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St. Mary's University, Ethiopia

***ST. MARY'S UNIVERISTY
SCHOOL OF GRADUATE STUDIES***

***PROSPECTS AND CHALLENGES FOR THE ESTABLISHMENT OF CAPITAL MARKET IN
ETHIOPIA***

**BY
Biniyam Getachew**

**April, 2017
Addis Ababa**

ST. MARY UNIVERSTY
SCHOOL OF GRADUATIE STUDIES
FACULTY OF BUSINESS

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APPROVED BY BOARD OF EXAMINERS

_____	_____
Dean, Graduate Studies	signature

_____	_____
Advisor	Signature

_____	_____
External Examiner	signature

_____	_____
Internal Examiner	Signature

DECLARATION

I, the undersigned declare that this thesis is my original work: prepared under the guidance of Assistant Prof. Semion Tarkge .All resources of materials used for the thesis have, been duly acknowledged, I further confirm that the thesis has not been submitted either in part or full to any higher learning institution for the purpose of learning any degree.

Name

St. Mary's University, Addis Ababa June, 2017

Signature

ENDORESMENT

This thesis has been submitted to St. Mary's University, School of graduate studies for examination with my approval as a university advisor.

Advisor
St. Mary's University, Addis Ababa

Signature
June, 2017

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Acknowledgement

This thesis would not have been possible without the guidance and the help of several individual who in one way or another contributed and extend their valuable assistance in the preparation and completion of this study.

First and for most I would like to offer my sincerest gratitude to my advisor Assistant Prof. Semion Tarkge for his constructive and supportive comments. My heart-felt thanks also goes to all my graduate friends, especially; Abaye kidana Mariam, Sadika Mohamode, and Abebe Esayase for giving comments and invaluable assistance.

Abstract

Ethiopia currently does not have a stock market except treasury bills and government bonds; financial institutions, including saving institutions have accumulated equity capital; profitable projects are established and may establish to raise equity capital for stock market. In other hand more than a dozen of African countries have been established stock markets; Ethiopia is not one of them. This paper aimed to identify prospects and challenges for the establishment of capital market in Ethiopia especially in the banking sector. More specifically identify the role and responsibility of financial markets, including factors that affect the establishment of capital market such as, development of different infrastructure like information technology, human skill, government reaction towards stock market investment, financial sectors development, timing, and progress toward establishment had been assessed. Relevant primary data was collected using interview which include key respondents drawn from seven banks and two organization, the discussions were based on unstructured interview. The questionnaire data were analyzed descriptively; data from the interview and documentations were constructed qualitatively. Finally, the study conclude that even if there is a strong demand in financial sector to inaugurating capital market in Ethiopia, there must be a strong financial, Economical, and technological foundation at hand.

Key words: capital market, financial institutions, investment

ACRONYM AND ABBERVATION

AIB	Awash International Bank
CBE	Commercial Bank of Ethiopia
CBK	Central Bank of Kenya
DBE	Development Bank of Ethiopia
ECX	Ethiopia commodity Exchange
IMF	International Monetary Fund
IPOs	Initial Public offerings
IFSE	International Federation of Stock Exchanges
NBE	National Bank of Ethiopia
NSE	Nairobi Stock Exchange
NYSE	New York Stock Exchange
WTO	World Trade Organization

CHAPTER 1: INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Capital markets are found in several countries. According to the International Stock Exchange Directory issued by the International Federation of Stock Exchanges there were 60 major stock exchanges in the world worth of 69 trillion (IFSE, 2015). In more mature economies, stock exchanges are found in several major cities. Among the biggest stock exchanges in the world are New York, Tokyo, London, Paris, Frankfurt, Zurich, Amsterdam, and Toronto. Some of the stock exchanges have long history.

In the United Kingdom and in the United States, both of these parts have grown very rapidly over the past few decades. The capital markets in the United Kingdom and the United States dominate. In the US, the capital markets have become the dominant element of the financial system in three ways. First, capital markets now outstrip depository institutions in the financial intermediation process. Second, the US equity market has become more important as an investment vehicle. Third, the derivatives market has grown extraordinarily rapidly (William and Glen, 2004).

According to Business dictionary Capital market is a market where buyers and sellers engage in trade of financial securities like bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. Help channelize surplus funds from savers to institutions which then invest them into productive use. The structure of a global capital market has two components it consists of primary markets and secondary markets. Primary markets deal with trade of new issues of stocks and other securities, whereas secondary market deals with the exchange of existing or previously-issued securities. Another important division in the capital market is made on the basis of the nature of security traded, i.e. stock market and bond market. Generally, this market trades mostly in long-term securities.

There are stock exchanges in 19 African countries. The development of stock markets in Africa tends to show an evolutionary process with various stages characterized by type of regulatory system, trading method and the scope for market participation. In general, most of the main markets in Africa started with no formally laid down rules and regulations trading activities were based on interpersonal relationship. Formal markets were then established, driven either

by the desire of traders to diversify sources of investment funds or by the need of governments to establish a formal market to float their debt stocks. Formalization and revitalization process saw changes in the regulatory framework, trading system and composition of market investors. The recent situation of stock exchanges in Africa is based on the expectations of the role of stock markets in financial development and economic growth of African economies. It is expected that these markets will become an avenue for attaining long term equity finance for the development of the economy as a whole. Also, the markets may be seen as an important part of a wider strategy for developing national, and even regional, economies, stimulation regional savings as well as growth in investment. (Victor, 2006)

The number of international bond or capital market issuances by sub-Saharan African countries in recent years has accelerated from only three issues in 2006 and 2007 to over six issues so far in 2013, and these issues are set to continue in 2014 (Moody's Analytics, 2013). In addition to South Africa, eight countries in the region have tapped the international capital markets in recent years, including first-time issuers Ghana, Gabon, Senegal, Namibia, Nigeria, Tanzania, Zambia and Rwanda. Furthermore, market intelligence suggests that other sub-Saharan African countries may tap international markets in the near future.

South Africa's capital markets are continuing to enjoy relatively healthy growth on the back of improved regulation and supervision. The authorities are working to strengthen the market's regulatory framework, particularly in terms of settlement cycles and systemic risk related to over the counter securities. Technical and regulatory improvements at the Johannesburg Stock Exchange are continuing apace, with new products, better supervision and a renewed emphasis on cross-border activity at the forefront of market developments. Market players are working to capitalize on growing investor interest in Africa and establish South Africa as a regional epicenter for initial public offerings and derivatives trading. (Donna, 2016).

The Nigerian Stock Exchange is the third largest stock exchange in Africa. It was established in 1960 as the Lagos Stock Exchange. It has been operating an Automated Trading System since April 27, 1999, with dealers trading through a network of computers connected to a server for remote trading and surveillance. Consequently, many of the dealing members trade online from their offices in Lagos and from all the thirteen branches across the country. The NSE is regulated by the Securities and Exchange Commission, which has the mandate of Surveillance over the

exchange to forestall breaches of market rules and to deter and detect unfair manipulations and trading practices.

According to Dasalegn, (2014), in the recent times, it is surprising news that different types of world media' s have frequently situates the name of Ethiopia on the journey equivalent to both immensely developing and advanced economies of the world. This is due to the reason that history shows as this country have passed through the cobblestones of endemic poverty, social and political war and different economic mal functioning. As of today however, everything starts to change preliminary from policy designing to green revolution, political stability to increments of foreign direct investment and to that end there is economic rising and also the financial sector like banks and insurance whether governmental or privet sector are rising in number. Other sector like agriculture and industry specially textile, flower, steal are grown. According to world trade organization Ethiopia is want to a member of WTO. This is all influence the country to inter in to capital market.

Ethiopia at present has no Capital Market to transact stocks or equity and bonds (debt instruments) in the secondary markets. The stock market facilitate the purchase of shares while the bond market provides a means by which to sell and trade bonds in the secondary market to enable participating governments, institutions and companies raise long term capital. As it stands today, Ethiopia has fallen behind in creating or implementing such a resourceful financial mechanism. (Applegarth, 2004).

