stock markets in East Africa. The following models were employed.

Stock Market Efficiency Model

In measuring the efficiency of stock markets, Pardy and Dong-He (1992) provide a model with three broad distinguishable measures of stock market development characteristics. The measures are as follows:

- Traditional characteristics include indexes of

growth like market capitalization, value of new issues, number of listed companies and market turnover.

- Institutional characteristics, which include, regulatory mechanisms, information disclosure, transparency rules and trading costs.
- Asset pricing characteristics, which refer to aspects of efficiency in pricing risk.

In this model, evaluation of the characteristics is based on their tendency to deviate from competitiveness and adherence to internationally recommended standards, which is a necessary precondition for regionalisation. Due to data constraints the study dwelt on the former two, i.e. traditional and institutional characteristics.

Market Capitalisation Ratio (MCR)

According to Derming-Kunt and Levin (1995), the MCR measures the ability of the market to mobilise capital and diversify risk in the economy. The Market Capitalisation Ratio (MCR) is given as:

$$MCR = \frac{\text{Market Capitalisation in Respective Year}}{\text{GDP of the Respective Year}} \times 100$$

The interpretation of MCR is that the higher the MCR, the greater the market's ability to mobilise resources and diversify risks in the economy.

Empirical Methodologies for Measuring Investment Diversification Potential

MCR Approach

According to (Houthaker, 1996), the correlation of the MCR gives insights into the investment diversification potential between markets, namely: a low correlation coefficient implies greater investment diversification potential and thus the rationale for integrating respective capital markets. This approach gives a broader economic picture of the capital market in relation to the economy. Both the GDP and market capitalization figures used are in real values so as to minimize the possibility of having spurious covariance between the observations. The empirical correlation model equation used is as follows:

$$r = \sum x_1, x_2, x_3$$

Whereby:

(i) $\sum$ = the correlation matrix of the daily returns of the portfolio
(ii) r = Pearson Correlation Coefficient
(iii) x_1, x_2, x_3 = Exchange rate (USD) MCR values for Kenya, Uganda and Tanzania respectively.

Risk /Returns Approach

A more focused and detailed analysis of the diversification potential is provided in Ahmed and Ayugo (2000), which involves returns and risks to securities that are listed in respective markets. To explore the potential benefits to a Tanzanian investor by diversifying into other East African Stock Markets, i.e. NSE and USE, (the same would apply to a Kenyan or Ugandan investor, with variations in the 'other' East African Stock Markets composition) the standard procedure would need to be followed, exposited in Levy & Sarnat (1970). The problem may be stated as that of a representative investor needing to determine the composition of an optimal international portfolio, international in this context referring to the positions of the respective

country and the 'other' two East African countries' markets. Let us define X as the proportion of the agents' wealth invested in country 1 for the period under consideration. Formally, the agent needs to find X'"'1 = (x"1, . . ., x*') to see that no other portfolio exists with either (i) a higher return and a lower risk (ii) a higher return at the same level of risk, and (iii) same level of return at a lower risk. That is X solves the correlation problem represented in the following empirical model:

$$V = X' \Sigma \; x_1, x_2, x_3$$

Whereby:

(i) $X'1 = 1$
(ii) $X'R = e$
(iii) V = the variance of the investor's portfolio
(iv) Σ = the correlation matrix of the daily returns on the portfolio
(v) R = the return on the portfolio
(vi) e = the minimum acceptable return on the portfolio to the investor.
(vii) x_1, x_2, x_3 = Exchange rate (USD) adjusted investment values for Kenya, Uganda and Tanzania respectively.

In principle, (e) represents the reservation return for the investment below which the investor is unwilling to hold the portfolio. Because the restrictions are all linear, the Kuhn-Tucker constraint qualifications are satisfied. By varying e-values we generate portfolio-efficient frontiers. These frontiers and the investment proportions implied by different segments thereof constitute the basis for subsequent analysis. Due to data availability limitations, the study will be confined to Σ for analysis. The returns on investment data employed are exchange rate adjusted to care for both exchange rate variations and to minimize the threat of spurious covariance between the time series data. It should be noted that the relevant and commonly used exchange rate for East Africa, and Tanzania in particular, is the US dollar and that, since this forex is more favorable to investors, the exchange-rate-adjusted return reported is in USD. It should also be noted that the adjustment may underestimate the relevant investment values in the region. The data employed in determining the two correlation coefficients (MCR and the risk/return) were of respective monthly values for the period 1999-2003.

According to Koutsoyiannis (1992), the theory of correlation provides a rule of thumb that a correlation coefficient (R) approaching plus or minus 1 implies a strong correlation between the two variables. The study thus employed a correlation analysis using SPSS to determine both coefficients of correlation (MCR based and the return/risk based), which were interpreted, to test to the null hypothesis set previously.

Research Findings

Overview of the Tanzanian Capital Market

In the Tanzanian context, capital markets exist in varying operational units ranging from formal, semi-formal to informal. Regarding - the informal sub-sector of capital markets, perhaps the most common practices include lending within family members, within religion/ethnic communities (mostly done by Tanzanians of Asia and Arab origins) and between individuals with a common understanding of each other (friends).

The semi-formal kind of capital markets operates mostly through Savings and Credit Cooperative Societies (SACCOS). Different

social and work groups have established such organisations whereby they mobilise funds and issue credit to their members at affordable interest rates.

As regards the formal category, different institutions exist in the Tanzanian financial system; Micro finance institutions like PRIDE, FAIDA and FINCA, which require no substantial collateral in terms of assets for issuance of loans, provide capital for most Small and Medium Size Enterprises (SMEs). Commercial Banks offer mostly short-term loans (overdraft) to ongoing businesses for enhancing working capital. There are currently 28 commercial banks in Tanzania (BoT, 2005). The other source is Non-Banking Financial Institutions (NBFI) like the Pension Funds that selectively give loans to individuals.

Regarding long-term financing, Tanzania's investment and finance institutional set up has faced several reforms, resulting in the current situation of almost non-existence. The Cooperative and Rural Development Bank (CRDB) opted to reorganize itself into a commercial bank; the Tanzania Investment Bank (TIB) is also going down the same path. Tanzania Housing Bank (THB) had to be closed and Tanzania Development Finance Limited (TDFL) has been privatized and subsequently reoriented. Over and above these developments, previous policies were also in favor of public sector access to credit. Consequently, there has been a vacuum in the long-term development financing area that as led to a crowding out of the private sector from effectively participating in the economy.

In recognition of the dire need for long-term financing of business and other developmental projects, the government, with the help of the donor community, established an authority that would oversee the availability of capital by means of trading in securities (shares and bonds), the Capital Markets and Securities Authority (CMSA), the history and operations are as hereunder.

The Capital Markets and Securities Authority (CMSA)

CMSA is the overseer of the Tanzanian capital market that was established by an Act of Parliament in 1994. It became operational as an autonomous institution in July 1995, charged with the responsibility of supervising, regulating and developing the capital market industry in Tanzania. The authority is also charged with the tasks of increasing market depth by increasing the number of listed securities, developing and attracting new products and instruments into the market. Other tasks include that of improving corporate governance and public awareness of capital market operations. CMSA also lobby for fiscal policies that facilitate long-term investment and capital market development as part of its tasks. Some of its functions include:

- To maintain surveillance over the securities business so as to ensure orderly, fair and equitable dealings in securities.

- To register, license and regulate the stock exchange, investment advisors, securities dealers, their agents and representatives and to control and supervise their activities with a view to maintaining proper standards of conduct and professionalism in the securities business.

- To determine the minimum capital requirements for licence holders given the size of operations and risk and monitor their solvency and take other measures which will protect the interests of investors where solvency of such holders is in doubt.

