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Bridging the Divide: Integrating SADC's capital markets

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African perspectives
Global insights

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Abstract

The Finance and Investment Protocol encourages SADC members to pursue the cross-market integration of their exchanges. As a result, in the 1990s SADC members collectively embarked on various initiatives to improve coordination and integration in the financial sector with a view to attract capital inflows and enhance domestic savings. This culminated in the establishment of the Committee of SADC Stock Exchanges (CoSSE) to drive the development of a harmonised, integrated and credible regional securities/capital market capable of mobilising capital to address the sustainability challenges of smaller national markets and alleviate inequalities. Recognising the benefits of developed capital markets and the limitations of individual country approaches, CoSSE embarked on a journey to create a regional capital market via interconnectivity to help channel much-needed capital to SADC countries. Notwithstanding various challenges, CoSSE has made some progress towards interconnectivity, albeit manually, through the finalisation of its updated interconnectivity project and the establishment of the SADC Brokers' Network. This paper gives an overview of the current state of capital market integration in SADC, paying particular attention to CoSSE's efforts at interconnectivity over the past decade. It begins by linking capital markets to sustainable development and thereafter provides the rationale for regional integration in capital markets in SADC. The last section takes a closer look at CoSSE and its road to interconnectivity over the past decade. Final recommendations are made for CoSSE to stimulate a greater appetite among national exchanges to work towards interconnectivity and integration by pursuing harmonisation of listing procedures; lobbying for political and regional support for its 2015/16 updated interconnectivity project; stepping up efforts to enhance cross-border trading in SADC; and enhancing the offerings of the SADC Brokers' Network platform to provide information to brokers and gather data for a baseline study on cross-border trading.

Introduction

International trade has evolved significantly over the last few decades. Globalisation has deepened and harmonised exchange processes, enabling an evolution from merchandise trading, such as tangible goods or commodities, to trade in services as well. Today, global trading has come to include significant activities/transactions in the finance sector. These activities include buying and selling shares in individual companies with operations in various regional and national jurisdictions. In this case, buyers and sellers trade in spaces called financial markets; in these markets, buyers and sellers sell and buy small components of individual companies or values within a dedicated market. Buyers and sellers engage in transactions that can be defined as flexible and that are in many instances very fluid. Such transactions include, but are not limited to, trading shares or mutual fund investments in bond markets or in other types of investments, for example. More often than not, these transactions involve various national jurisprudences. With deeper global integration, the bulk of these activities increasingly occur in regional and global financial markets.

The number of stock exchanges has grown phenomenally in the post-Cold War era. The World Federation of Exchanges[1] (WFE) notes that, while there were only about 50 states with stock exchanges in 1975, this number exceeded 160 in 2015. More than 30 countries in sub-Saharan Africa now boast their own national exchanges, compared to only five about two decades ago. This phenomenal growth is in part the result of a widely accepted wisdom that there is a positive relationship between a functional national stock exchange and national economic development. This is borne out by significant statistical evidence[2] of a relationship between higher levels of financial development and real per capita gross domestic product (GDP) growth rates.[3] Others argue more explicitly that financial markets play an integral role in facilitating economic development.[4] Proponents posit that, given proper regulation, security and transparency, stock markets and developments in banking tend to correlate with both current and projected rates of economic growth. Stock exchanges are deemed instrumental in facilitating the mobilisation of financial resources by bringing together those who need capital with those who have resources to invest.[5] The existing wisdom is that financial markets have become a crucial source or a new finance stream for driving national development, making the private sector – through banks and stock exchanges – a central player in economic development.[6]

SADC recognises the importance of capital market development to achieving its goal of a modern and integrated regional economy

SADC recognises the importance of capital market[7] development to achieving its goal of a modern and integrated regional economy. Deep capital markets and integrated regional financial systems can help to raise funding for SADC's long-term infrastructure and social development programmes through stocks, bonds and other investment offerings. SADC sought to facilitate this process by establishing the Committee of SADC Stock Exchanges

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1 WFE (World Federation of Exchanges) & UNCTAD (UN Conference on Trade and Development), 'The Role of Exchanges in Fostering Economic Growth and Sustainable Development', p. 2, http://unctad.org/en/PublicationsLibrary/WFE_UNCTAD_2017_en.pdf, accessed 2 November 2017.

2 See King RG & R Levine, 'Finance and growth: Schumpeter might be right', The Quarterly Journal of Economics, 108, 3, 1994; Levine R & S Zevros, 'Stock markets, banks, and economic growth', *The American Economic Review*, 88, 3, 1998.

3 *Ibid*.

4 WFE & UNCTAD, *op. cit*., p. 7.

5 *Ibid*.

6 Beck T & R Levine, 'Stock markets, banks, and growth: Panel evidence', *Journal of Banking and Finance*, 2002; Demigüç-Kunt A & V Maksimovic, 'Financial constraints, use of funds and firm growth: An international comparison', Policy Research Working Paper. Washington DC: World Bank, 1996.

7 'Capital market' is defined as a market where buyers and sellers engage in the trade of financial securities such as bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. Capital markets help channel surplus funds from savers to institutions, which then invest them into productive use. Generally, this market trades mostly in long-term securities. *The Economic Times*, 'Capital market', https://economictimes.indiatimes.com/definition/capital-market, accessed 5 September 2018.

(CoSSE) in 1997. CoSSE is aimed at encouraging the development of a harmonised, integrated and credible regional securities/capital market. Integration and harmonisation are closely aligned with the operations of national financial markets through converging practices and harmonised rules. SADC anticipates that integrating its stock exchange operations will have the desirable effect of expanding and increasing the investment potential of the regional market in order to enable these markets to generate revenue and supplement declining financial contributions from traditional sources.[8]

This paper provides an overview of the state of capital market integration in SADC and focuses on the progress made towards the implementation of the interconnectivity project. It begins by establishing the link between capital markets and sustainable economic development at a macro level, and thereafter focuses on SADC's readiness for strong capital market development and integration. It then maps out CoSSE's road to interconnectivity over the years and concludes with an overview of the current state of integration in SADC's capital markets. The last section discusses the interconnectivity challenges facing the region and how they can best be addressed.