The paper provides contemporary image on the establishment of capital market .Based on the finding from depth unstructured interview and discussion held with Bank managers, officials and highly interrelated organizations. The paper argues that at these time government primary focus is on developing the banking system and developing the commodity exchange of agricultural products in rural areas. Although the government is not against a stock exchange system in the country, the position and the commitment to establish capital market in near future were not clear.

1.2 DEFINATION OF TERMS AND CONCEPTS

Capital market: - is the system of financial organization from which companies and governments raise money selling stock, bond, etc. to investors: domestic/global/international capital markets long term interest rates, such as those on mortgages, are determined by global capital market (www.Cambrige Business English Dictionary.com).

Stock Exchanges: - Are formal organization that are made up of that use the facilities certain common stock (Fabozzi and Modigliani, 1996).

Stock market: - is a market for corporate securities. Corporation may also issue debt securities, but the basis of all corporate resides in stock. It is stock that provides the initial capital for a corporate venture (Teweles and Bradly, 1998: pp. 17)

1.3. STATEMENT OF PROBLEM

In Ethiopia, several studies were conducted to assess the infrastructural development required to Establish stock market by different institutions, scholars, associations and consultants including NBE (1995), Asrat (1998), Ruecker (2011), have recommended to establish stock market upon fulfilling requirements required to establish stock market. Previous studies including , McKinnon (1973), Shaw (1973), Fry (1988) and more recently, King and Levine (1993) have ascertained that financial development is a prerequisite for economic growth.

According to Ayo Martins, (2013), Capital market is one of the key components of the engine of a modern economy, as it mobilizes and pools savings from the public and efficiently channels them into business investments. It also helps firms and individuals to manage risks and provides incentives for companies to improve their performance. Capital markets complement other sectors of the financial system, such as banks and insurance.

Capital markets are a modern focal point for raising cheap long term capital and for the mobilization of savings. They also help increase transparency in the privatization process by encouraging wider share ownership. Capital market improves efficiency in resource allocation

through a competitive mechanism. They increase liquidity and provide risk capital for trail blazing ventures (Wang C.K and Ang L.B, 2004)

Capital market or Stock exchange has a multiple advantage especially for the developing or emerging economy. As Levine, (1996) states that greater stock market liquidity boosts or at least precedes economic growth and GDP grow faster in economies with liquid stock markets. There are a lot of benefits, And in our country from the past five or six years we experience that there is a rapid growth, or at least a stable economy, but there is no established capital market in general and stock market in particular.

There is different opportunity of economic growth of Ethiopia for opening of capital market in country. The country which is sub-Saharan Africa's fifth biggest economy is at the focal point of emerging economies' interest with various delegations of foreign investors seeking investment opportunities in the largest landlocked country in the continent. The country's economic growth is principally attributed to intense government projects aimed at achieving its Millennium Development Goals (MDGs) as the country aims at becoming a middle income status by 2025. Ethiopia has witnessed an increased contribution from the sector, particularly focused on increased production in sugar, textiles, leather products and cement (Elayne W, 2016).

“Even though the scholars are in debating whether the financial market development causes an economic growth or the economic growth creates the financial market development, most recent empirical evidences especially from developing countries show that the financial market development accelerates economic development. And even tough this is the case, in our country there is no stock exchange established and it is difficult to predict, from the situation, when the stock exchange will be established. Therefore this study was attempted to see whether this is the right time to establish a stock exchange in Ethiopia or not and what advantage have for economic growth (Levine R, 1996).

Despite some of the acclaimed advantages of the stock exchange market for countries, Ethiopia is the only country of the world's 15 most populous countries which does not have a capital market or stock exchange (Access Capital, 2012). Even in the past fifteen years several Sub-

Saharan countries have established exchange markets and the number has been increasing by the passing of a year.

Previous studies conducted by (Getachew M., 2016) in title the challenges and prospects of establishing stock market in Ethiopia, he raises predominant questions, mainly his studies focus areas are as follow. According to him previous studies did assess the telecom infrastructure development, legal and regulatory infrastructure including accounting, auditing and reporting standards as well as government stand points.

However, these studies mainly focus on investigating current private and governmental financial institutions, like private banks and there challenges in respect to establishing capital market. The pragmatic move by government including the establishment of ECX, Abaye bond selling, request of permission for WTO and other recent developments further discussed. The paper included but not limited on the know how to overcome above challenges for future headway in leading capital market in Ethiopia.

1.4. RESEARCH QUESTIONS

This study focuses on investigating prospects and challenges for the Establishment of capital market in Ethiopia there by, determines the need for establishing the capital market. Thus, Research questions includes

- What are the current challenges for establishment of capital market in Ethiopia?
- To identify potential of capital market for economic development of Ethiopia?
- What are the effects of the absence of capital market in Ethiopia?
- What are the roles of financial institution in establishing capital market in Ethiopia?
- How to eradicate those challenges of the establishment of capital market in Ethiopia?

1.5 OBJECTIVE OF THE STUDY

1.5.1. GENERAL OBJECTIVE

The general objective of this study is *prospects and challenges for the Establishment of capital market in Ethiopia.*

1.5.2. SPECIFIC OBJECTIVES

The specific Objectives are:

1. To identify the role of financial institution on establishment of capital market in Ethiopia.
2. To identify favorable condition and progress for the establishment of capital market in Ethiopia.
3. To assess the current challenges for establishment of capital market in Ethiopia.
4. To identify the advantage of establishing capital market on financial institutions.

1.6. SCOPE OF THE STUDY

This study limited to the prospects and challenges for the establishment of capital market/stock market of Ethiopia. Specifically, in National Bank of Ethiopia(NBE),Commercial Bank of Ethiopia(CBE)Development Bank of Ethiopia (DBE),Awash International Bank(AIB) and Dashen Bank(DB), Wegagen Bank (WB),Nib International Bank (NIB), Ethiopian Investment commission(EIC), and Ethiopian Commodity Exchange(ECX).Therefore those intuitions were explored in respect to their role of capital market/stock market in the country in facilitating and contributing for sustainable development and at the same time the research try to look the drawbacks of capital market/stock market in one's country. Due to time limitation (from April, 26, 2017 - May 12, 2017), data collection conducted by interviewing key informant and interviewees taken from nine financial institutions (Total = 22) informants. All selected institutions head offices are located in the city of Addis Ababa.

1.7. SIGNIFICANCE OF THE STUDY

The researcher believes that, the result of this research project would have the following significance:

- This study will contribute to the efforts of policy makers for establishment of capital market by giving highlights on the country's situation for stock exchange. Moreover, it will serve as supplement for subsequent studies in the field. In addition, the fact that the study focused on the current practice of capital market and stock exchange in Ethiopia gives additional insight on the issue.
- To develop experience and open eyes to conduct further research in the future.
- This research work could serve as a supportive literature for further studies.
- To estimate future out comes as we go further in the development arena

1.8. ORGANIZATION OF THE RESEARCH REPORT

The thesis consists of five chapters. The first chapter includes the introductory issues about the research, the researchers' purpose, brief overview about the methodology, the research objective and the research questions to be answered, definition of terms and concepts used in the study and the significance for undertaking this research.

The second chapter is devoted to literature to the area under study so as to better understand concepts, theories and models related to project plan. The third chapter is devoted to research methodology in a bit more detail than what is discussed in the introduction part while the fourth chapter is dedicated to data presentation, analysis and findings.

The final chapter (chapter five) concludes the topic under discussion with concluding remarks and recommendation.

CHAPTER 2: LITERATURE REVIEW

2.1. THEORETICAL LITERATURE

2.1.1. DEFINITION

In particular, there are two categories of financial instruments that capital markets are involved. These are equity securities, which are often known as stocks, and debt securities, which are often known as bonds. Capital markets involve the issuing of stocks and bonds for medium-term and long-term durations, generally terms of one year or more.

According to business dictionary Capital market consists of primary markets and secondary markets. Primary markets deal with trade of new issues of stocks and other securities, whereas secondary market deals with the exchange of existing or previously-issued securities. Another important division in the capital market is made on the basis of the nature of security traded, i.e. stock market and bond market.