As an overseer, the CMSA regulates operational institutions that execute actual transactions in the industry. In some cases it also facilitates the establishment of these institutions, for example CMSA was instrumental in the establishment of DSE and also the promotion of Investment Advisory and Stock Brokering firms. Although all these institutions are privately run, the government through the CMSA had to play a key role in their establishment and some initial operations because of the infancy of the private sector on the one hand and low public awareness on the other.

The Capital Market and Securities Act has been amended to accommodate issues that would contribute to capital market development. In 1997, the Act was amended to include the collective investment schemes and prospectus requirements regulations. Regulations have also been given from time to time with the view of strengthening the capital market industry. One of the latest interesting developments is the government's decision in 2003 to liberalize the capital account, that foreigners to participate in the capital markets. Following the opening of the capital account, the following rules and regulations were instituted:

- Foreign investors are allowed to invest in listed companies in Tanzania, but Tanzanians are not allowed to invest outside the country.
- Foreigners can invest in shares of a listed company up to a maximum of 60% with 40% of the ownership of the listed companies being reserved for exclusively domestic investors whereas the 60% is for both foreigners and locals.
- Cross-listing is only possible for companies from approved territories. As of 2003, Kenya and Uganda were the only approved territories (CMSA, 2003).

The decision to open up the capital account was echoed quickly by cross- listing of Kenya Airways shares and later by the East Africa Breweries Limited (EABL). Tanzanian companies are yet to cross-list in either of the approved territories though the study found some interesting developments in that there is at least one foreign-owned company operating in Tanzanian, which has listing history in foreign stock markets. The Financial Gazette issued on May 15, 2003 quoted a Tanzanian official saying "African Gem Recourses (AFGEM), which is listed on the JSE, has also indicated an interest in listing" on the DSE. Likewise CORE 2005 reported that during July/August 2004 they were Joint Sponsoring Brokers to the IPO of Tanzanite One Limited (AFGEM was sold in April 2004 and changed its name to Tanzanite One, see Daily News, 18th March 2005. on the Alternative Investment Market (AIM) of the London Stock Exchange. This is an encouraging development that maps Tanzania as an investment avenue capable of attracting portfolio investors in such developed capital markets. This fact thus counters the arguments of multinationals that African stock markets are too small for them to invest in due to small capitalisation (Fischer, 2004). Change of a listing bourse to DSE, for example, would have boosted its capitalisation from both domestic and foreign investors and added to the improvement of the situation on board. Furthermore, results from examination of the listed companies on the DSE, show that over 40 % percent of them are foreign-owned. It is only DAHACO and TOL that have not reached the ceiling, thus suggesting that the ceiling wasn't liberal enough to attract foreigners to stimulate liquidity in the market as intended.

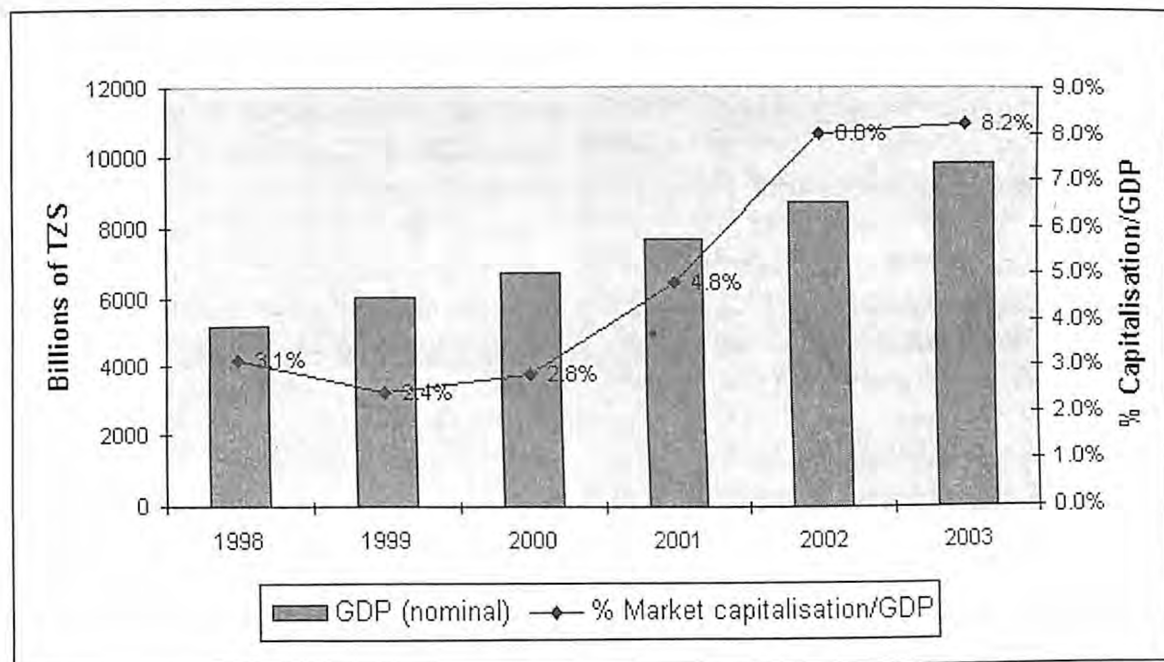
The Dar es Salaam Stock Exchange (DSE)

A stock exchange is a market where investors both large and small buy and sell securities (shares and bonds). There are usually market makers who facilitate the buying and selling of these securities, who are called stockbrokers and those brokers specializing in certain types of securities are called jobbers. The DSE is a private company that was incorporated in 1996 and started operations in 1998. Since its inception, it has listed both bonds and securities and, as at 1st July 2005, equities listed include Tanzania Breweries Limited (TBL), Tanzania Oxygen Limited (TOL), Tanzania Tea Packers Limited (TATEPA), Tanzania Cigarette Company (TCC), Tanga Cement Company Limited (SIMBA) and Dar es Salaam Airports Handling Company (DAHACO). With the exception of TATEPA, the rest were formerly parastatals that were privatised, demonstrating the fact that the DSE has also facilitated the privatisation process by in theory, giving a secondary market of the shares of the privatised parastatals as reported in Engleberg (1975). DSE has also cross-listed 2 equities which are Kenya Airways and East African Breweries (EABL). DSE has also listed 3 corporate bonds, which are East African Development Bank (EADB) 5 year-bond, PTA bank 7 year-bond, the BIDCO 5 year-bond and the 8 billion Tshs Standard Chartered Bank Bond which are truly private sector bonds, the rest being of regional banks. Standard Chartered Bank has pledged to lend to large-scale farmers (70%) and SMEs (30%), using the capital raised from the bond. These securities are evidence of the theory that capital markets are a means of transferring resources from the idle and informal sector to productive and formal lines of production as provided in Shaw (1973). Furthermore, there is a broad array of treasury bonds of different duration, 5 years, 7 years and 10 years, with coupon rates ranging from 5% to 11.44% together totalling 248.4902 billions Tshs as of July 2005.

The DSE does not have an official index that measures its performance as in other stock markets, though different actors have developed unregistered indices for their current and future use. CORE (2005) is reported to have designed the COREDEX Average Index and the COREDEX Composite Index to track the performance of the DSE, modelled on international stock market indices. These definitive benchmarks are used to serve their clients but are also available by arrangement for use by other fund managers. The Composite Index is a key part of the design and performance assessment of the Akiba Unit Trust (as discussed below) for regulatory reporting. Having no index is a weakness that needs to be addressed, so as to give DSE a more international outlook.