Role of exchanges in sustainable development

SADC countries need financing to build infrastructure and eradicate poverty, which in turn will allow sustained growth. Central to an exchange's role in an economy is the mobilisation of finance. Capital markets are traditionally an alternative source of financing to supplement funding from commercial banks. Today, stock exchanges play an even bigger role in the economy. First, capital markets are no longer just a place for big firms to raise capital, but also a place for small and medium-sized enterprises to mobilise capital to address the long-term sustainability challenges faced by smaller market players.

Second, the private sector, including stock exchanges, has a role to play in achieving the Sustainable Development Goals (SDGs) that the UN launched in 2015. Traditionally, stock exchanges have been responsible for helping to form well-regulated markets with transparent and well-governed companies. Prevailing wisdom has it that exchanges contribute towards the promotion of good corporate governance,[9] as they demand transparency and accountability from listed issuers, including respect for the rights of shareholders and key stakeholders. However, in the 21st century stock exchanges are ensuring or perhaps also insisting that companies go beyond their traditional business mandate by adopting best practices on environmental, social and governance (ESG) issues that are central in measuring the sustainability and ethical impact of an investment in a business. In order to address the challenges of the 21st century, economic development

8 For example: domestic public resources mainly from national tax systems, official development assistance, revenues generated from natural resource extraction in the form of commodity prices, sovereign debt from regional development banks (complemented by multilateral development banks at the global level), etc.

9 WEF & UNCTAD, *op. cit.*

should be sustainable and inclusive, and it is crucial to mobilise significant financing to achieve the SDGs. Thus, stock exchanges can contribute in two main forms: by promoting good governance in business practices and promoting investment in sustainable development. Good governance is defined[10] by the WFE to mean good ESG practices.

The Sustainable Stock Exchanges[11] initiative was launched in 2009 by the UN secretary general as a partnership programme of the UN Conference on Trade and Development, to complement and support the attainment of the SDGs by contributing more directly to four delineated goals of ensuring gender equality, promoting sustainable information, addressing climate change and building global partnerships.[12]

In their quest to improve infrastructure and eradicate poverty in the region, Southern African governments have sought to bolster economic growth by harnessing the potential of regional financial markets as alternative sources of finance to complement traditional sources of development capital. Some have argued cogently that an integrated regional market is a much bigger and more attractive investment destination that offers greater flexibility and efficiencies. Therefore, regional cooperation in the financial sector is deemed to open a realistic alternative for addressing the liquidity problems of many developing countries.[13]

Two initiatives are underway at the regional level in Southern Africa. The East African Community (EAC) has sought to develop an efficient and reliable regional capital market to facilitate the development of an integrated financial market in which investors and issuers can participate seamlessly with a wider range of investors. The EAC Common Markets Protocol became effective on 1 July 2010 and aims to regionalise East African capital markets.[14] In Southern Africa, SADC governments agreed on a vision for regional capital market integration and harmonisation in the 1990s.

SADC: Rationale and goals for regional market integration

SADC governments went about deepening regional financial links by harmonising various national policies, unifying existing financial institutions and/or developing new ones to facilitate collective goals in this sector. Efforts were made to increase the cohesion of regional capital markets' regulatory frameworks, operational structures and information

10 See *ibid*, p. 3.
11 The Sustainable Stock Exchange Initiative, http://www.sseinitiative.org/how-we-work/overview/, accessed 5 August 2018.
12 *Ibid*.
13 Moshoeshoe M, 'Multiple Logics of Collective Action: A Comparative Study of Cooperation in the Southern African Development Community', Dissertation submitted to the Department of International Relations, University of the Witwatersrand, 2012, p. 95.
14 EAC (East Africa Community), 'Rational for regionalisation of capital markets', p. 1, https://www.eac.int/financial/capital-markets-regionalisation, accessed 4 January 2018.

systems with the view to achieving a seamless regional market. This in turn would allow disparate national market entities to begin functioning as a single regional entity.

On 18 August 2006, during a summit meeting in Maseru, SADC member governments signed the Finance and Investment Protocol (FIP) to give legal and practical effect to earlier commitments to cooperate on regional finance and investment matters. The integration programme had various elements, including removing barriers to intra-regional economic relations and harmonising regulatory frameworks. The protocol identified harmonisation of capital markets as one of the primary components of regional integration.[15] SADC perceives the potential gains of regional integration to include a large and efficient market that can boost intra-regional trade and investment flows into the region. The conventional wisdom is that well-developed and bigger financial and capital markets with fewer restraints on the movement of capital are better able to attract foreign direct investment than smaller, less flexible markets. This wisdom holds that consolidated financial markets bring together scarce savings, viable investment projects and financial infrastructure that enhances competition and innovation while insulating central banks from domestic fiscal excesses. Therefore, integrating national financial and capital markets into bigger entities improves their viability and enables them to compete effectively for foreign investments. Consolidating regional markets also enables domestic capital markets to have desirable poverty-reducing effects in developing countries in general.[16] Regional economic integration in SADC is geared towards creating larger markets with a favourable business and investment climate aimed at achieving economic growth and ultimately improving the livelihoods of citizens.

However, the key impediment for SADC, as for many other developing subregions, is the fact that domestic markets are generally small, illiquid and relatively undeveloped. This provides a strong rationale for regionalising capital markets in Southern Africa, as many are convinced that regionalisation increases market size and improves operational efficiencies by streamlining activities and exploiting economies of scale. So far, the lack of liquidity and low market capitalisation that characterises SADC's markets has been identified as a key obstacle to investment in securities.[17] Hence the Regional Indicative Strategic Development Plan (RISDP) of SADC refers specifically to the goal of[18]

> fast-track[ing] the development of capital markets in the region by improving the liquidity of trade in equities, bonds, derivatives and other financial instruments in Southern Africa, so as to raise capital for regional economic development and make the SADC securities markets more attractive to local and international investors.

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15 Harmonisation was further emphasised as a regional priority at a meeting of donors and African regional economic communities held at the African Development Bank, in Tunis, December 2009.

16 Levine R, 'Financial development and economic growth: Views and agenda', Journal of Economic Literature, 35, 1997, pp. 688–726.