In addition to this, Financial market that work as a conduit for demand, supply of debt and equity capital. It channels the money provided by savers and depository institutions (banks, credit unions, insurance companies, etc.) to borrowers and investees through a variety of financial instruments (bonds, notes, shares) called securities. It is not a compact unit, but a highly decentralized system made up of three major parts: (1) stock market, (2) bond market, and (3) money market. It also works as an exchange for trading existing claims on capital in the form of shares.

Capital markets are also generally divided into two categories of markets, the first of which being primary markets. In primary markets, stocks and bonds are issued directly from companies to investors, businesses and other institutions, often through underwriting. Primary markets allow companies to raise capital without or before holding an initial public offering so as to make as much direct profit as possible. After this point in a company's development, it may choose to hold an initial public offering so as to generate more liquid capital. In such an event, the company will generally sell its shares to a few investment banks or other firms (Victor M., 2016).

According to Victor M., (2016) at this point the shares move into the secondary market, which is where investment banks, other firms, private investors and a variety of other parties resell their equity and debt securities to investors. This takes place on the stock market or the bond market, which take place on exchanges around the world, like the New York Stock Exchange though it is often done through computerized trading systems as well. When securities are resold on the secondary market, the original sellers do not make money from the sale. Yet, these original sellers will likely continue to hold some amount of stake in the company, often in the form of equity, so the company's performance on the secondary market will continue to be important to them.

The evolution of the emerging capital markets in the last two decades has been dichotomous; in the sense the markets have experienced both integration and segmentation. On the one hand, some emerging capital markets have recorded a dramatic increase in foreign investment due to an expansion in privatization listings, the use of bond instruments in international debt settlements and some successful implementation of economic stabilization programmers. The inflows of foreign capital to the mature capital markets have enabled these markets to become more integrated with global markets. On the other hand, some very small, less developed capital markets, which are defined as 'frontier markets' by the International Finance Corporation / Standard & Poor's' Emerging Market Database, have not received much of the foreign inflows. The markets have become consequently segmented from global markets. The dichotomous patterns of integration and segmentation have important consequences for the roles that these markets will play in emerging economies, particularly in Africa (Victor M., 2016).

2.1.1. MAJOR PARTICIPANT IN CAPITAL MARKET

Capital markets have numerous participants including individual investors, institutional investors such as pension funds and mutual funds, municipalities and governments, companies and organizations, banks and financial institutions. While many different kinds of groups, including governments, may issue debt through bonds (these are called government bonds), governments may not issue equity through stocks. Suppliers of capital generally want the maximum possible

return at the lowest possible risk, while users of capital want to raise capital at the lowest possible cost.

The size of a nation's capital markets is directly proportional to the size of its economy. The United States, the world's largest economy, has the largest and deepest capital markets. Because capital markets move money from people who have it to organizations who need it in order to be productive, they are critical to a smoothly functioning modern economy. They are also particularly important in that equity and debt securities are often seen as representative of the relative health of markets around the world.

2.2.1. THE ROLE OF CAPITAL MARKET

(Levine R. And Zervos S.,1998) the capital market is expected to encourage savings by providing individuals with an additional financial instrument that may better meet their risk preferences and liquidity needs. Better savings mobilization may increase the savings rate. Capital markets also provide an avenue for growing companies to raise capital at lower cost. In addition, companies in countries with developed stock markets are less dependent on bank financing, which can reduce the risk of a credit crunch. Stock markets therefore are able to positively influence economic growth through encouraging savings amongst individuals and providing avenues for firm financing.

(Sule O.K. and Momoh O.C., 2009) argues that through the capital formation and allocation mechanism the capital market ensures an efficient and effective distribution of the scarce resources for the optimal benefit to the economy and it reduces the over reliance of the corporate sector on short term financing for long term projects and also provides opportunities for government to finance projects aimed at providing essential amenities for socioeconomic development. In a study published at the beginning of the nineties. (Levine R., 1991) points out that capital markets can help the process of financial integration, financial intermediation and speed up the economic growth through two key processes. The first is by making property changes possible in the companies, whilst not affecting their productive process; the second is by offering higher possibilities of portfolio diversification to the agents.

Note that the capital market contributes to economic growth through the specific services it performs either directly or indirectly. Notable among the functions of the stock market are mobilization of savings, creation of liquidity, risk diversification, improved dissemination and acquisition of information, and enhanced incentive for corporate control. Improving the efficiency and effectiveness of these functions, through prompt delivery of their services can augment the rate of economic growth (Kumar, 1984). At any stage of a nation's development, both the government and the private sectors would require long-term capital which is provided by a well-functioning stock market.

According to the nature and economic significance of the relationship between capital market development and growth vary according to country's level of economic development with a larger impact in less developed economies (Filler, R.K., 1999). The proponents of positive relationships between stock market development and economic growth base their argument on the fact that the stock market aids economic growth and development through the mobilization and allocation of savings, risk diversification, liquidity creating ability and corporate governance improvement among others.

The structure of a global capital market has three components. The first is the primary capital market, for new capital issues by firms and other institutions, including governments. The second is the secondary market, for the exchange of existing securities. The third is the derivative market, which serves the exchange of securities created by the exchange and whose value is derived from the underlying securities. Hence, it may be argued that, by functional classification, capital markets play three main roles. First, long term funds can be raised by companies from those with funds to invest, such as financial institutions and private investors; in fulfilling this role, they act as primary markets for new issues of equity and debt. Second, capital markets provide a ready means for investors to sell shares and bonds they own, or to buy additional ones to increase their portfolios; in fulfilling this role, the capital markets act as secondary markets for trading existing securities. Third, the markets provide mechanisms for trading future and contingent claims, based on the values of the underlying assets; hence the derivatives market (Victor M., 2016).

2.2.1. CAPITAL MARKET AND ECONOMIC GROWTH

Empirical studies to substantiate whether capital market establishment and development will have a positive significant effect on economic growth of nations. In principle, the capital (stock) market is expected to accelerate economic growth, by providing a boost to domestic savings and increasing the quantity and the quality of investment. The market is expected to encourage savings by providing individuals with an additional financial instrument that may better meet their risk preferences and liquidity needs. Better savings mobilization may increase the saving rate. The capital market also provides an avenue for growing companies to raise capital at lower cost. In addition, companies in countries with developed stock market are less dependent on bank financing, which can reduce the risk of a credit crunch. The capital market therefore is able to positively influence economic growth through encouraging savings among individuals and providing avenues for firm financing. (Obamiro J. K, 2005).

Different studies for example (Singh A., 1999) shows that least developed countries establish a capital market; it should contribute to the economic growth of a country. In such circumstances companies will raise the required capital and savers (mainly households) will search for an investment with a better return in the capital market.

The establishment of capital markets in least developed countries won't do anything good towards the economic growth of a country. establishing a capital market, for African economies particularly those in Sub-Saharan African, at the present stage of their development is likely to do more harm than good, because they are prone to high volatility African countries would do better to use their human, material, and institutional resources to improve their banking systems than to promote capital market. Capital markets in developing countries are generally less well regulated and more poorly organized than their counterparts in developed countries (Singh, A. 1999).

2.3.1. THE FINANCIAL SECTOR ROLE FOR GROWTH

In an empirical analysis on the link between financial intermediation (financial institutions) and capital markets indicated that the development of a well-developed financial intermediary sector is important for stock market development (Yartey, C.A. 2007). The stock market is a complement rather than a substitute for the financial sector (mainly banking sector) particularly at the first stage of its establishment. Developing the financial intermediary sector can promote stock market development. Support services from the financial intermediary sector (particularly the banking system) contribute significantly to the development of the stock market. He further elaborated that; liquid interbank markets, largely supported by an efficient banking system, are important for the development of the stock market. Conversely a weak banking system can constrain the development of the stock market.

(Yartey, C.A. 2007) had also touched upon the relevant institutions that should be in place in the African capital markets while explaining that capital markets offer a great deal of promises for economic development in Africa. Developments of capital markets can be seen as an integral component of overall financial sector (capital market, banking sector and other financial institutions) reform currently undertaken in most African countries because there are complementarities between capital markets and the banking sector and other financial institutions.