Observations reveal that, generally, the market is narrow, offering only two products (equity shares and corporate bonds) with secondary market for treasury bonds. Consequently there has been a low rate of growth in the number of people participating in the market. According to CORE (2005) by January 2005, only 98,000 people (most of whom are urban dwellers) out of a population of 35 million participated in DSE activities using IPO figures. This is only 0.28 % of the total Tanzanian population.

Fig.1: *Trend of Market Capitalisation Ratio (MCR) at DSE*



Source: *Researcher's Own Computations Based on DSE and NBS Database*

The MCR percentage for Tanzania as shown in figure 1, also complements the results. Although the reported 8% is low, the deeper analysis of this study considers it high, based on a report by Maliyamkono *et al* (1990) that an estimated of 40% of the reported GDP goes through the informal sector, which is thus not accounted for in the national accounts, worsening the situation even further. This situationin the market is partly attributed to low public awareness as confirmed by reports from public awareness programmes conducted by CMSA, UTT and DSE in the lake zone of Tanzania which observed that in some areas there was not one person who had either heard of or bought a share of any kind whatsoever (Daily News 18th February, 2005). These results thus endorse the challenge reported by (Senyo, 2004) that without mobilising resources from the remote and rural parts, it is difficult to have a meaningful market in Africa.

Despite the aforesaid limitations in the supply side, evidence from the demand side shows that there is a demand for portfolio investment opportunities in the securities industry. For example, the last listed equity, DAHACO, had an over-subscription of its shares by 700% (raising 25.2 billion Tanzanian Shillings), achieving a three-fold price appreciation within the first three weeks of secondary trading (CORE, 2005). The last listed corporate bond, BIDCO, was over-subscribed by 140% (raising 14.0 billions Tanzanian Shillings). Furthermore, there has also been a reasonable response in the purchase of shares that are relatively illiquid, such as those of non-listed equities, e.g. CRDB.

ACB and DCB. All these are signals that the market is in demand of securities. The regulator has reacted to these signals, and has come up with initiatives that try to stimulate the market, as discussed in the following sub-topic.

Initiatives to Stimulate the DSE

Establishment of Tier II Market Segment

The CMSA, together with the DSE, is currently working on establishment of the second segment of the market (tier II) and the over the counter market (OTC) in due course to try to enlarge the market. This is a positive move as it gives room for more securities to be listed on the DSE by giving a chance to companies that cannot meet the demands of the tier I market which are assumed to be more stringent. Analysis of the two segments has established that the differences in the requirements are not so great and as such they are set low for ordinary, well performing businesses as seen in appendix 1.

For the sake of this paper, two requirements that appear to be crucial are examined. A listing company should have a minimum amount of paid-up capital of 50 millions in tier I whereas it is 25 millions in tier II. The difference may sound big, "half", but in reality, for a viable business that will make an impact on the Tanzanian economy because paid-up capital of 50 Tshs million is not expected to be an issue impeding its listing. The other requirement is that a company should have 1,000 shareholders in tier I whereas in tier II there should be 300 shareholders. Given the public demand explained in the background, this too is not an overriding constraint significantly impeding listing.

For ease and convenience of elaborating the two requirements, the study considered the financial sector. Furthermore, the study further limits itself to the banking and non-banking industries within the financial sector. The rationale for the choice is based on the logic that operators in these industries can contemplate and easily adapt issues of the capital markets as the two are closely related and often overlap in their operations. In these industries there 28 are registered commercial banks, five (5) non -Bank Financial Institutions and two (2) regional cooperative banks (BOT, 2005). According to the regulator the minimum capital requirements for establishment of institutions are as follows:

Table 1: *Minimum Capital Requirements for Financial Institutions*

Type of Financial Institution	*Minimum Amount Required*
Commercial Bank	1 billion Tshs.
NBFI	200 million Tshs.
Regional Cooperative Bank	200 million Tshs.

Source: *BOT, 2005*

These minimum requirements imply that there are 35 potential companies in this particular industry that meet the criteria. Unfortunately, it is observed that none of these financial institutions is registered at the DSE. Furthermore, there are commercial and community banks that are owned by securities, i.e. floated shares by IPO[9] with permission from CMSA, e.g. CRDB Bank, Akiba Commercial Bank, Dar es Salaam Community Bank etc. These would meet both criteria and would qualify to be listed in tier 1, making at least three (3) more securities listed.

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[9] So far all IPOs have attracted more than 1,000 shareholders. Evidence of this is the case of listed under-subscribed TBL shares and recently under-subscribed NICO shares which more than ten thousand people applied for.

This is the situation in the financial sector. In other sectors the mining, there is now evidence that developed markets list companies in the Tanzanian mining sector. Apart from those declared listed, there are at least three (3) other multimillion dollar gold mining projects, i.e. Kahama Mining Company Limited, Geita Gold Mines and Africa Mashariki Gold mine. Their going public in Tanzania would most probably attract 1,000 people, given the IPO history.

Establishment of the Over-the-Counter (OTC) Market Segment

The Over-the-Counter market aims at trading in securities that are of low volume and are traded infrequently. Usually market makers (brokers) commit the market, e.g. the DSE and the company, to buying a certain amount[10] of specialised securities and selling them to prospective subscribers. This kind of arrangement entails that the exchange is a "broker-to-broker" kind of dealership, whereby one broker can collect orders of certain securities and buy them from the specialised broker on behalf of subscribers. In Tanzania, the OTC will be ideal for companies that have registered securities but are not trading in both segments (tier I and the prospective tier II) of the secondary market, i.e. DSE. OTC shall also benefit those companies which do not qualify in both segments in the anticipation that after operating in the OTC their businesses will expand and be listed in either of the two segments.

[10] A broker specialises in certain types of securities or securities of a certain company and agrees with the company and the exchange authority on the maximum number of securities (ceiling) that the broker shall deal with at one particular time.

Establishment of Municipal Bonds

Municipal Bond is another area that is of great potential if well ventured into. It is a double-pronged instrument that can stimulate both the supply and demand sides of the market. Municipal bonds are commonly used to finance long-term developmental projects that local government authorities cannot afford with their own capacities. Infrastructure projects such as bridges and roads are the projects commonly funded by municipal bonds in developed economies.

According to the DSE official interviewed, there are plans to start such a product in the market. Identification of potential municipalities and respective projects has been done, together with sensitisation and preliminary negotiations. It was anticipated that, by June 2002, at least one municipal bond could have been listed (CMSA, 2002), but to date nothing has happened. This silence inspired the author to probe into the nucleus of the impediment, focusing on yhe realities on the ground. It was observed that the setting of operations within local governments gave room for political rule[11] and interventions that might hamper the professional (economic and business) environment that the bond needs for it to be operated successfully. The other shortfall is lack of trained and skilled manpower to

[11] Full Council is the supreme decision-making organ in the district/municipal council decision making setting. It is a political organ that does not guarantee the presence of professionals since its members are democratically elected by means of voting. These members also form subsequent committees, including the one that might be responsible for the bond. Some unprofessional (political) decisions can logically be expected at the expense of the bond.

operationalise this relatively new business entity in Tanzania. These were observed as potential setbacks that could be foreseen.

Furthermore, following the government's decision to abolish "nuisance" taxes, which were imposed by these local authorities, the tax collections have been significantly reduced in most municipalities. This is an opportunity that can make the idea "well understood" and gladly welcomed as a salvage tool in financing what the local authorities are supposed to deliver to the public with or without the abolished "nuisance" taxes.

Much as we appreciate the fact that all the above initiatives will stimulate the market inside and outside the DSE, the impact is predictably limited, because of the facts discussed. Having realized that, this study went further into scrutinizing the latent issues responsible for the low numbers listing on the DSE.