17 SADC, 'The Regional Indicative Strategy Development Plan', p. 80, https://www.sadc.int/files/5713/5292/8372/Regional_Indicative_Strategic_Development_Plan.pdf, accessed 20 November 2016.

18 *Ibid*., p. 26, paragraph 3.2.5.1.

Therefore, integration in this sector was also meant to improve the importance of these markets as destinations for investments and as possible new sources of state revenue. The rising external interest in African capital markets and the benefits expected to come with these external injections of capital further incentivised integration and provided momentum for broader and deeper capital market reforms on the continent as a whole.

The signing of the FIP in 2006, in particular Annex 11, was motivated by envisioned prospects of the real mutual socio-economic gains that an integrated regional capital market could offer individual national economies and the region as a whole. Therefore, part of the rationale for integration was based on a common awareness of the potential contribution that the national stock markets could make to increasing national revenue. SADC has taken several steps to ensure the implementation of the FIP.[19] These require individual member states to actively facilitate the creation and expansion of their capital markets while closely coordinating the policies and practices of their existing stock exchanges. The broader FIP objective is to create a dynamic and more liquid capital and financial market in SADC. The FIP, therefore, commits participating national stock exchanges to synchronising their efforts and working towards creating a more efficient regional capital and financial market. The Committee of SADC Stock Exchanges (CoSSE) was established to drive the development of a harmonised, integrated and credible regional securities/capital market capable of mobilising capital to address the sustainability challenges of smaller national markets and alleviate inequalities.

CoSSE was established to drive the development of a harmonised, integrated and credible regional securities/capital market capable of mobilising capital to address the sustainability challenges of smaller national markets

The FIP states that all SADC member exchanges need to:

- improve the operational, regulatory and technical underpinnings and capabilities of SADC exchanges to make their securities markets more attractive to both regional and international investors;
- increase market liquidity and enhance trading in various securities and financial instruments;
- promote the development of efficient, fair and transparent securities markets within SADC;

19 SADC, 'Protocol on Finance and Investment', http://www.sadc.int/files/4213/5332/6872/Protocol_on_Finance__Investment2006.pdf, accessed 3 November 2017.

- encourage the transfer of the intellectual capital of the securities markets and the technical expertise among CoSSE; and
- encourage interaction among market participants.[20]

In line with Jacqueline Irving's observation that regionalisation of small financial markets in developing countries encourages harmonisation of regional financial laws and institutions,[21] Article 2 of the FIP emphasises that cross-market harmonisation should be pursued by member exchanges on an on-going basis.[22] Theoretically, harmonised listing rules are a step towards consolidating the region's capital market. If successfully implemented, it could also give a SADC capital market a competitive edge among other regions. Technically, harmonising and streamlining listing rules and processes across a number of regional stock exchanges can be mutually beneficial. Harmonisation can improve efficiencies of regional stock markets by bolstering their operational, regulatory and technical capabilities, thereby increasing market liquidity; enhancing trading in various securities and financial instruments; and spurring development of an efficient and transparent regional securities market.

In addition, streamlining national policies, rules and practices can benefit SADC governments by addressing some of the common constraints they face in their financial and capital markets. Firstly, harmonisation of policies eliminates expensive duplications by distributing the costs across a number of economies, thereby reducing fixed costs in financial market development. Secondly, an integrated regional market offers flexibility and efficiencies that enhance its status as an attractive investment destination. Thirdly, regional cooperation opens a realistic opportunity to address the liquidity problems of these countries. However, harmonising national policies has cost implications because synchronising various functions could include acquisition of new technologies, development of requisite skills and capacities, and new legislation by some member states. Despite all the implicit benefits from integration, the cost considerations[23] associated with synchronising policies could prove to be a real hurdle for cooperation and progress among SADC members.

Regional developments supporting capital market integration in SADC

SADC's long-term vision is to establish harmonised regional securities markets that can attract investment and allow the regional economy to compete on a global scale. Under

20 SADC, 'Protocol on Finance and Investment', *op. cit.*, p. 107.

21 Irving J, 'Regional Integration of Stock Exchanges in Eastern and Southern Africa', IMF (International Monetary Fund), June 2005, pp. 4–6, https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Regional-Integration-of-Stock-Exchanges-in-Eastern-and-Southern-Africa-Progress-and-Prospects-18301, accessed 30 March 2019; Wakeman-Linn J & S Wagh, 'Regional Financial Integration: Its Potential Contribution to Financial Sector Growth and Development in Sub-Saharan Africa', Paper presented at the seminar of the IMF Institute in collaboration with the Joint-Africa Institute, Tunis, 4–5 March 2008.

22 SADC, 'Protocol on Finance and Investment', *op. cit.*, Annex 11, Article 2, sub-section 6, p. 110.

23 Market integration is a process that involves eliminating restrictions on cross-border financial operations by firms in the region, as well as harmonising rules, taxes and regulations. During the process, separate national markets eventually become one market characterised by converging prices, product supply and converging efficiency among financial service providers. This process in itself has financial implications for each participating country that is moving over to the new regional practices.

the auspices of the Committee of Central Bank Governors (CCBG), SADC has embarked on a substantial liberalisation of the banking and financial sectors and capital and investments services, and has made progress towards implementing the FIP.

There are important developments that support the orderly development of capital markets in SADC.

First, the macroeconomic environment in SADC has improved substantially in recent years. In 2017 inflation was in single digits in most countries, with the exception of Zimbabwe, Angola, Malawi and Mozambique.[24] Low inflation is conducive to the holding of long-term financial assets. However, economic growth is weak, with an average SADC growth rate of 3.8% in 2017. Tanzania has been leading the region with a consistent 7% real growth rate since 2015 while South Africa and Eswatini (formerly Swaziland) are the only two countries that recorded a real GDP growth rate of less than 2%.