2.2. EMPIRICAL EVIDENCE AND FRAMEWORK

2.3. CAPITAL MARKET IN DIFFERENT AFRICAN COUNTRY

2.3.1. OVERVIEW OF AFRICA'S CAPITAL MARKET

In Africa the banking system is the predominant sources of finance. In theory financial markets reduce the dependency on banking. Most African countries did not established capital markets until recently and those that exist in few African counties were stagnant for years in their

performance relative to the developed markets around the globe. The promotion of capital markets in Africa: Assessment of needs in capital markets development southern, western, and central Africa, November 1999; recently the evolutions of capital markets in Africa have seen considerable developments. Prior to 1989 there were only eight stock markets, Five in Sub-Saharan Africa and three in North Africa. At present there are over twenty stock exchanges in the continent (Amare W., 2008).

Africa's capital markets have an extraordinary potential to help transform and sustain Africa's growth trajectory. The perception that has often characterized Africa has been that of political instability, lack of development, poor infrastructure as well as lack of human capital skills, all of which have often mired its overall economic growth. However, a new dynamic is in playing much more stable political landscapes, fast-paced growth and investments pouring in in a race to reduce the infrastructure deficit. Africa's equity markets are also witnessing rapid growth and this is changing the investment landscape <http://allafrica.com/stories/201603011826.html> .

In addition to this Africa has recovered quickly (compared to developed markets) due to sound and prudent macroeconomic policies, political stability, and multilateral agency support. Besides, the recent successful initiatives to stabilize and strengthen many African economies and to liberalize the business environment (deregulation and privatization) coupled with increase regional collaboration has promoted African equity markets not only as viable investment opportunity environments but also a notable segment of global frontier markets.

Global investors commonly refer to African markets as the last frontier. As has been witnessed in both the developed and the large emerging economies, developing the capital markets in Africa will improve domestic savings and investment. The resultant effect will be to strengthen and deepen domestic financial and capital markets systems as well as promoting good corporate governance. African equity markets have now begun to provide funding for many African businesses and are fast becoming one of the most significant sources of long-term corporate finance (Ndikumana L., 2001).

To sustain the current level of economic growth and encourage both domestic and foreign investment in the continent, Africa needs to rapidly expand, develop and modernize its financial

markets. Evidence from recent empirical economic studies suggests that deeper, broader, and better functioning financial markets can stimulate economic growth (Ndikumana L., 2001).

Most African stocks exchanges are still at early stage of development and face several constraints facing such challenges like political instability in some economies, high volatility in economic growth, macroeconomic uncertainty, liquidity constraints, limited domestic investor base, underdeveloped trading and settlement structures, and limited market information (Kumo W.L., 2008).

2.3.2. AFRICANS MARKET PLATE FORM

The number of active securities exchanges in Africa has increased from seven (Egypt, Morocco, Tunisia, South Africa, Zimbabwe, Kenya, and Nigeria) in 1989 to currently twenty-four (representing thirty-nine countries' capital markets), with the Seychelles Securities Exchange (established in 2012) being the newest and the Egyptian Exchange the oldest (1883). Many of capital markets in Africa are still in their infancy and market capitalization remains generally low relative to more developed markets and to the true capacities of the African markets. This means that there is still considerable scope to deepen the capital markets across Africa.

The development of stock markets in Africa tends to show an evolutionary process with various stages characterized by type of regulatory system, trading method and the scope for market participation. In general, most of the main markets in Africa started with no formally laid down rules and regulations; trading activities were based on interpersonal relationship. Formal markets were then established, driven either by the desire of traders to diversify sources of investment funds or by the need of governments to establish a formal market to float their debt stocks. Formalization and revitalization process saw changes in the regulatory framework, trading system and composition of market investors (Victor M., 2016).

2.3.3. THE NIGERIAN CAPITAL MARKET

According to (Pat D. & James O., 2010) The proper functioning of the capital market was not set up until the establishment of the Central Bank in 1959 and launching of the Lagos stock exchange in 1961 even though securities were floated as far back as 1946. The needs to have an organized stock exchange came up and committee was set up by the government.

The Nigeria capital market was established for the following reasons below.

- ❖ To overcome difficulties of selling government stock
- ❖ To provide local opportunities and lending for long term purpose.
- ❖ To enable authorities mobilized long term capital for economic growth and development
- ❖ To enable the foreign business the chance of offering their shares to interested Nigerians to invest and participate in the ownership of these foreign business.

2.3.4. CAPITAL MARKET SOUTH AFRICA

South Africa's capital markets are continuing to enjoy relatively healthy growth on the back of improved regulation and supervision. The authorities are working to strengthen the market's regulatory framework, particularly in terms of settlement cycles and systemic risk related to over-the-counter securities. Technical and regulatory improvements at the Johannesburg Stock Exchange (JSE) are continuing apace, with new products, better supervision and a renewed emphasis on cross-border activity at the forefront of market developments. Market players are working to capitalize on growing investor interest in Africa and establish South Africa as a regional epicenter for initial public offerings and derivatives trading. While the market will continue to be buffeted by international headwinds and a weaker global economy, the JSE is set to maintain its reputation as Africa's soundest capital market. South Africa's Johannesburg Stock Exchange (JSE) led African exchanges in Initial Public Offerings (IPO) transactions and capital raised in the past five years, amounting to \$2.7 billion (Donna O., 2016).

2.3.5. SITUATION OF SUB SAHARAN AFRICAN CAPITAL

Most of the sub Saharan African markets do not attract international investors despite the fact that capital/stock markets in Africa and other emerging markets seem to have higher returns than developed stock markets. Therefore these are the major impediments to sustained development of capital markets in Africa. Nonetheless, to enhance their performance, most African countries have revitalized their capital markets in terms of key institutional reforms, namely revitalization of the regulatory framework, modernization of trading systems, and relaxation of restrictions on foreign investors (Victory M , 2006).

According to Victory M, (2006), a study made on Stock Market Development in Sub Saharan Africa has indicated that sound macroeconomic environment, well developed banking sector, transparent and accountable institutions, and shareholder protection are some of the challenges stock markets in the Sub Saharan African countries are facing for their efficient functioning. Same study has also suggested factors that help develop stock markets in Africa. These range from the need to increase automation, demutualization of exchanges, regional integration of exchanges, promotion of institutional investors, regulatory and supervisory improvements, involvement of foreigner investors, and educational programs.

(W/Senbet L., 2008) has also identified factors that could hinder capital markets in Africa. One is the issue of macro-economic and political stability with regard to rates of inflation, the levels of domestic saving and investment, quality of institutions such as law and order, democratic accountability, the rate of changes in government policies. The second, as per the study, emanates from the depreciation and wide fluctuations in the values of African currencies. The third relates to the crisis of international confidence which stems from images of war, famine, massive corruption, failed projects, undisciplined governance and gross violation of human rights. This information has the consequences for the capital/stock markets and financial system in general.

2.3.5.1. GHANA

Ghanaian Stock Exchange institutional characteristics in terms of the legal and regulatory frameworks, information disclosure requirements, transparency of transactions, accounting and auditing standards, transaction costs, delivery and settlement of transactions, barriers to entry and exit, taxation of investment income, market structure and public knowledge and awareness that ensure protection and security of investors. The study also finds out that the delivery and settlement are performed satisfactorily by brokers, while introducing a centralized clearing system would improve the clearing and settlement procedures (Osei A., 1998).

2.3.5.2. TANZANIA

According to (Massele et.al, 2013), the challenges the Darussalam Stock exchange market is facing. The study has pointed out lack of desirable characteristics of the stock market in terms of liquidity, availability of information that leads to market efficiency; high price sensitivity to new information, small price sensitivity, narrow price spread as factors having impacted the market. He also indicated lack of public awareness and knowledge about stock market, few market participants, lack of ICT and technology support for trading sessions and settlement of transactions, macro-economic instability from the point of view of inflation, currency depreciation, unemployment, population increase and poverty as some of the challenges. Lack of competent experts in the financial sector was also emphasized like stock analysts, financial analysts, lawyers, licensed brokers and professional financial advisors.