Latent Factors Hindering Listing on the DSE

In key interviews with stakeholders in the capital markets industry, the issues raised as being responsible for the low numbers listing on the DSE included the following:

- General awareness of the public is low, especially from the supply side, i.e. companies to be listed on the DSE.

- The other problem is that of disclosure, as most companies are not ready to disclose their business plans for reasons that could be linked to tax evasion and fraudulent activities entailing elements of poor corporate governance. For those in a competitive industry like banking, the issue of inadequacy of the judiciary and rent seeking from the bureaucrats has often impaired enforcement of the law and other regulations, amounting to a disincentive to listing.

- Fear of dilution of ownership; most owners expressed the fear that they may lose a substantial amount of the decision-making powers as a result of going public.

- High cost of IPO was also cited as a potential impediment for companies to be listed. IPO involves media publicity, promotional events and other logistics that are often expensive. Depending on the responsiveness of the public in subscribing to the securities, the exercise can be a potential loss should the IPO performance fail to deliver as stipulated in the prospectus and as per regulations.

These reasons among others are responsible for the low turn-out for listing on the DSE and opting for conventional ways or raising capital, i.e. borrowing from financial institutions. Solutions to curb some of these constraints have been contemplated as discussed below.

Proposed Solutions to the Latent Factors

Concerning low awareness, there have been sensitization campaigns to create awareness of the public concerning capital markets. The CMSA, DSE and the UTT have already started and are still engaged in public address, mostly up-country in sensitisation of the citizenry about the securities business. The sensitisation programmes are mostly for subscribers to be aware and knowledgeable of what the industry does and what they should do. Ultimately, the public is urged to buy securities, which is a demand creation activity. Parallel to these sensitisation programmes possible suppliers should be headhunted by conducting specific training sessions aimed at pursuing potential companies

for listing shares and corporate bonds. Supply side stimulants are more instrumental at the moment at least to meet the demand discussed earlier.

Incentives of a different nature have often been used to stimulate capital markets elsewhere in the world. Fiscal incentives in particular have been used as tools to attract both subscribers and companies to be listed on the DSE. Currently the tax incentives are as follows; withholding tax on dividends for listed companies' shares is 5% whereas for non-listed it is 12.5%. There is tax exemption on interest earned on listed corporate bonds as for government bonds, whereas for non-listed corporate bonds a withholding tax of 12.5% is charged. Both stamp duty on transfer of shares and tax on capital gain of securities have been exempted from taxation for listed companies. Lastly, all costs incurred by a company in IPO are allowed to be deductible from the respective year's profits for the purpose of computing the corporate tax payable.

Examination of the incentives revealed that most of them are either not effective given some latent realities of actual happenings on the ground, or they are demand biased, i.e. favor investors/ subscribers to the companies and not the supply side, i.e. the listing companies. The deduction of IPO costs in tax calculation is attractive, but the fact that IPO is not a recurring event makes it felt to be less effective as an incentive. With the transfer of shares, experience shows that the percentage of equities offered to the public is often low, because of the fear of dilution of ownership discussed earlier. This in turn favors more the subscribers in the secondary market thus making the effect of the exemption less effective for the parent stakeholder. The withholding tax on capital gains and interest on bonds are calculated internally by the companies, though audited by independent firms, which entails taking advantage of all tax avoidance (which is legal) and furthermore, given the level of corporate governance, loyalty and honesty to the tax regime, the exemption could logically be rendered less effective.

Given the situation on board, offering more incentives than at present is important so as to attract more firms for listing. This initiative should place more emphasis on stimulating the supply side by making listing more attractive and the best operating mechanism for firms in the economy. Consequently the cost of not listing should be so well felt, that it challenge the non-listed firms.

International best examples include that of Malaysia, whereby, in 1989, the government decided to give listed companies a 5% preferential tax rate (i.e. from 40% to 35%). This reduction led to a 193% increase in the number of listed companies by 1998 (i.e. from 251 to 736 companies). On a yearly basis, between 1989 and 1990, the increase was 12.3%, almost double the record high annual increase of the 1980's. Years 1991 and 1992 witnessed even larger increases in the number of listed companies, 13.8 and 14.5 respectively. Likewise by 1996, market capitalization as a percentage of GDP had risen from 54% to 305% (IMF, 2000). In Brazil, studies showed that preferential tax treatment on corporate profits did not play a large role in the development of the primary market. Instead, tax breaks on corporate profits were instrumental in decreasing the effective tax on equity, leading to an increased number of firms relying on new issues for financing and the supply of equities in the primary markets (IMF, 2000).

Learning from these experiences, Tanzania, given the business environment discussed, should consider a deeper measure in formulating its incentives in the capital markets industry. A

proposal is made to consider either exemption or reduction of taxation on routine expenditures. This could bring about a more effective incentive for potential companies to list, e.g. a reduction of VAT. like those offered in some FDI cases.

Listing Potential in the Tanzanian Capital Market

According to Delloitte and Touche (2004), there are several companies in the private sector that are seriously considering listing in due time when the government is stabilized and the business environment is right and conducive. The conditions, though generalized, point towards the findings discussed above. Table 2 shows some potential companies in the private sector.

Table 2: *Companies in the Private Sector for Potential Listing*

Name of the Companies	
Akiba Commercial Bank Limited	Barclays Bank Tanzania Limited
CRDB Bank Limited	Diamond Trust Bank Limited
Geita Gold Mining Company Limited	Kahama Mining Limited
MIC (T) Limited	Shelly's Pharmaceuticals Limited
Stanbic Bank Limited	Standard Chartered Bank Tanzania Limited
Tanzania Development Finance Limited	Toyota Tanzania Limited

Source: *Researcher's Own Findings and Delloite & Touche*

In the public sector, there are two categories of companies, those that have already been divested and those in the early stages of divestiture. A full list that includes other parastatals that the government has not yet mentioned concerning their divestiture is shown in appendix 2.

Table 3: *DivestedCompanies for Potential Listing*

Name of the Company	*% of Shares Retained By Government*
Tanzania Telecommunication Company Limited (TTCL)	65
Aluminium Alaf	40
Tanzania Portland Cement Company Limited	39
NBC (1997) Limited	30
Tanzania Electric Goods Manufacturers Company	30
Williamson Diamond Mines	30
Kilombero Sugar Company Limited	25
Air Tanzania Company Limited	49

Source: *Researcher's Own Findings and Delloite & Touche*

Shares that the government own can be offered and traded on the DSE on its discretion. The study speculated on the potential number of shares in table 3, based on the interview with officials of the respective companies. Table 4 shows companies that are potentially at different stages of divestment. Despite their transition, the study also speculated their potential for listing on the DSE. As of July 2005, the government has already initiated for listing through CIS at least one company from the list BP, Tanzania (see Financial Times 30th March 2005). The government, through PSRC, has also decided to dispose of its retained shares in the Tanzania Portland Cement Company Limited (TPCC) through IPO and equity listing on DSE sooner rather than later (see Daily News, 22nd March 2005). If this happens, the challenge thereby given to Tanga Cement (SIMBA) can only be for the good of the market. The NBC's (Ltd.) declared intention to be listed appears to have stalled as a result of Barclays Bank PLC's purchase of a controlling interest in ABSA, NBC's parent company in South Africa. It remains to be seen if the premium paid to ABSA will be passed on to NBC and reflected in the IPO price.