Second, although domestic capital markets and their regulatory regimes are at different stages of development, the successful initiation of the SADC Payment System Integration project, at the core of which is the SADC Integrated Regional Electronic Settlement System (SIRESS), serves as a basis for the development of a regional market. The fact that SADC successfully launched SIRESS in 2013 is a bonus in the pursuit of a regional approach, as its payment sector laws and legal institutions are informed by the same basic legal concepts and readily compatible with one another. SIRESS has created a safe, enabling banking environment for cross-border trade that is aligned to Annexure 6 of the FIP (Co-operation on Payment Systems, Clearing and Settlement Systems). This aims to implement a safe and efficient payment system in each SADC country and develop a cross-border payment strategy for the region. SIRESS has allowed SADC countries to transact on a real-time basis for cross-border payments using one currency (the rand). SIRESS offers multiple benefits to SADC members, including the creation of regional common standards and processes and a common regional payment platform, as well as the increased safety and efficiency of the regional payment and settlement system.[25] SIRESS will also benefit ordinary banking sector customers in SADC by enabling them to transact across borders while enhancing pricing transparency and improving their safety and security (through the use of cards). The South African Reserve Bank hosts and operates SIRESS.

Third, the existence of a common monetary area (CMA) between South Africa, Namibia, Lesotho and Eswatini provides a common framework for monetary and exchange rate policies and helps maintain price stability. There is financial market integration within the CMA (evidenced by the structure of the financial sector in Lesotho, Namibia and Eswatini (LNS countries) focusing on the banking sector. The significant presence of

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24 SADC, 'Macroeconomic convergence data: Headline inflation', https://www.sadcbankers.org/Lists/News%20and%20Publications/Attachments/222/SADC%20MEC%20Indicators%20-%20Inflation.pdf, accessed 3 August 2018.

25 SADC Banking Association, SADC Payments Project, 'Celebration of the Implementation of SIRESS', eNewsLetter, 8, December 2013, https://www.sadcbanking.org/wp-content/uploads/2017/09/SADCBA-DECEMBER-2013-E-NEWSLETTER-FINAL.pdf, accessed 4 August 2018.

South African financial institutions and their subsidiaries in LNS countries has created a virtually unified banking system within the CMA. The second factor indicating high banking sector integration is the relatively uniform banking sector financial soundness indicators across CMA countries.[26] The key factors contributing towards the fairly uniform performance are the strong presence of South African banks, and closely aligned banking supervision standards and prudential requirements. However, financial markets in the LNS countries are not as developed and advanced as the South African financial market.[27] Although the rand serves as legal tender that is widely used and accepted in the participating countries, other member states are entitled to issue their own national currency and all three countries have made use of this provision. The main benefit of participating in the CMA is the fixed and predictable exchange rate with the rand, as participating countries depend heavily on trade with South Africa. The currencies of these countries have been pegged to the South African rand at par since their introduction and their banknotes are freely convertible into the rand, but are not legal tender in South Africa. There are no restrictions on the transfer of funds, which mean that there is no restriction on cross-border investments from South Africa, contributing directly to economic integration and development. Given this, it would be easy to link CMA stock exchanges first, allowing cross-border trading within that sub-regional market.[28]

Fourth, all four members of the CMA (as well as Botswana) belong to the Southern African Customs Union and as such capital and goods are highly mobile across the CMA region.

Fifth, the legal and regulatory framework for payments in individual SADC countries is reasonably sound and could serve as a basis for developing a regional capital market.[29]

There is a clear and strong commitment by all SADC countries to promote the development of their capital markets, as evidenced by a range of fiscal and other incentives supporting the activities of capital markets. Most SADC countries' stock exchanges were established by their governments, which continue to operate and nurture their development to this day. Nevertheless, although the current policy framework in SADC is conducive to the development of capital markets, there is room for improvement.

26 Capital adequacy, asset quality, liquidity, earnings and profitability.

27 Wang J-E *et al*., 'The Common Monetary Area in Southern Africa: Shocks, Adjustment, and Policy Challenges', IMF Working Paper, WP/07/158, July 2007, https://www.imf.org/external/pubs/ft/wp/2007/wp07158.pdf, accessed 10 August 2018.

28 Van Zyl L, 'South Africa's Experience of Regional Currency Areas and the Use of Foreign Currencies', BIS (Bank for International Settlements) Paper, 17, 2003, pp. 134–136, https://www.bis.org/publ/bppdf/bispap17o.pdf, accessed 4 August 2018.

29 Langhan S & K Smith, 'The Legal and Regulatory Framework for Payments in 14 SADC Member States Master Report', FinMark Trust, August 2014, http://www.finmark.org.za/wp-content/uploads/2016/02/Rep_LegalRegulatoryFramework_Payments_SADC_14states.pdf, accessed 5 August 2018.

Committee of SADC Stock Exchanges (CoSSE)

Comparative analysis of CoSSE members

According to the charter of CoSSE, it was established with the aim of integrating the real-time network of the national securities markets within SADC and pave the way for cross-border listings, trading and investments regionally in order to facilitate regional financial integration.[30]

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CoSSE reports to the CCBG, which was established to help implement the FIP and assist the SADC Committee of Ministers of Finance and Investment (COMFI) in developing well-managed financial institutions and markets. Its mandate further includes cooperation in international and regional financial relations, and monetary, investment and foreign exchange policies.[31]

CoSSE comprises 13 member exchanges: the Angola Securities and Debt Stock Exchange (BODIVA); the Botswana Stock Exchange (BSE); Dar es Salaam Stock Exchange (Tanzania); Johannesburg Stock Exchange (JSE, South Africa); Lusaka Stock Exchange (Zambia); Malawi Stock Exchange; Maseru Securities Market (Lesotho); Mozambique Stock Exchange; Namibian Stock Exchange; the Stock Exchange of Mauritius (SEM); Trop-X (Seychelles); Swaziland Stock Exchange; and the Zimbabwe Stock Exchange (ZSE). One of the striking observations about the members of CoSSE is the contrast between them in terms of their institutional size and structures. For example, the gap between the JSE and the rest of the exchanges in the region is astounding. However, this difference should not mask considerable variations among the smaller exchanges themselves in terms of size, turnover, liquidity, growth and number of listings.

Some SADC exchanges (BSE, JSE, SEM, Dar es Salaam Stock Exchange, Namibian Stock Exchange) have demutualised or self-listed. Demutualisation helps to enhance corporate governance within an exchange for the sustainable protection of all its stakeholders.