2.3.5.3. RWANDA

(Musonera E., 2008) has explored some of the challenges of the Rwandan Stock Exchange. These are: low domestic saving, complex tax regime, absence of financial intermediaries, lack of adequate accounting and auditing expertise, family owned companies, lack of information, underdeveloped market infrastructure and problems in capacity development.

2.3.5.4. UGANDA

(Bohnstedt et al,2000) on Capital Markets development in Uganda has analyzed the potentials and challenges of the Ugandan Stock exchange market and identified those factors that need to be improved to enable an efficient market in Uganda. An enabling environment which provides macroeconomic stability, prudential financial sector regulation, active government support, an improved tax regime and tax incentives, installing clearing and settlement system and strengthening the accounting profession were identified as important measures.

2.4. HISTORY OF CAPITAL MARKET/STOCK EXCHANGE IN ETHIOPIA

Ethiopia used to have stock exchange market in the mid-1960s before it was abandoned by the Derg regime in 1974. According to Mohammed A., (2010), Ethiopia's brief history of stock exchange shows that there were share and bond dealings under the sponsorship of the National Bank of Ethiopia (NBE) starting in March 1965. Later, the Addis Ababa Share Dealing Group was set up to trade in shares and government bonds. The group started functioning with share

dealings of 15 listed companies and four government bonds, and the number of listed companies reached 17 by 1966.

After the change of the socialist government in 1991, attempts were made to re-establish stock exchange market in Ethiopia by interested parties like the Addis Ababa Chamber of Commerce and Sectorial Associations. According to Ruecker R., (2011), in 1995, the National Bank of Ethiopia undertook a study on the Feasibility of Establishing of Securities Exchange Market in Ethiopia and also prepared a draft securities and exchange proclamation which are awaiting government endorsement.

Different seminars and studies were undertaken by different scholars who emphasized on the necessity of having capital market in Ethiopia. Despite the attempts Ethiopia does not have a stock exchange market nor does it allow companies to be listed in foreign countries until now. Due to this, share trading has been carried out through various means like part-time brokers or through the invested companies or the seller has to find buyers by him, exposing the seller to unfair prices and delays. This is not because of the lack of buyers and sellers in the market; rather, it is because of the lack of the proper institutions that could facilitate the trade (Tsegaye, E., 2007).

According to Solomon A, (2011), Ethiopia currently faces the following problems and the creation of capital market is justified by its potential to solve these problems.

- Bank loans are usually given on short term basis and most private companies suffer from high leverage, less access to finance as banks usually require huge collaterals due to high NPLs of banks. The securities market can fill the gap by allowing direct formation of equity and debt capital.
- The country has limited share of foreign capital investment which forces the utilization of domestic resources to finance investments. The securities market can facilitate the mobilization of domestic resources to meet the need.
- Both the government and a large number of private companies have already issued securities to the public and these have lacked market for secondary trading. The issuance, transferability, liquidity and proprietary value of all these securities has, however, become severely weak due to absence of securities market.

- Excess liquidity and reserve of banks are kept idle which could have been invested in securities markets. The securities market can help the banks and the NBE to mop up and manage their idle fund during this situation.

2.4.1. THE NEED FOR AND CHALLENGES IN INTRODUCING CAPITAL MARKET IN ETHIOPIA

Studies show that especially (Jetu E., 2014); stock market can benefit the economy of a developing country in a number of ways, particularly when prices fairly and accurately reflect supply and demand.

- ❖ First, companies with prospective growth potential will be able to raise equity capital, forcing banks to compete to supply the same financing.
- ❖ Second, the public issuance of shares can provide precious investment resources for enterprises that do not have enough retained earnings or which are unable, or unwilling, to go to the banks.
- ❖ Third, in addition to acting as a source of finance, the stock market also offers firms the opportunity of varying the costs and risks of their financing structures, potentially insulating them from higher interest rates and a credit crunch.³⁰
- ❖ Fourthly, introducing stock markets enhances the liquidity of assets as it provides high level of buying and selling stocks without affecting its market price. Hence, in the absence of stock market facility, the ability to convert stocks into cash quickly could be hampered.
- ❖ Finally, the market can also play a role in facilitating long-term asset management such as private insurance and pension funds.

Studies conducted in the Ethiopian context show that introducing stock market, among other things, allows the “de-concentration of ownership, improve accounting and auditing standards, provide effective tools for monetary and fiscal policy and help privatization efforts. Another study also states that the establishment of stock market in Ethiopia could contribute to economic

growth, since it encourages investment by helping traders buy and sell stocks quickly and efficiently (Jetu E., 2014),

According to Jetu E., (2014), Absence of stock market in Ethiopia may cause illiquidity of assets as holders of stocks may find it difficult to sell same at a fair market price. Specifically, as Ethiopian investors only have a small portion of their household income to invest, a fair priced stock trading is significant in order to avoid creating systematic losses for the general public. Consequently, in order to ensure the liquidity of assets in Ethiopia, it is vital to introduce stock market because of the limited investor and issuer base. However, a stock market does not automatically provide any of the indicated benefits. This is because it relies on an array of institutions for its benefits to be realized. For instance, institutions, such as a free press, an efficient and independent judicial system, corporate lawyers and accountants, professional underwriters and a group of mature institutional investors are difficult to establish at an early stage of economic development. The current limited facilities of the OTCs market in Ethiopia cannot cope with rapidly growing demand as share prices are uncoordinated between counters thereby facilitating arbitrage and manipulation. Therefore, absence of centralized registration for share certificates and illegal stock trading may grow into a largely unregulated space thereby posing stock investment risks and impacting the benefits of stock markets. It is noted that when everyone is speculating and playing for short-term gains, a stock market has little economic benefit. It does not channel capital towards good-quality firms or productive investments; it does not discipline involved, it can have damaging consequences for the government's finances (Solomon A., 2011).

A stock market can have a deleterious impact on a country's economy and its corporate development unless a prudent regulation is designed. Yet, lack of such regulation does not undermine the positive role of stock market in the enhancement of saving and investment because the regulatory challenges that inhibit its effectiveness can be addressed (Solomon A., 2011).

CHAPTER 3: RESEARCH DESIGN AND METHODOLOGY

3.1. RESEARCH DESIGN

The primary objective of the study was to identify prospects and challenges for the Establishment of capital market in Ethiopia. For these purpose descriptive research design is applied to describe what the prospects and challenges for the Establishment of capital market in Ethiopia. The researcher has chosen this design because the major purpose of descriptive research is description of the state of affairs as it exists at present and it reports what has happened or what is happening (C.R. Kothari, 1990). For these reason, such type of studies are recommended to use research design in the descriptive technique. It is used to explain something as it is and to report.

3.2. TARGET POPULATION

Even if, it is difficult to determine the total population size, as data could not be obtained from all financial institutions, however, 27 (twenty seven) bank officials and managers had been selected and 22 (twenty-two) participated on the interview. The study was conducted in the National Bank of Ethiopia (NBE), Commercial Bank of Ethiopia (CBE), Development Bank of Ethiopia (DBE), Awash International Bank (AIB) and Dashen Bank (DB), Wegagen Bank (WB), Nib International Bank (NIB), Ethiopia Investment Commission (EIC) and Ethiopian Commodity Exchange (ESX).

3.3. DATA TYPE AND SOURCE

For conducting the study qualitative data was applied. As a source, both primary and secondary sources of data are used. For collecting the primary data self-administered unstructured questionnaire was employed to identify prospects and challenges to establish capital market in Ethiopia. Secondary data is collected from publications, journal articles and other online materials from the internet.