Table 4: *Companies in Early Stages of Divestiture for Potential Listing*

Name of the Company	*Proposed % of Shares Retained by Government*
NMB	49
National Insurance Corporation	49
General Tyre East Africa Limited	49
BP Tanzania Limited	25
Tanzania Harbours Authority	Undecided
Tanzania Electric Supply Company	Undecided
Dar Es Salaam Sewerage and Water Authority	Undecided

Source: *Researcher's Own Findings and Delloite & Touche*

Shares from the former government-owned companies that are retained by the government after divestment of the respective companies were supposed to be warehoused in the former Privatisation Trust (PT) and the latter Unit Trust of Tanzania. This leads to a discussion on another important development in the Tanzanian capital markets industry, the collective investment scheme.

Collective Investment Scheme (CIS) and Private Investment Companies

The Capital Markets and Securities Act was amended in 1997 to incorporate the collective investment scheme[12] which means:

a) An open-ended investment company;
b) A unit trust scheme;
c) Such other arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income; and
d) Any other scheme or arrangement deemed by the authority to be a collective investment scheme for the purpose of this Act, (CMSA, 1997).

The broad definition of the Collective Investment Scheme (CIS) above allows for different settings that fit into the definition to engage in business in the capital markets industry in Tanzania, including participation in the DSE. Both the government and the private sector are eligible participants in establishing CIS. According to CMSA (2002), four groups were attempting to establish four CIS namely NICO, TAWIT, UTT and PANGEA Securities East African Limited. It was anticipated that by the end of 2002/2003 financial year, at least two would be approved. This never happened until the 2003/2004 financial year when NICO was approved as a private investment company.[13] The Tanzania Chamber of Commerce Industries and Agriculture (TCCIA) has also established and launched an investment company (Guardian 18th March, 2005). UTT launched its CIS in May 2005. In CORE (2005) it was also reported that

[12] It involves aggregation or pooling of resources from a variety of investors. As against a limited liability company, CIS specifically targets, marketable securities. It also has several advantages, such as aggregating small savings into large pooled funds, professional management of the pooled funds, risk diversification through diversified portfolio, lower transaction costs and access to investment of higher minimum shareholdings.

Core Securities Limited had developed a CIS by the name of Akiba Unit Trust that comprises three funds: an income fund, capitalisation fund and a managed fund. It has already been submitted to the Capital Markets and Securities Authority for approval; all sponsors have been identified and CORE as the Manager has already developed appropriate unit trust registrar and management software. For the sake of this paper, the two, i.e. NICO and UTT, will be discussed firstly because they have taken off somewhat and secondly they represent the private sector and government respectively.

National Investment Company (NICO)

According to its prospectus, the National Investment Company Limited (NICO) is a public limited liability incorporated on 27th June 2001. Its mission is to bring about a radical enhancement of participation of Tanzanians in their national economy. In particular, the mission of NICO is to provide a vehicle for collective ownership of commercial enterprises by Tanzanians capable of generating returns to its shareholders. NICO targets selected enterprises being or already privatised by the Government of the United Republic of Tanzania specifically, NMB, TANESCO, NASACO etc. NICO also intends to finance the establishing, acquiring on managing of enterprises in industry, finance services, telecommunications, agriculture, mining and in the service sector.

Through private placements, the company was been able to attract 148 Tanzanian shareholders, most of whom contributed TZS 1,000,000/= towards the equity capital of the company, thus acquiring at least 4,000 shares each. Equity contributions by members of the company therefore stand at a total of TZS 139,842,000/= as at 31st December 2003.

In November 2004, the company launched its Initial Public Offer (IPO), without applying for listing on the DSE. The IPO lasted for two months then NICO orchestrated a massive sensitisation campaign through the media, public lectures and meetings, with the intention of marketing its shares. The IPO was structured in 80,000,000 ordinary shares of the company, representing 40% of its issued share capital at a price of TZS. 250/= per share. The IPO was intended to raise T.Shs. 20,000,000,000.

The issues raised concerning NICO ranged from the approval of its prospectus to the *modus operandi* of the company. Among the hotly debated issues were the following:

- The prospectus failed to demonstrate to prospective shareholders the specific viable projects into which their money would be invested. Conventionally, since NICO had no track record in business, a viable business plan would be necessary to demonstrate how the core business of the company would be operationalised. It is perhaps because of this reality that NICO was not listed on the DSE, as it could not meet such an essential listing requirement. Regardless of the absence of the business plan, there was mentioning of parastatals such as NMB, TANESCO,

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[13] It resembles so much the CIS but it is allowed to invest in securities other than marketable securities. Involves aggregation or pooling of resources from a variety of investors which is the activity most commonly known to most people. The differences in operational and legal technicality between the two can be misleading to the investing citizenry if the individual investors do not take the trouble to learn about them.

NASACO and other divested companies as immediate targets for NICO's investment portfolio during the IPO campaign. Regulations provide that the fate of bids to acquire firms in the privatisation process is competitively determined, implying no guarantee of success to any interested party. As the campaign rose to its height, NICO had a misunderstanding with PSRC, the latter claiming that the former was pre- determining the fate of the bidding of NMB as a result of their campaign.

- NICO is a public company limited by liability, and is allowed to establish several projects as provided in the prospectus, including agricultural and telecommunication infrastructure. In the event that certain projects fail, the management/board may wish to cross-subsidize ill performing projects to the disadvantage of shareholders who were attracted by a specific project. Such a situation could have been avoided if the projects had been defined before hand and the subscribers given the choice of which specific project to invest in.

- Given the nature of its prospectus, the success of NICO critically depended on the quality of its Board of Directors and its committees together with its Management. Examining the board and the investment committee, which are both key decision-making organs of the company, it was observed that both were comprised of senior citizens, most of whom are retired dignitaries and a few business persons in Tanzania. Pessimism is centred on the credibility of some members as they had declared their interest in running for the presidency and so could use NICO for political purposes. Likewise some members were in the government at the time of the demise of what they now want to acquire through NICO. The two observations pose a challenge to the board that those involved in NICO should be dynamic, energetic and also have an undoubtedly good track record.

The IPO attracted 20,961 Tanzanians and raised 4,419,090,500 Tshs (only 22.1 percent) of the 20,000,000,000 Tshs mentioned in the prospectus. Comparing the result with the last two IPOs which where heavily over subscribed raising 14 billion (BIDCO) and 25.2 billion (DAHACO) and given the demand for securities discussed before, these results send a signal that there is also a level of technical awareness of the subscribers, which they use in making investment decisions. Furthermore, the findings prove the theory as reported in Jordan (1996), and Shaw (1973), that capital markets are used to raise capital and as information transmits asymmetrically in the Tanzanian capital market. This being the case, it is implied that the problem of under-subscription partly lies with NICO itself amid reasons given by its officials that PSRC gave scary statements to the public among other reasons as reported in www.ippmedia.com/ipp/guardian/2005/02/15/32525.htlm.

On the other hand, the fact that the shares were purchased despite the shortfall shows that there still is a need for more sound securities. This is the challenge given to the regulator and the companies interested in the industry to quench this self-evident thirst in a more attractive way. Much as the government's reduced participation in mainstream business is advocated, the issue of regulating and overseeing remains under its auspices; it should thus ensure that ambiguities such as those raised by NICO's case are resolved

so that the public makes more informed decisions based on the government's approval.

Furthermore, such efforts by private indigenous Tanzanians should be viewed alongside the policy of empowerment to see how best to involve them in a less risky manner to avoid them being be left stranded by risky undertakings they get into unknowingly. As NICO was the first in the list of private investment companies, it should be used as an example for other such other entities to follow.

The following sub-topic discusses the government's initiative of CIS, the UTT.