30 SADC, 'Charter of the Committee of SADC Stock Exchanges', https://cossesite.files.wordpress.com/2016/11/cosse-charter.pdf, accessed 2 November 2017.

31 Van Zyl L, *op. cit*.

In addition, it provides access to efficiently priced funds to finance the exchange's growth and capital market development, including capital investments in trading technologies as well as the introduction of new products and services. The other eight exchanges remain dependent on government financial support or donor subventions.

Table 1 draws comparisons between the regional stock exchanges across four indicators, namely national GDP, national population size, national stock market capitalisation, and stock market capitalisation as a percentage of national GDP.

TABLE 1 SADC NATIONAL STOCK EXCHANGES

		GDP ($bn)	Population (mn)	Market cap ($bn)*	Market cap/GDP
Botswana	BSE	14.0	1.8	3.9	28%
Malawi	M SE	5.0	15.7	1.8	36%
Mauritius	SEM	9.7	1.3	6.8	70%
Mozambique	BVM	9.9	21.6	0.4	4%
Namibia	NSX	11.9	2.1	1.1	9%
South Africa	JSE	357.0	50	923.0	259%
Swaziland	SSX	3.6	1.2	0.3	7%
Tanzania	DSE	22.7	41.3	3.2	14%
Zambia	LuSE	16.2	13.3	6.3	39%
Zimbabwe	ZSE	7.5	12.6	3.6	48%
Total		457.5		95.3	21%

Source: World Bank, 'Market capitalization of listed domestic companies (% of GDP)', https://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?locations=BW-ZA-MU-AO-LS-MZ-TZ-NA-MW-ZM-SZ-SC-MG-ZW-CD-CG, accessed 9 April 2019

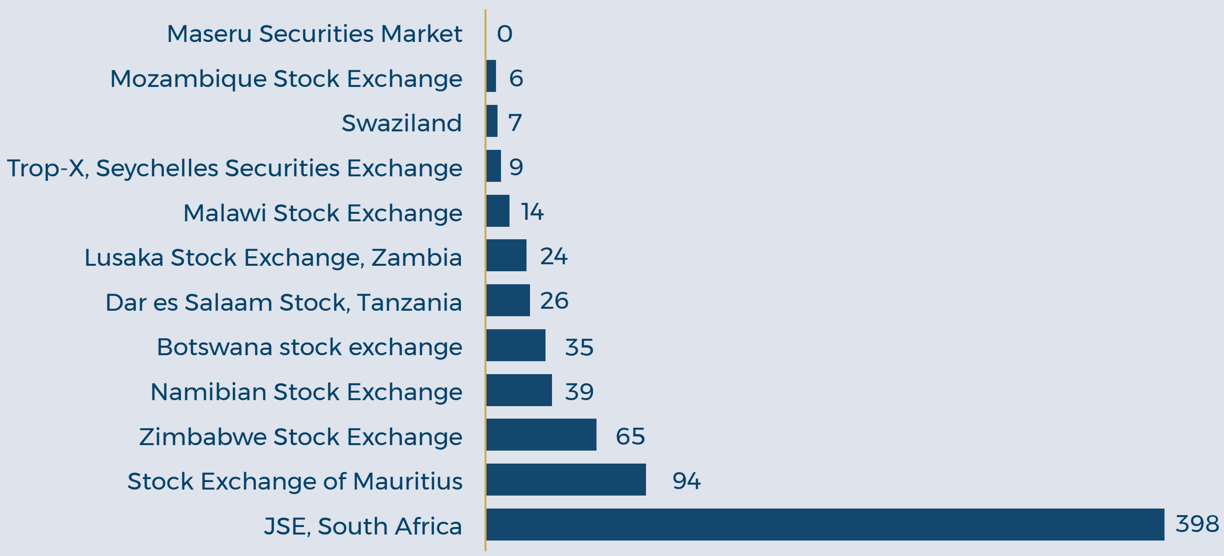
The JSE is much larger than the other exchanges and provides a much larger and more diverse and liquid pool of investable funds than they do. The smaller regional stock markets are also dependent on captive customers, who are restricted by exchange controls or prudent regulations from placing funds in markets outside their country of origin. Faced with relatively high fixed costs and low trade volumes, smaller markets generally struggle to bring listing fees and transactions costs down to levels that are regionally competitive. The perception among SADC leaders is that smaller stock exchanges are constrained in various ways and generally operate inefficiently. Table 2 ranks exchanges using 2017 market capitalisation data while Figure 1 ranks exchanges using the number of listed companies.

TABLE 2	SADC STOCK EXCHANGES RANKED BY MARKET CAPITALISATION	
		Market cap/GDP
1	Johannesburg Stock Exchange, South Africa	995.12
2	Dar es Salaam Stock Exchange, Tanzania	21.70
3	Zimbabwe Stock Exchange	9.28
4	Stock Exchange of Mauritius	7.95
5	Namibian Stock Exchange	2.39
6	BODIVA (Angola Securities and Debt Stock Exchange)	2.19
7	Trop-X, Seychelles Securities Exchange	0.104 (2016)
8	Swaziland Stock Exchange	0.78
9	Mozambique Stock Exchange	0.63
10	Malawi Stock Exchange	0.14
11	Lusaka Stock Exchange, Zambia	0.6
12	Botswana Stock Exchange	4.55
13	Maseru Securities Market, Lesotho	$0 (Launched in 2016, not yet trading)

*Market capitalisation data from exchange websites and conversions to $ at 2010 exchange rates.

Source: See Zambia - http://www.luse.co.zm/; Botswana http://www.bse.co.bw/; Malawi https://mse.co.mw/; Namibia -http://nsx.com.na/; Lesotho https://www.msm.org.ls/; South Africa https://www.jse.co.za/; Swaziland http://www.ssx.org.sz/; Angola http://www.bodiva.ao/; Mozambique http://www.bolsadevalores.co.mz/index.php/en/; Zimbabwe https://www.zse.co.zw/; Seychelles https://www.trop-x.com/; Mauritius https://www.stockexchangeofmauritius.com/

Figure 1 SADC exchanges ranked by number of listed companies in 2017



Source: Authors *Data sourced from exchange websites (see Table 2).