3.4. SAMPLING DESIGN AND PROCEDURE

The sampling technique of the study was undertaken using non-probability purposive or judgmental sampling technique. Sampling in this case is purposive as stated (C.R. Kothari, 1990). Purposeful sampling selects information that is rich in case for in-depth study. The main reason to use non-probability sampling is always appropriate for in-depth studies of a few cases. In-depth research on sensitive topics requires non-probability sampling. Palpably, respondents were drawn from different levels of pre-selected institutions. Data was collected on a purposive sampling technique, which was taken from persons who were believed to possess the requested knowledge and expertise on the subject matter. In order to obtain primary data collected from

systematically selected governmental and private banks that have direct and indirect relation to the establishment of capital market in Ethiopia such as National bank of Ethiopia (NBE), Commercial Bank of Ethiopia (CBE), Development Bank of Ethiopia (DBE), Awash International Bank (AIB) and Dashen Bank (DB), Wegagen Bank (WB), Nib International Bank (NIB), Ethiopia Investment commission (EIC) and Ethiopian Commodity Exchange (ESX). The above Private Banks was selected based on the bases of initial deposit and year of establishment. Those private Banks had initial deposit more than one Billion Birr, highest number of Branches, relatively high number of man power and capability in the financial industry.

3.5. METHODS OF DATA COLLECTION

The data collection was administered by using both primary and secondary data sources. The primary data was collected using key informant using unstructured interview guide line questioners. The Secondary data collected from company website, internal brochures and publications and annual report. It was used to gain understanding about the current situation. Books, articles, journals and scholarly websites are used to fulfill this study

3.6. METHODS OF DATA ANALYSIS

After the data collection process completed; the next task was analyzing and discussing those data (primary and secondary data) properly. The data were quantified, analyzed by employing descriptive method. Whereas, the primary and secondary data was analyzed, quantified and discussed by substantiating with words, statements and theoretical frameworks. Unstructured Interviewees questionnaires were summarized and organized. The collected primary data was first prudently reviewed for any missing information or unclear statements. After being certain that all needed data is there in required manner, then the compiled data using a format prepared specifically for this purpose. Qualitative data collected from the respondents was grouped in accordance with the core focus areas used for this study such as Current Capital Market Situation, Advantage of Capital Market, roles of financial market, progress, Timing and promising factors, Current Environmental factors and challenges of capital market. The grouped

data was analyzed through descriptive analysis form and elaborated in such a manner the output could be clearly understood effortlessly by any reader.

CHAPTER 4: DATA ANALYSIS, RESULTS AND PRESENTATION

4.1. INTRODUCTION

This chapter discusses and analyzes the data collected from various sources related with identifying prospect and challenges of the establishment of capital market in Ethiopia. The data were obtained both primary and secondary data sources. The data was presented and analyzed by the form of qualitative method.. Capital market in Ethiopia is at stagnant position as reset of the world move forward the Ethiopian capital market seems stiff. Therefore under this title researcher summarized weight and describes prominent factors by identifying major prospect/ advantage and challenge for establishment of capital market in Ethiopia, by assessing the current situation in Ethiopia this had been done by gathering information from National Bank of Ethiopia (NBE) and selected private banks. Other issues include in this chapter are the major role of financial institutions (banks) for establishing of capital market in the country and the capacity to favorer for economic growth, describing the prospect and challenges of capital market for country. Identifying the current economic policy and economic growth are promising for establishment and development of capital market in Ethiopia with some point regarding to minimizing such challenges related to governmental and political commitment and financial strength were discussed.

4.2. THE CURRENT CAPITAL MARKET SITUATION IN ETHIOPIA

In the present Ethiopia has no Capital Market to transact stocks and bonds (debt instruments) in the secondary markets. The stock market facilitate the purchase of shares while the bond market provides a means by which to sell and trade bonds in the secondary market to enable participating governments, institutions and companies raise long term capital. As it stands today, Ethiopia has fallen behind in creating or implementing such a resourceful financial mechanism. According to information gathered from Birritu magazine (2017, p.27), which published by the National Bank of Ethiopia, currently there is no regulatory authority and other related institutions to establish capital market in Ethiopian. Instead of this Ethiopia government treasury bills are

issued in the primary market on weekly basis. These bills are short-term with a maximum maturity period of one year. In addition, there is a long term bond issued by the development bank of Ethiopia for the financing of the grand renaissance dam. The two securities are the only ones being traded in the primary market however; there is no secondary market for both acquainted of the benefit of financial market development. In these regard ECX is the only close institution that have similarity with stock market in Ethiopia. According to senior Directorate officer at ECX authority they believe the institution play a vital role in the introducing modern marketing plat form. The authority established by the law to be responsible of ensuring the development of an efficient modern trading system controlling the secure transportation and stable functioning of a commodity exchange protecting the interest of the variance actors of the system and public at large. According to the ECX Authority senior official the main constrain for ECX and future capital marketing are the producers and traders (merchants) has still lack awareness or knowhow in modern market system show resistance to adopt new ways. From those vast and different motives the main reason that can take a lion share is the question of strength in the financial sector when it is compared with other countries accumulation of experience and power. Most respondents believed that there is no strong financial institution that can handle capital market.

4.3. THE ROLES OF FINICAL INSTITUTIONS IN ESTABLISHING CAPITAL MARKET IN ETHIOPIA

According to National bank of Ethiopia, in contemporarily financial sphere there are government and private owned financial institutions like banks, insurances and micro finance institutions operating in the country. State owned banks were established through initial capital raised by government whereas private banks were through sell of shares to the public by Initial Public Offering without stock market. In the present banking industry state banks accounted to 46percent and private banks 54 percent of the paid capital. This showed private banks accounted higher amount due to sell of shares from the day of establishment up to the fiscal period ended June 2016. Insurance companies which comprises state-owned and private are operating in the economy. Out of all insurance companies the highest amount of capital is registered by private companies which accounted to 78.7 percent. Whereas state owned insurance company accounted

to 21.3 percent. The implication of this are the availability of the financial industry including banking and insurance company have greater advantage on the establishment of capital market in Ethiopia this means the strength banking system and the whole financial system contribute significantly to the development of the capital market. On the hand, a weak banking system can limit the development of the capital market.

They proved issues related to the role of financial institutions of for establishing capital market related to the current Ethiopian economic growth and investment activity. Any investor around the world to invest their capital in different sector, they directly see the country financial system related to availability of capital market and the financial strength, if the bank loan capacity is rise at the same time they have a capacity to survive such difficulties related to in capability of financial capital. All respondent substantiated that banks can collect money from different ways on the other hand government banks like National bank and Development bank of Ethiopia also take an advantage and play pivotal role by formulating rule and regulation for establishment of capital market on the country. Whereas, respondent from private banks suggested that the political leaders especially, those found in the area of Ministry of Finance and Economic Development, Central Bank, and National Bank should have to take vital step and takes the responsibility to clearly forecast for effective implementations of this market by strongly integrating it with financial systems.

But Some respondent rise different assumptions related the our financial strength and capital market situation, these means the financial industry has its own problem on financial strength, loan, IT infrastructure, skilled man power, banks and insurance branch expansion, the competition environment etc. this all are challenges for the financial sector to fulfill their great role on establishment of capital market in Ethiopia. According to them, one of major cause raises the issue which related to the government responsibility working on building strength and capacity of financial industry especially private financial industry to compute with foreign banks. There is a pressure from IMF and the World Bank to liberalize the financial sector of Ethiopia. Ethiopia is also queued for membership in the World Trade Organization (WTO). These organizations may consider liberalizing the financial sector (banking and insurance) and establishment of capital market as a precondition for the country to get further development

assistance and co-operation. High quality financial institutions and infrastructures have a positive influence on the depth and development of financial markets /capital markets.

The research result clearly reflected developing the financial institutions can promote stock market development; Support services from the financial sector (particularly the banking system) contribute significantly to the development of the capital/stock market. Conversely a weak banking system can constrain the development of the stock market. Without financial institutions, financial markets would not be able to move funds from initial deposit to productive investment opportunities; and thus hinders important effects on the performance of the economy as a whole.