Unit Trust of Tanzania (UTT)

UTT was set up as a successor to the previous organisation, which was known as the Privatisation Trust (PT). It was incorporated in June 2003 under the Trustees Incorporation Ordinance (Cap 375). PT basically stored shares of the privatised parastatals, and as its life ended based on the law that established it, the Unit Trust of Tanzania took over. UTT was given a mandate to ensure that shares, which were held by the Privatisation Trust and others that will be transferred to it, are distributed among Tanzanian citizens in a manner that will encourage and facilitate savings and wider participation of citizens in the privatisation process and also stimulate them in participating in the capital market. This objective carries an empowering mandate and so for the sake of operationalising it, UTT has developed several action plans, which include initiating collective investment schemes, compliance, capacity building and training. The latter three have been and are still being implemented; there have been several training and capacity building campaigns, especially up-country done either by UTT itself or jointly with CMSA and DSE, targeting both its prospective clients and collaborating institutions.

Regarding compliance, shares currently held are evidence of it, though deliberate efforts are needed to enrich UTT's capitalization. Records show that UTT holds shares of only two of the privatised companies, i.e. TCC and TBL (both are listed on the DSE). Table 3 shows a list of already privatized companies with government-retained shares, but not transferred to UTT. Findings of this study show that this is partly caused by the fact that most of the companies which are not yet transferred to UTT are not listed on the DSE, thus making their valuation and marketability difficult to achieve. Consequently, the UTT cannot at the moment use them to realize the best results as per its objective.

On the CIS initiating front, UTT has established a CIS known as UMOJA FUND, which was launched in May 2005. UTT has used the 23,594,277 shares of Tanzania Breweries Limited (TBL) and the 3,000,000 shares of Tanzania Cigarettes Company Limited (TCC) it holds as seed capital in establishing the fund, whose principle objectives will be to help ordinary Tanzanians participate in the DSE by purchasing and selling securities traded there. Capitalization of the fund has been valued at 30 billion Tshs whereas units of the fund have been valued at 100 Tshs but will be sold at 70 Tshs to give its subscribers a 30 Tshs (42.8%) guaranteed capital gain upon subscription. The units can either acquire or lose value, depending on the seed capital shares' performance on the DSE. In recent days, the two seed capital shares' (TCC and TBL) performance has been challenged differently. East African Breweries Limited (EABL) was listed on the DSE on Wednesday 29th June 2005. On the listing day, the shares opened at T Shs 2,300 and 100 shares were traded, leaving a somewhat larger amount of shares as outstanding bids. Going by the KQ experience,

it will take a bit of time, 2 to 4 weeks, for brokers to establish NSE alliances and build up significant stock of EABL shares to sell. What the market is awaiting is TBL's reaction. Interestingly, observations half way (1st July 2005) through the Umoja Fund IPO's time lapse have revealed that trading in almost all the shares has been and still is thin (a few shares have been bought). In particular, it was observed that TCC shares fell to under 1,580 and the COREDEX Composite Index fell below 237 for the first time in more than a year; all "blamed" on the Umoja Fund. Much as there can be such fluctuations in the price of these shares, the fact that Umoja units are a balanced fund (70% debt; 30% equity) the risk of losing appears well cushioned by the debt investment which in usually less risky.

The main operational difference between the UMOJA FUND and the other CIS we discussed earlier is that UTT will float shares (by IPO) of specific schemes (UMOJA FUND to start with). The regulator, i.e. CMSA, approves the particular scheme not a "blanket" share that its investment target is to be determined later whereby individual subscribers' choice has already been impaired. This phenomenon can give UTT an upper hand over the other types of CIS. Elsewhere in the world, India to be specific, there has been a remarkable development of unit trusts. As UTT borrows some ideas and expertise from the Unit Trust of India (UTI-Mutual Fund), this study will briefly examine its success story.

Unit Trust of India (UTI)

Unit Trust of India was the first mutual fund set up in India in 1963 as an initiative of the Government of India and Reserve Bank. In 1992, the Securities and Exchange Board of India (SEBI) Act was passed with the overall objective of protecting the interests of investors in securities, promoting the development of and regulating the securities market. In the early 1990s, the government allowed public sector banks and institutions to set up a mutual fund. In 1993, SEBI notified regulations that allowed mutual funds sponsored by private sector entities to enter the capital market. All mutual funds, whether promoted by public sector or private sector entities, including those promoted by foreign entities, are governed by the same set of regulations and all are subject to monitoring and inspections by SEBI. On the other hand, mutual funds can mobilise funds from the investors by launching schemes only after getting registered with SEBI as mutual funds.

Examination of the Indian case shows a resemblance to most of the issues that CMSA has as far as CIS is concerned in Tanzania. However, there are two main differences; first the Indian government restricted private operations of CIS for twenty years, so that it gained enough experience by administering its own initiative - the Unit Trust of India (UTI) before letting in private entities. The Tanzanian case calls for review as the first private CIS has reflected the immaturity of the industry, partly because of lack of hands-on experience, which is necessary, especially when it comes to portfolio investment.

Secondly, the SEBI only registers schemes that are compliant with its requirements as seen in the demonstrating examples in tables 5,6 and 7 below. Although NICO does not come under unit trusts, because it does not have details of specific schemes, making it non-compliant with issues like possible investment in portfolio avenues, it is deemed necessary to comprehensively review CIS operations in Tanzania.

The following are examples of Collective Investment Schemes run under the auspices of UTI. Important things to note are the asset allocation and the limits thereof to reflect

objectives of the scheme while also complying with the SEBI requirements of investing in marketable (portfolio) securities. Table 5 shows a CIS that targets the Auto Sector and invests specifically in equities (shares and not bonds) of companies that are registered.

Table 5: *Sector-Specific Equity Fund Collective Investment Scheme*

UTI-Auto Sector Fund	
Type of scheme	Open Ended Equity Fund
Date of Inception	9/5/2004
Scheme Objective	The scheme aims to provide investors with growth of capital over a period of time as well as to make periodical distribution of income from investment in stocks of respective sectors of the Indian economy.
Asset Allocation	At least 90% in equity / equity related instruments
Face Value	Rs.10/-
Plans	
Minimum Investment Amount	Rs. 5,000/-
Registrars	UTI Technology Services Ltd.

Source: *www.utimf.com/products*

Its asset allocation is also biased towards equities and equity-related instruments. It is open-ended meaning that the shares have an exit mechanism for transferring from one subscriber to another

UTI Bond Advantage Fund	
Type of scheme	Open Ended Income Fund
Date of Inception	Dec 7 1999
Scheme Objective	It aims to generate attractive returns consistent with capital preservation and liquidity
Asset Allocation	Debt - Maximum 90% Money Market - Minimum 10%
Face Value	Rs. 10/-
Plans	Institutional Plan- Bonus Bonus Plan Institutional Plan-Growth Growth Plan Institutional Plan-Annual Dividend Annual Dividend Plan Quarterly Dividend Plan
Minimum Investment Amount	Rs.5. 000/-
Registrars	Karvy Computershare Pvt. Ltd

Source: www.utimf.com/products

Table 6 shows a CIS that has debt-oriented instruments (bonds and not shares); its asset allocation is biased towards bonds and other money market instruments to reflect its specialisation. It aims at giving attractive periodic returns (liquidity) to preserved capital.

Table 7 provides a tailor-made CIS that caters for basic traditional needs of its clients with options. It is a balanced fund in that its asset allocation is in both bonds and equities; furthermore it is a close ended CIS, meaning that there is no formal exit mechanism.

Close-endedness implies either infancy of the CIS or a weak liquidity base reflecting the poor nature of subscribers as India is a developing country with women being the poorest of the poor. By making it close-ended, the CIS reduces the risk of failing to meet its obligations when they fall due as the turnover is usually low among the poor.