* NOTE: BODIVA (Angola Securities and Debt STock Exchange) currently has 393 debt securities listed and no company listings

CoSSE's road to interconnectivity

African capital markets are inefficient and unattractive to investors given their high transaction costs and the high cost of capital for issuers. However, local markets are best suited to meet the needs of local economies, especially as the use of technology to create linkages between national exchanges can improve the offering to local users. This enables

> Local markets are best suited to meet the needs of local economies, especially as the use of technology to create linkages between national exchanges can improve the offering to local users

investors on one exchange to buy shares seamlessly on other exchanges within the SADC region. If an enterprise has approval to raise capital on one SADC exchange, then it should be able to raise capital across all SADC exchanges.

In the face of scarce capital resources and a host of other challenges, including unattractive, small and illiquid exchanges, SADC governments embarked on market integration hoping to exploit the full potential and benefits that an integrated market can offer. Efforts to form a real-time integrated network of stock exchanges in 1999 were relatively well received and in principle enjoyed immediate support from SADC member governments.[32] The strategy was first to get all the stock exchanges to harmonise their listing rules and procedures based on the 13 principles of the JSE's listing requirements[33] as an enabling step towards an automated and more efficient regional capital market. The second task for CoSSE was to come up with a list of requirements for the integration of SADC exchanges, including investigating and developing a suitable model for interconnecting the regional stock exchanges. The strategy compels each national exchange to offer automated trading instruments via a regionalised system easily accessible from a single workstation. CoSSE was formed to undergird cooperation and facilitate stronger working relations between member exchanges.[34] However, its members have been struggling to find a mutually acceptable interpretation or model of a mutually desirable region-wide capital and securities market as anticipated by the FIP and the RISDP.

It was anticipated that by 2006 the operations of all SADC stock exchanges would be sufficiently harmonised and interconnected to make them electronically accessible from

32 Kadzere M, 'Southern Africa: SADC regional bourse harmonisation on course', *The Herald*, 15 March 2010.

33 JSE (Johannesburg Stock Exchange), 'JSE Limited Listings Requirements', https://www.jse.co.za/content/JSERulesPoliciesandRegulationItems/JSE%20Listings%20Requirements.pdf, accessed 21 February 2019.

34 SADC, 'The Regional Indicative Strategic Development Plan', *op. cit.*, p. 80.

a single point via the Internet.[35] Both stockbrokers and buyers were expected to be able to easily access information and to buy from a wider region-wide pool of shares in various regional companies. However, this phase of the harmonisation project did not make much progress, as individual stock exchanges voluntarily implemented only those elements with which they felt most comfortable. National rules remained largely un-identical across the board and individual national stock exchanges chose to maintain significant differences reflecting both national constraints and different levels of technical development. This strategy was deemed vague and not actionable; consequently, the programme remained largely unimplemented by members.

However, at a meeting in Gaborone in September 2002 CoSSE members agreed to draft a multilateral Memorandum of Understanding (MoU) charting the way towards achieving harmonisation and automation among regional stock exchanges.[36] The milestone agreement on this newly redefined and more elaborate project was reached in a meeting held in Livingstone, Zambia in May 2003. CoSSE members agreed to link emerging stock markets in the region with the JSE, making it possible for any SADC citizen to trade or buy shares in any regional stock market from home through their national stock exchange.[37]

In practice, this model of integration would involve installing common electronic platforms to facilitate communication, trading and automation between regional exchanges. Therefore, the technology, rules and practices in various national stock exchanges seeking to integrate operations needed to be harmonised to appropriate levels that allowed the efficient, uninterrupted flow of information and activity across member exchanges in various countries in the region. The linking of regional stock exchanges and achievement of seamless operations between them and the JSE was meant to facilitate flexibility and facilitate cross trading. However, such a prospect exacerbated fears among smaller stock exchanges of being dominated by the JSE.

It was not until a CoSSE meeting held in Maputo in 2004 that CoSSE members clarified some of the issues that had hindered the agreement, slowing down progress towards the envisioned integrated real-time network of the region's national bourses. It was at this meeting that concerns about possible domination by the JSE compelled CoSSE members to adopt a less ambitious project that required a looser type of cooperation. Earlier attempts (from 1999 to 2002) to find a substantive and workable cooperation agreement faced various challenges, including technical, planning and funding problems. Lack of consensus around modalities to achieve a SADC vision of an integrated real-time network of national securities hindered progress and prolonged the negotiations. Consequently, the 2006 deadline was missed.

After 2006 CoSSE was tasked with drawing up a list of requirements for yet another integration initiative of SADC stock exchanges through a suitable and mutually agreed

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35 Chanda A, 'Harmonising regional stock exchanges', *SADC Today*, 6, 2, June 2003, p. 3.

36 *Ibid*.

37 *Ibid*.

model of interconnectivity. These efforts culminated in the introduction of a new interconnectivity model, the 'SADC Interconnectivity Hub and Spoke Project', adopted in a meeting held in Livingstone in May 2008,[38] which aimed to achieve integration through shared trading platforms. This model was met with resistance, as most SADC exchanges feared a loss of independence brought about by platform sharing that could ultimately lead to the consolidation and emergence of a single regional exchange. Most SADC states prefer having their own national exchanges governed by a national regulatory framework responsible for regulating the market activities of local issuers and brokers. The perception among the smaller, less competitive members was that larger exchanges seemed to be much more attractive to larger and more lucrative companies, and the possible migration of these companies to larger regional exchanges would come at a cost to smaller regional exchanges.

An Interconnectivity Project Steering Committee was set up to deliver a comprehensive business case for the implementation of a revised hub and spoke model that would replace the initial 2008 model. In 2010 CoSSE revealed its revised Hub and Spoke Interconnectivity model,[39] which it intended to fund through an equity/for-profit investment structure that would involve development finance institutions. However, the project was not implemented because at the time only six of the 11 SADC stock exchanges had automated systems and CoSSE was unable to raise funding for a technology hub solution.