All respondent proposed that before establishing capital market in Ethiopia first the availability and capacity of financial institutions must be taken in to consideration. The Central bank of the country; National Bank of Ethiopia (NBE), Commercial Banks (state and private), insurance companies and MFIs, Credit Unions and co-operative banks should be strengthened before embarking on the establishment of capital markets. According to (Amare W., 2008) we can find this aspect similarly in his conclusion Specialized banks (such as investment) and mutual and pension funds need to be in place and their capacity strengthened by creating favorable working environment and finance specialists and brokers needs to in place as well .

4.4. THE PROSPECT OF ECONOMIC DEVELOPMENT FOR THE ESTABLISHMENT OF CAPITAL MARKET

All respondents indicate that there is undeniable economic development in the country for the last ten consecutive years in all sectors of the economy including service, agriculture, industry and infrastructure (road and rail way), electric power generations, telecom expansion and in real estate sectors.

On the other side Asret T., (2003) states that many prospects (opportunities) for developing securities markets exist in Ethiopia. The prospects are Ethiopia has considerable unexploited resources, one of the largest potential markets in Africa. Ethiopia's process of transition from a centrally planned to a market-oriented economic system and the process of economic liberalization underway is encouraging, The privatization efforts going on would help with the

supply problems, particularly if a public offering of shares is used as the method of privatization; The existence of many profitable companies, which can potentially benefit from floating shares to the public, The existence of institutions like the country's Pension Fund, insurance companies, credit unions, etc., with large sums of money. If allowed to invest, they would boost the demand for securities; the gradual improvements of the incentive packages in the successive investment proclamations help attract new investors including Ethiopians with foreign passports; the debate going on in academics, the business community at large and the government circle is encouraging. Similarly Abebe, (2006) state that there are prospects including the current scenario in share buying is a testimony of the existence of demand and supply sufficient to begin the long journey: the government has consistently maintained that the macroeconomic situation is reasonably stable and there are already some legal pronouncements, which can be reinforced a little more for a start.

4.5. THE PROGRESS, TIMING AND PROMISING FACTORS TO LAUNCH CAPITAL MARKET IN ETHIOPIA

According to the informants from Awash International Bank, stated that the government had positive interest towards establishing stock market. Recently, National Bank of Ethiopia is on preparation to launch Secondary Market for government bonds to the public and issued Sovereign Eurobond to foreign investors after securing credit ratings by foreign credit rating agencies. The government had also issued a proclamation to establish a regulatory board to direct certify and control public accountants' and auditors' work and further started to revise the commercial code of Ethiopia. Further to note, recently the government by its initiative has started to study the feasibility of establishing stock market in Ethiopia. The document is at a draft level for subsequent approval. Parallel to the study, National Bank of Ethiopia is prepared to issue corporate governance directive to all financial institutions. The officials and managers of private banks believe it's time to establishment of capital market including bond market, stock exchange, strengthening the money market and so on. There is also a promising indication like the previous study done by National Banks of Ethiopia and the governments notified all private banks to increase minimal initial deposit from 500,000,000 million birr now to two Billion birr at the end of the second GTP. For this purpose the bank formulate a committee composed of foreign and its

own experts to conduct study on this area. In adverse National Banks stand on these regard stay controversial according to sources “still now we don’t have anything to publicize but the work is in progress and additionally the government is not hundred percent ready to institutionalize the capital market in general and the stock exchange in particular like that of commodity exchange and the government’s commitment to establish the stock exchange is not clear” ,continually in Ahforem, (2011)study other hand show that academicians believe that this is the time for the establishment of stock exchange. Here they add that even though they agree on establishing stock exchange at this time, this doesn’t mean that the pre-conditions for the establishing stock exchange are not fully available but this is the time for starting institutionalizing the stock exchange.

There are different directives and indication for promising the launch of capital market in Ethiopia. It is collected from investment commission of Ethiopia and National Bank of Ethiopia that the following are promising areas.

- In the current scenario Ethiopia is accepting and applying Foreign Direct Investment this means the investors wants to loan from capital market.
- The government strong request to be grant membership in World Trade Organization, if it is happened and Ethiopia member in WTO everything goes on rule and regulation of the organization so there must be capital market in the country.
- The rise of educated Man Power In the financial Sector

Another strong indication for the establishment of stock market in Ethiopia is the recent privatization of public enterprises, where the government’s Privatization Agency declared the privatization of 394 companies in manufacturing, construction, agro-industries, transport, export-import and mining. This year alone, the agency has identified 20 more companies in its pipeline slated for privatization and marketed the firms as direct sale (auction). Unfortunately none of these firms were privatized as equity or share companies to the public (Ezana, 2015).

4.6. ENVIRONMENTAL SITUATION AND ITS CHALLENGES

Establishing financial markets is not an easy exercise; rather it is constrained by several factors in the environment such as political, social, economic, and technological (PSET).On these

respect the main challenge based the government police and lack of strong financial institutions in the country. Ethiopia economy is manly dependent in agrarian leading economy before embarking capital market there must be a transformation from agrarian to industrial to service leading economy. According to Dahou, Omar and Pfister,(2009) the prerequisite environmental factors for a well-functioning financial markets and system are macroeconomic stability, adequacy and independence of the judicial system, political stability, security, good corporate governance, accounting and auditing standards, transparency and availability of information, institutional framework, initiation and promotion of privatization, potential investor base, potential issuer base, financial literacy, technological factors, etc.

All respondents noted on the issue what challenges the establishing capital market in Ethiopia related to the strength of financial sector in terms different infrastructure like information technology, skilled manpower, forming relation with each other and from foreign banks, financial strength Payment systems of banks, automatic payment systems were not in placed and use few banking products. Technological facilities commonly used in our banks include ATM, Mobile banking, branching networking, and use of point of sales (POS) terminal, Ethiopian Automated transfer system (EATS) and credit reference system in the National Bank together with Eth Switch and premier Switch remain important infrastructure. When we the capability of technology application some African countries like Kenya, South Africa and Tanzania are doing well. We have ample opportunities to catch up all the success stories and even to excel them if the above shortcomings are addressed. According to Alemayehu,(2008) only few firms (1.5 %) report the existence of theft robbery and the accuracy of vandalism, despite that however, close to 92 percent of the firms do procure security service. According to banking supervision directorate of the National Bank of Ethiopia to mitigate technological risk, among others, the already started effort against cyber security threat needs to be strengthened; power and network failures should be addressed. Capability and awareness of regulatory body, banks and their customers need to be enhanced. Legal and regulatory framework on e-banking and e payment should be further strengthened.

It was also found that most of government and private sector mangers believe that if financial institutions are opened for foreign investors local banks will not be able to compete in due to

lack of technology, knowhow on operation, lack of capital market experience and general financial capacity and branch networking.

There is no capacity of regulatory framework to guide the market, this is rise the question if the country establishes the capital market on the future who administer and regulate the market whether private banks or the national bank alone. According to Ruecker, (2011).There is no institutional, legal and policy framework for any capital market activity in the country as financial markets are not yet established in Ethiopia. The absence of such framework will definitely be an obstacle for launching a capital market in Ethiopia. It is therefore crucial that this framework is put in place prior to the launching of a formalized capital market

According to the interviewers and the review of secondary data shows there is no specific regulation of capital market and related activities in the country to date. Thus, no assessment of strengths and weaknesses with emphasis on the regulator's independence, objectivity, integrity, and enforcement capacity made to rectify the existing scenario. There is no an independent regulatory authority like Capital Market Authority, Stock Exchange and other related institutions that could facilitate capital market in Ethiopia.

There are also no specific training programs to educate prosecutors and judges towards capital market regulation. Other challenges for establish capital market in Ethiopia is corruption. Capital market and related markets are faced for corruption and gambling by its own feature it means in an open and direct financial market there is some fraud.