Table 7: *Balanced Fund Collective Investment Scheme*

Mahila Unit Scheme	
Type of scheme	Close Ended Balanced Fund
Date of Inception	
Scheme Objective	To provide an enabler to adult female persons in pooling their own savings and/or gifts into an investments vehicle so as to get periodic cash flow near the time of any chosen festival/occasion or to allow income/gains redeployed in the scheme and -repurchase units partially or fully as and when desired.
Asset Allocation	Debt- Minimum 70% Maximum 100% Equity - Minimum Nil. Maximum 30%
Face Value	Rs.10
Plans	Regular Plan Gift plan Festival Cash Option
Minimum Investment Amount	Regular Plan Rs. 1,000/- Gift planRs. 1,000/- Festival Cash Option Rs. 5,000/-.
Registrars	UTI Technology Services Limited

Source: *www.utimf.com/products*

The three are examples of those CIS products that could fit into the Tanzanian environment. The examples show how CIS could be used to finance needs of every class of the citizenry, as the elites, middle income and the poor could equally benefit from the CIS. Even though UTI is a unit trust kind of a CIS, the presentation gives some satisfying explanations as to what investment. Subscribers' money will actually be put into. Supposedly, more or less the same could be the case for other CIS arrangements for ease of adoption by the public. In return, this would bring more participants into the Tanzanian capital markets and even more products at the DSE to stimulate the growth of the stock market.

The above findings and discussions have answered the first objective of identifying and commenting on past, current and future issues within the Tanzanian capital market.

The following sub-topic discusses the East African stock markets, based on selected characteristics.

The East African Stock Markets

The three (3) East African countries cover an area of 1.8 million square km with a population of approximately 86.5 million people with different levels of development, resources potential and diverse entrepreneurial culture. Each of the three countries has a stock market that it solely started. As the three states have considered initiating a regional integration bloc, i.e. the East African Community (EAC), financial cooperation, particularly in the area of capital markets, was identified as a potential area to develop. Several initiatives have been taken towards integrating the East African capital markets, including the establishment of the following fora and institutions:

- East African Stock Exchanges and Capital Markets Regulatory Authorities (EASRA) in 1997.
- East African Capital Markets Development Committee (CMDC) in 2000.
- East African Securities Exchange Association (EASEA) in 2004.
- East African Securities Brokers Association (EASBA) in 2004.

Generally all are tasked with the coordination and integration[14] of capital markets among the partner states either collectively or independently. The focus of these initiatives is on attaining harmonized fiscal, monetary and investment policies in the three partner states that provide a sound enabling environment for a regional securities exchange. The rationale for integration of the East African capital markets lies in its anticipated benefits as discussed below.

Rationale for East African Stock Markets Integration

Integration tends to expand geographical boundaries, increasing the market size, thereby increasing the number of buyers and sellers of securities in the market, implying a widened access to capital. As competition mounts among these many actors, prices for financial services (transaction costs) are reduced to allow regional firms to exploit economies of scale and scope. In turn, this will promote savings for the subscriber, provide capital to the issuers and liquidity in the market. Consequently, as

[14] Means that investors can buy and sell securities in any East African stock market without restrictions. Identical securities are traded at essentially the same price across markets after adjustment for foreign exchange.

demand for securities increases, the financial sector deepens to pull resources from the interior and remote areas of the economy. Different products evolve to tap the demand, thus leading to the possibility of diversification of the investment portfolio. Other advantages of regionalisation of the capital markets is facilitation of a large number of privatizations in the region. With a bigger market, privatisation through stock markets can be realistically thought of, especially now that all three bourses allow foreigners' participation. The NSE, which is bigger than the other two bourses, has been used in successful divestment of Kenyan parastatals by selling merger shares of these parastatals. According to the World Bank (1997), the initial Kenya Airways divestment, which was done through the NSE, emerged as the best model of privatisation for 1996, and consequently the team was rewarded for its success. Among other African privatization success stories is that of Ghana's Ashanti Goldfield Corporation in 1994. By sharing information and exchanging expertise, the integrated market is in a position to handle bigger divestments. As suggested by (Fischer, 2004), a large number of privatisations will help expand and deepen the stock markets in Africa. All the advantages ultimately converge into facilitating economic growth and development by making the market wide and competitive enough to take position as one economic bloc. Much as we appreciate the fact that individual capital markets in the region can reap these benefits, regionalisation can quicken realization of many of them, thus making it the best option to follow. The following section examines the traditional and institutional characteristics of the three stock markets in East Africa.

Traditional and Institutional Characteristics of the East African Bourses

These are the characteristics that determine a stock market's performance and efficiency, which also help in predicting the future prospects of a stock market. Traditional characteristics refer to who the actors are, the market size, market concentration and liquidity in the market. Traditional characteristics describe a bigger outlook of the market, dealing with aggregates that are responsible for overall delivery of the market. Institutional characteristics refer to the process of securities dealing at the trading flow. Market procedures and regulations, market structures, trading costs are the issues followed under these characteristics. Table 8 shows both the traditional and institutional characteristics of the stock markets in East Africa.

Table 8: *Traditional and Institutional Characteristics 2004/2005*

Traditional Characteristics			
Characteristic	*Tanzania*	*Kenya*	*Uganda*
Market Capitalisation (in US $ Mil) as at 28th February, 2005	784	3,785	812.2
Market Capitalisation/GDP (%)	8.2	43.6	12.5
Market liquidity ratio (%)	2.87	6.45	0.02
Listed Companies:			
Equities	6	50	4
Government Bonds	14	60	5
Corporate Bonds	4	3	1
Cross Listed Companies	2	-	2
Number of Stock Brokers	6	17	5
Number of Investment Advisors	9	19	6
Number of Investors in the Market	72,000	530,000	15,000
Institutional Characteristics			
Characteristic	*Tanzania*	*Kenya*	*Uganda*
Settlement Process	Book Entry through CDS	Book Entry through CDS	Physical through USE
Settlement Cycle	T+5	T+5	T+5
Transaction Cost (Commissions)	Regulated but there is an upper ceiling	Negotiable but there is an upper ceiling	Regulated but there is an upper ceiling
Institutional Barriers:			
Foreign Investment Restriction	Restricted	Ceiling set at 40% for institutions and 5% for individuals	No restriction
Foreign Ownership Allowed	40%	75%	No restriction
Market Structure:			
Main Investment Market	Operating	Operating	Operating
Alternative Investment Market	No Operations	Operating	No Operations
Fixed Income Securities Market	Operating	Operating	Operating
Over the Counter Market	No Operation	No Operation	No Operation
Trading system	Open Outcry	Open Outcry	Open Outcry
Official Stock Index	-	NSE 20–share	USE All Share

Source: *USE, DSE and NSE Database*

In principle, the type of securities offered by all three stock markets resemble each other, though further examination of the equity category showed that in Kenya there were a few preferential shares in addition to ordinary shares that were the majority. Uganda and Tanzania have only ordinary shares; furthermore it was only Kenya that had companies with cross-listed shares in the other two countries (Tanzania and Uganda).

In the bonds market, generally only a few bonds are registered, with corporate bonds in particular being very scarce compared with the dominating government bonds. Despite Kenyan dominance in the type and number of registered products, there is an absolute lack of collective investment schemes and other kinds pooled of investments, like municipal bonds. Such products are key in mobilizing resources from a vast number of people, including those in the rural areas. This situation calls for their immediate establishment and listing, following what Senyo (2004) reported earlier that, without CIS, it is difficult to have meaningful stock markets in the African context.

On the market segments, none of them operate the Over the Counter Market. Kenya operates the Alternative Investment Market segment in addition to the Main Investment Market, and the Fixed Income Securities Market segments that are also operated by Tanzania and Uganda. Given the existence of many SMEs in the region, perhaps less stringent conditions, especially having a few shareholders in the alternative market and the OTC, would attract more companies to the market.