Between 2015 and 2016 the African Development Bank (AfDB) partnered with CoSSE to assess and review the feasibility of the regional interconnectivity project. This included an international benchmarking assessment and review of the latest African capital market developments. It also included targeted stakeholder (regulators, stockbrokers, potential information technology suppliers, broker network providers and data vendors) engagements, resulting in a completely new and updated business plan.[40]

The revised business plan highlighted the benefits of cross-border trading in a linked market:

- local brokers in each country will have online access to the other SADC exchanges, which will facilitate cross-border investments;
- the latter will lead to a diversification of the range of products available to investors in SADC countries;

38 Interconnectivity Project Steering Committee, 'Committee of SADC Stock Exchanges (CoSSE) Hub & Spoke Interconnectivity Project', Report submitted to CoSSE Meeting in Maputo, Mozambique, 14 September 2009.

39 Mahabirsingh V, 'Hub and Spoke Interconnectivity Model for SADC Exchanges', Interconnectivity PSC, CoSSE (Committee of SADC Stock Exchanges), 15 February 2010, https://www.die-gdi.de/fileadmin/_migrated/content_uploads/Vipin_Mahabirsingh.pdf, accessed 1 November 2017.

40 Committee of SADC Stock Exchanges, 'Interconnectivity Project: Progress 2015–2016', December 2016 presentation, https://cossesite.files.wordpress.com/2016/12/cosse-interconnectivity-presentation160618_sadc_draft3.pdf, accessed 1 November 2017.

- there will be a single point of access to SADC exchanges, making them more visible and accessible to international investors;
- the latter will eventually result in greater liquidity in smaller exchanges by overcoming structural constraints;
- this new structure will do away with compliance issues and practical difficulties relating to dual listings; and
- local issuers/investors can easily tap into investors in other SADC countries, leading to increased visibility, which can offer opportunities for market expansion.[41]

The updated interconnectivity project offered three technology options, including smart order router networks and exchange technology suppliers that have been used for linkages in the EAC and South-East Asia. In this model, the exchanges establish a joint venture that will own and operate the technology that will send orders from brokers using an automated trading system via gateways on one exchange to another exchange. For such a massive technological undertaking, the smart order router network systems require a fit with existing technological systems in use in stock exchanges; compliance with the global standards for pre-trade orders (Financial Information Exchange protocol); and the existing networks already used by local and foreign investment institutions and stockbrokers.

Exchanges will continue to operate different platforms, regulate their own listings [and] regulate their own trading, but with interconnectivity and accessibility of trading on others

Today, CoSSE's main guiding principles[42] for interconnectivity are that exchanges will continue to:

- operate different trading, clearing and settlement platforms;
- regulate their own listings, but their instruments should be visible to other markets;
- regulate their own trading, but with interconnectivity and accessibility of trading on others;
- trade and settle in their own domestic currencies;
- be held in the domestic country of registration of that exchange;

41 Mahabirsingh V, *op. cit.*

42 CoSSE, 'Committee of SADC Securities Exchanges: Interconnectivity Project', Presentation, December 2016, https://cossesite.files.wordpress.com/2016/12/cosse-interconnectivity-presentation160618_sadc_draft3.pdf, accessed 7 November 2017.

- decide independently on data sales and management, but make visible market data internationally;
- comply with all their individual domestic country legislation such as company law and insider trading legislation; and
- override/ignore exchange controls in various countries and the CMA.

SADC's objective to establish a real-time integrated network of capital markets has led to a sustained search for a mutually acceptable vision that is also in line with the integration objectives set out in the RISDP and the FIP. The principles of the CoSSE Charter have been pursued but a mutually acceptable implementation strategy has eluded CoSSE over the years. This has in turn limited cooperation or progress among its members. As a result, superficial harmonisation has led to minimal progress being made since 1998. For example, there have been reasonable cooperation and progress in information sharing and mutual cooperation in capacity building. However, the same cannot be said about negotiating and enacting common rules and regulations that facilitate the establishment of an integrated real-time network of the region's national exchanges as envisioned by its members.

SADC Brokers' Network

The above discussion shows that CoSSE member exchanges are not anywhere near ready for a technological solution, given their apparent differing levels of development and the fact that not all SADC exchanges have automated systems. In order to kick-start the implementation of the updated interconnectivity project CoSSE resolved to start a SADC Brokers' Network[43] to raise market awareness of and encourage cross-border trading in the region.

The launch of the SADC Brokers' Network in South Africa in December 2016 was the first step towards a manual linkage solution. It was used to convene a formal platform for all SADC stockbrokers with the aim of sharing information about their respective markets and launch a standardised SADC associate agreement[44] that stockbrokers can enter into to enable them to trade each other's stocks. Today, the network is operational and CoSSE is working on enhancing its utilisation by SADC stockbrokers. In addition, the network's usage data will be used to track cross-border trading in SADC.

There is a no doubt that having a standardised SADC associate agreement and a brokers' platform is the first step towards more harmonised and integrated regional capital markets. Traditionally, the little cross-border trading there is in SADC comes from stockbrokers' having associate agreements with South African stockbrokers in order to service their local markets, where they trade South African stocks as these are more liquid than any other

43 CoSSE, 'SADC Broker's Network Session', 7 December 2016, https://cossesite.files.wordpress.com/2016/11/ei4261-cosse-poster-options_d2-2.pdf, accessed 7 November 2017.

44 CoSSE, 'CoSSE SLA draft agreement', 7 December 2016, https://cossesite.files.wordpress.com/2016/11/standard-counterparty-agreement-for-cossee-cross-border-trading.pdf, accessed 3 November 2017.

African stocks. It will therefore be beneficial for CoSSE to engage SADC members in a possible regional body that could be used to resolve disputes or facilitate the settlement of legal disputes in cases of disagreement or conflict.

Although there are currently low levels of cross-border trading in the region, clients in one country can now instruct their brokers to place an order with a broker in another country. There is therefore a need to conduct a baseline study to collect data on cross-border trading activities undertaken since the launch of the SADC Brokers' Network, which could be used to build a business case for potential investors and donors interested in the development of capital markets in SADC through investing and supporting the interconnectivity project.

CoSSE should also assess linking the more technologically advanced front-runner exchanges electronically and identifying bilateral regulatory and other restrictions to lobby for governments' and regulators' support. Cross-border initial public offerings have been identified as low-hanging fruit that could boost regionalisation. Other initiatives that will be pursued include investigating the possibility of sharing live trading data and statistics with broker trading systems and creating a CoSSE/SADC asset class to improve information flows about Southern African assets.