There is low level of public awareness about securities markets, lack of public confidence in share investment, lack of institutional capacity to facilitate securities trading, underdeveloped state of the bond (debt) market, low level of private sector development and a low level of market orientation in the economy, easy access to loans by wealthy Ethiopians, problems with the supply and demand for securities at least initially. There is neither the tradition nor the trust in share companies; due to the historical prominence of bank financing; there is still government interference in the market. In addition to this Abebe Y.,(2006) stated that lack of adequate legal, regulatory, accounting, tax, supervisory systems, lack of awareness and willingness among Ethiopian policymakers, low implementation capacity on the part of the government as the major direct challenges in establishing financial markets in Ethiopia.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

Capital markets being the major components of the financial sector it expects to play huge amount of role by mobilizing the domestic resources of the nation as well as attracting foreign direct investment to the economy. In many developed and emerging states institutional investment account for the bulk of growth national investment. For the developed economies of the west and the recently emerging economies in Asia, South Africa and Latin America the financial sector in general and capital markets in particular were the engines behind the strength of their respective economies. African countries particularly those in Sub-Saharan Africa (SSA) including Ethiopia were not fortunate enough to make use of this engine so as to develop and grow their economies.

Empirical studies conducted so far have verified that at least in theory there is a positive correlation between capital markets and economic growth. The study analyzed the current situation of capital market in Ethiopia, the role of financial institution for establishment of capital market, capital market and its advantage for economic growth , The promising factors, progress, and timing for the launch of capital market of Ethiopia, The current challenges and environmental foundation for Establishment of Capital Market in Ethiopia, identifying prospect of establishment of capital market in Ethiopia in relation with strength of financial institution, political commitment of government, skilled man power for working on this and availability of infrastructure of information technology etc... , Major conclusions are made regarding these variables in the study conducted

- ❖ Capital markets could lead to the economic growth and prosperity of Ethiopia if establish as well provided that the capital market of an economy is backed by quality institutions of all sorts.
- ❖ Capability and awareness of regulatory body, banks and their customers need to be enhanced. Legal and regulatory framework on e-banking and e-payment are weakly functioned.

- ❖ All participants believe that if financial institutions are opened for foreign investors local banks will not be able to compete in due to lack of technology, knowhow on operation, lack of capital market experience etc.
- ❖ Before inaugurating capital market in Ethiopia there must be a strong financial, Economical, and technological foundation. Most importantly transformation in between agriculture economy to service giving economy in all spheres is needed.
- ❖ Similarly, the establishment of capital markets has to give critically consideration on financial institutions and building there capacity accordingly. “Political commitment” is also very crucial to this effect, which lacks in most of the circumstances in past. In other way the establishment of capital market is not an easy task for Ethiopia there must be different complex work in financial institution, human power development information technology infrastructure, creating public awareness related to capital market and economic development.

5.2 RECOMMENDATION

Generally speaking the strength and performance of the financial system is an indicator of the strength and performance of the nation’s economy. Financial markets, being an element of the financial system play a pivotal role in expediting the nation’s economic growth through mobilization of domestic resources and attracting foreign direct investment. Existence of the financial markets encourages the private sector involvement in the economy which is usually described as the engine of the national economic growth. Besides, financial markets help to mobilize local savings, enhance competition among financial institutions, increases remittances because of such advantage it must be establish of capital market by reducing different factors listed in the above. But establishing financial markets is not an easy task for the Ethiopian government. It is affected by several environmental factors emanating from different sources.

- Before establishing capital market the government should be learn from other African countries like Kenya and Tanzania stock exchange system.

- Infrastructure like information technology, skilled manpower, and strong relationship between financial institution and with foreign banks should be formed; financial strength Payment systems of banks, automatic payment systems should be well established.
- Financial institutions should be strong like formal- Banks, Insurance companies, credit unions, and pension funds, mutual funds and MFIs and; non-formal-financial institutions of Ethiopia.
- There should be clear relevant laws, rules and regulatory systems including political commitments.
- Legal institution should be established and other related institutions with the technical assistance (training, manuals, expertise service, etc.).
- To sum up, addressing the core elements of capital market development and management is crucial for development of our country; we should develop policy and legal framework, and management support systems to move onward.

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Appendix 1: Name of Institutions and position of interviewees

No.	Name of institution	Position of the interview		
1	National Bank of Ethiopia	Directorate	Official	-
2	Commercial Bank Ethiopia (CBE)	-	Official	-
3	Development Bank	Officials	Research and marketing Department	-
4	Awash international bank S.C.	Senior manager	Research and marketing Department	Officials
5	Dashen Bank S.C	Manager	Officials	Research head
6	Wegagen Bank S.C	Officials	-	-
7	NIB International Bank S.C.	Manager	-	-
8	Investment commission	Officials	Research head	-
9	Ethiopian Commodity Exchange	Senior officer	Directorate	-

Appendix 2: Studies conducted on stock market

No.	Title	Author	Date
1	Feasibility of Establishing of Securities Exchange Market	NBE	1995
2	Prospects and Challenges for developing securities Market in Ethiopia: An Analytical Review	Prof.Asrat Tessema	1998
3	Proceedings of the National Seminar Towards Promoting Capital market in Ethiopia	Mekele University	2001
4	Towards the development of Capital market in Ethiopia	Tadewosharege-Work and Araya Debessay	1995
5	A study on the Feasibility of Securities Exchange market in Ethiopia	East Africa Securities Company	1999
6	Proposal for the Formation of a Share Market in Ethiopia	East Africa Securities company	
7	The Addis Ababa Stock Exchange Rules & Regulations Manual-Volumes 1 and 2	Ernst & Young	1999
8	IFC/Conceptor-Mission	Conceptor	2001
9	Capital Market Infrastructure Development	Maxwell Stamp(UK)	2010
10	Should Ethiopia Consider Establishing of a stock Exchange?	Ahfrom Telay	2011
11	Market Potential Assessment and Road Map Development for the Establishment of Capital market in Ethiopia	Ruecker	2011
12	Should Ethiopia promote the development of a stock Market? lessons from Kenya, Tanzania, Uganda and some transition economies	Solomon Gizaw Kebede	2008
13	Developing securities markets in Ethiopia	Public Financial Enterprises Agency	2012
14	Is Ethiopia Ready To Institute stock exchange market?	Alemneh Abebe	2015
15	Challenges and prospects of establishing Stock Market in Ethiopia	Getachew Mulatu	2016

Appendix 3: list of Private Banks

No.	Banks in Ethiopia	Accumulated paid-up Capital (in Br.)
1	Awash international bank S.C.	1,394,066,531
2	Dashen Bank S.C	1,064,118,000
3	Bank of Abyssina S.C	923,971,393
4	Wegagen Bank S.C	1,341,291,000
5	United Bank S.C	898,275,709
6	NIB International Bank S.C.	1,201,027,500
7	Cooperative Bank of Oromia S.C.	632,183,300
8	Lion International Bank S.C.	446,833,287
9	Zemen Bank S.C.	449,576,000
10	Oromia International Bank S.C.	540,499,430
11	Berhan international Bank S.C.	435,532,329
12	Bunna International Bank S.C	417,445,903
13	Abay Bank S.C.	288,507,143
14	Addis International Bank S.C.	261,644,000
15	Dehub Global Bank S.C.	177,271,425
16	Enat Bank S.C.	261,671,660
	Total	10,733,914,610

Appendix 4: Interview guide line Question

Guideline questions for unstructured interviews questions adopted from (Ahferom, 2011)

1. What are the efforts done by the government to establish a stock exchange?
2. At what level the study on the establishment of stock exchange or capital market reaches, if any?
3. What do you think about the establishment of stock exchange in Ethiopia? Is this the right time to establish it?

Appendix 5: Interview Guide line Questions

Key Informant Interview Questions

1. How do you describe the current capital market situation in Ethiopia?

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2. Are the Ethiopian private financial sectors ready for establishing capital market?

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3. How do you describe the current capital market situation in Ethiopia?

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4. What is the current general PSET (Political, Social, Economic, and Technological) Capability to establish capital market?

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5. What are the roles of financial institution in establishing capital market in Ethiopia?

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6. What economic advantage and disadvantage will be gained from capital market if we establish in future?

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7. Does the economic development have role for the establishment of capital market?

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8. Is the current economic policy of Ethiopia promising for the launch of capital market?

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9. What are the current challenges of the establishment of capital market in Ethiopia?

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10. How can we eradicate those challenges to accelerate the establishment of capital market in Ethiopia?

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