Kenya and Tanzania have a Central Depository System (CDS) which studies elsewhere have related to high liquidity (Houthaker, 1996). This is a positive development that challenges Uganda to move towards international settlement standards. Nonetheless, all of the three bourses operate an Open Outcry trading system, whereas international standard favor the Automating Trading Systems (ATS), which means all three have to take up this challenge. Concerning the commissions charged on the transactions in the stock market Tanzania and Uganda charge fixed commissions that are associated with low liquidity (Houthaker, 1996). The negotiable commission that Kenya charges is in accordance with international standards, thus delivering a challenge to Uganda and Tanzania.

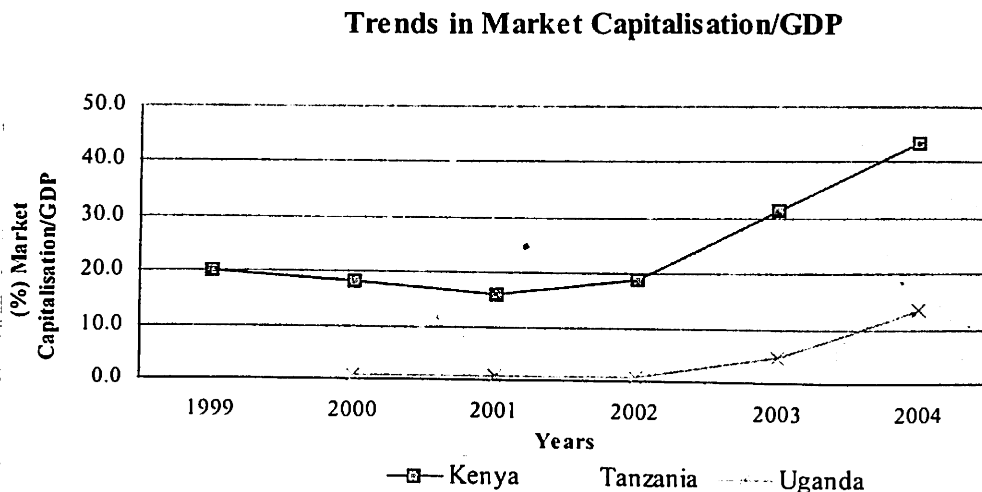
Empirical Evaluation of East African Stock Markets

Market Capitalisation Ratio (MCR)

As provided in the methodology, MCR is used in estimating both size and performance of a respective market. Figure 2 shows an upward trend in all three markets, with the Kenyan NSE of 43.6 % appearing to be high compared with Uganda and Tanzania. Comparing the East African markets with other developing world markets, e.g. South Africa, 123% and Chile, 80%, shows that the region is poorly performing in mobilizing capital and diversify risk in the economy.

The low MCR also implies that only a small percentage of national income goes through the stock market, thus manifesting less development of the market. A deeper analysis shows that Tanzania is the poorest performer of all despite having more participants than Uganda, suggesting that the volume of transactions per subscriber is also low for Tanzania. Examining the countries' capital accounts, it is logical to partly attribute Uganda's better performance to full liberalization of its capital account, i.e. no restriction on foreigners' participation. The liberalization could have allowed FDI inflow through the USE to boost its capitalisation better compared with the slightly liberalized (40%) Tanzanian account. Given the situation on board, foreigners' participation harmonization should either follow the Kenyan model (75%) or the fully liberalized Ugandan model.

Fig. 2: *Trends in % Market Capitalisation/GDP in East Africa*



Source: *DSE, NSE and USE Database*

Investment Diversification Potential of the East African Stock Markets

Tables 9a and 9b show the correlation results of East African MCR and Risk/Return on securities investment respectively. According to the results, all the partial correlations were approaching 1, implying a strong correlation between the markets and thus lower investment diversification potential and essential integration of the respective markets. Insights from the results further imply that the products offered, their respective values together with their risk/return on investment closely resemble each other in the East African capital markets. This means thre will be no choice even after regionalisation which is shown by the products the markets offer as given in Table 8, namely a few equities with many government bonds, especially for Uganda and Tanzania.

Table 9a: *Summary Statistics and Correlation Matrix*

SUMMARY STATISTICS			
Variable	**Mean**	**Standard Deviation**	**Cases**
Kenya	24.7667	10.7193	60
Uganda	4.0600	5.5954	56
Tanzania	4.8833	2.6233	54
CORRELATION MATRIX ON MCR			
	Kenya	**Uganda**	**Tanzan ia**
Kenya	1.0000		
Uganda	.970**	1.0000	
Tanzania	.901*	.798	1.0000

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

Source: *DSE, NSE and USE Database*

Table 9b: *Summary Statistics and Correlation Matrix*

Summary Statistics			
Variable	Mean	Standard Deviation	Cases
Kenya	63.5823	7.6598	60
Uganda	35.0585	4.2598	53
Tanzania	34.9876	5.1587	60

Correlation Matrix on Exchange Rate Adjusted Risk/Return Values			
	Kenya	Uganda	Tanzania
Kenya	1.0000		
Uganda	.935**	1.0000	
Tanzania	.967**	.825**	1.0000

* Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.01 level (2-tailed).

Source: *DSE, NSE and USE Database*

Based on this result, the alternative hypothesis is thus adopted that "there is no investment diversification potential with a united East African stock market." Much as these results further confirm the argument previously reported by Ndi Okereke-Onyiuke (2004) that there cannot be a merger of what does not exist, the study contradicts the report's implications, suggesting that the two efforts (domestic capital market development and regionalisation) should run parallel. Given the importance of capital markets in the globalising world economy and the fact that they already lag behind, these countries should not wait till they attain a culture of operating efficient individual stock markets so as to regionalize as discussed below.

Other Integration Prerequisites for the East African Stock Markets

Since efficient stock market operations are also influenced by adequate legislation and a favorable macroeconomic environment, macroeconomic parameters such as inflation, interest rate, interest rates spreads, fiscal deficits, capital account convertibility, exchange rate regimes, etc, have to be harmonized so as to have an equal-opportunity integrated market. Likewise the legislation has to be reviewed and harmonized to avoid confusion, such as having multiple regulators and multiple integration initiatives in the industry, e.g. Tanzania is also discussing integration with SADC whereas Kenya and Uganda are discussing integration with COMESA member states. Most of these issues are still on the drawing board of the regional market initiative, as they require a more committed level of integration, which in some cases involves the political will of the member states. As the EAC is still a customs union, some of these legislative, fiscal and monetary issues become difficult to address, making it inevitable that a full integrated capital market (with a regional stock exchange) will have to evolve gradually as the level of EAC integration deepens towards stronger regional integration forms, i.e. monetary union and later a political federation.

Conclusion And Policy Implication

The Tanzanian capital market is characterized by the features of most emerging markets, suffering from the same problems as other emerging African countries' capital markets. A revisiting of the basic necessities of an efficiently functioning domestic capital market is essential so as to stimulate both its growth and contribution to economic development. Integration of the stock markets, though of secondary importance, is essential in further deepening the capital markets since capital markets are a new phenomenon in East Africa and Tanzania in particular. As the region lags behind in capital market development as given in the MCR,

adequate research and deliberate efforts backed by political willingness are deemed necessary so as to have the respective countries' domestic markets optimally functioning. Concurrently, the required legislation, as well as fiscal and monetary harmonization to put the required institutions and regulations in place should be effected so that a regional market can evolve from optimally functioning domestic markets. To make regionalisation work means to widen and deepen the markets and not primarily to solve individual markets' structural problems.

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