The risk of a one-sided trading pattern is very high – as is currently the case, with investors showing a preference for South Africa's sophisticated and globally competitive market. However, the launch of the SADC Brokers' Network is one way to get the market to explore and grow other African markets outside the massive South African market currently dominating not only the region but also the continent.

The launch of the SADC Brokers' Network is one way to get the market to explore and grow other African markets outside the South Africa market

Challenges facing CoSSE

Market participants welcomed the idea of a linked real-time regional market, but concerns remain.[45] There are currently no networks or relationships among SADC stockbrokers that foster exposure and facilitate access to other African markets. As a result, most stockbrokers do not trade with other African stocks on their exchanges, owing to a lack of demand and interest from their clientele. The region also does not have the infrastructure to enable

45 CoSSE, 'CoSSE Interconnectivity Hub Project: Broker Feedback and Results', https://cossesite.files.wordpress.com/2016/12/cosse-interconnectivity-hub-project_broker-feedback-results-presentation.pdf, accessed 7 November 2017.

the automated cross-border trading that the proposed interconnectivity project aims to achieve. Another constraint is that the costs associated with executing cross-border trading may increase overall transaction costs; and the existence of tight controls by central banks lengthens turnaround times, resulting in a loss of trading times for stockbrokers.

CoSSE will have to address these issues to encourage stockbrokers to prioritise trading regional stocks. From a regulatory perspective, the market would like to see a stable and reassuring regulatory environment, such as amended pension and provident fund regulations to relax prudential limits and relaxed foreign exchange controls for investments and divestments. Taxation issues – such as taxes on capital gains and dividends – will also need to be considered in a linked market.

From a market perspective, participants require market visibility and awareness of the listed universe, market liquidity and a clientele that is willing to complete KYC ('know your client') processes. From a settlement perspective, there needs to be efficient execution, fast confirmations, safe and secure settlements, and a trading platform with moderate transaction costs. Information requirements include the need for more information on trading rules across the region, robust communication among stockbrokers and the availability of research done by participating stockbrokers.

From a clearing perspective, there is a need to make use of global clearing houses, to implement a common settlement cycle, and for all exchanges to have electronic settlement systems in place. From a technological perspective, technological compatibility among stockbrokers based in different jurisdictions seeking to conduct cross-border trading is critical. Technological compatibility is also needed to support the requisite broker networks. As such, appropriate protocols among exchanges will need to be in place to allow for the free flow of capital across jurisdictions, permissive investment environments, and a free flow of information, trade execution, and settlement and payments.

From a stockbrokers' perspective, a fee-sharing structure among stockbrokers conducting cross-border trades is preferred. There will also be some comfort in knowing beforehand the compliance risks involved when dealing with stockbrokers operating in non-equivalent jurisdictions. Stockbrokers are naturally concerned about the possibility of facing additional regulations in a linked market.

There is a need to harmonise existing regulations in the region and move towards homogeneity with regard to logistics, trading rules, trading procedures, technology and standardised costs.

However, concerns raised by market participants will require broad-based input and support beyond CoSSE member exchanges. Regulators and governments represented by the CCBG, COMFI and the SADC Committee of Insurance, Securities and Non-Banking Financial Authorities (CISNA) will have to engage on these issues and come up with regional solutions. CISNA works closely with CoSSE and has also worked towards implementing a harmonised, risk-based regulatory framework that encourages investment in capital markets while mitigating risk and protecting consumers.

Other interconnectivity developments

In January 2017 the AfDB and the African Securities Exchanges Association announced that they had signed a five-year MoU[46] that will guide the implementation of various projects aimed at deepening and connecting African financial markets. The MoU's maiden project is the African Exchanges Linkage Project, which will link four exchanges as regional hubs – the Casablanca Stock Exchange, the JSE, the Nairobi Securities Exchange and the Nigerian Stock Exchange. This project aims to address the lack of liquidity in African capital markets by creating linkages across markets that will allow cross-border visibility and open up markets, allowing investors to trade in any of the linked markets. This initiative capitalises on the relative size, depth, openness and level of development of these stock exchanges to spearhead and lead capital market integration in Africa.

SADC can also learn important lessons from other regional markets. Compared with other markets, capital markets in the EAC remain small even when combined. However, they are more advanced in terms of integration than SADC. EAC capital markets have greater levels of harmonisation than SADC with few hurdles arising from differences in the level of market development. Three (Kenya, Uganda and Tanzania) of the exchanges are members of the International Organisation of Securities Commissions (IOSCO), which sets standards and best practices in securities regulation. The fourth country has developed its laws in compliance with the IOSCO principles. The EAC's regionalisation project is currently implementing a technology platform designed to link EAC markets to create a single capital market offering for domestic investors, thereby giving them a greater choice and more potential to raise capital from a wider range of investors.[47] The development of an efficient and reliable EAC capital market infrastructure will establish a solid foundation for financial sector integration in the region by allowing investors and issuers to participate in the regional market without physically having to be in that country. The most notable achievement in the EAC's capital market integration is the finalisation of an integration road map guiding the integration process and the cross-listings that have taken place since the latter project began.

Conclusion

An integrated regional financial market is perceived by governments as a potential instrument and mechanism for channelling both foreign and domestic savings into

46 See ASEA (African Securities Exchanges Association), 'AfDB and ASEA sign Memorandum of Understanding to join forces to develop Africa's capital markets', Media Statement, 16 January 2017, http://www.african-exchanges.org/en/media/press-room/press-releases/afdb-and-asea-sign-memorandum-understanding-join-forces-develop , accessed 2 January 2018.

47 EAC, *op. cit.*, p. 1.

investments. Therefore, governments see regional cooperation as a cost-effective way for regional exchanges to overcome some of the common impediments that constrain the development or growth of smaller markets. By pooling the resources of fledgling and fragmented national capital markets, regionalisation could boost liquidity and the ability of these markets to mobilise local and international capital for private sector and infrastructure development.[48]

There are various steps CoSSE could take to stimulate a greater appetite among national exchanges to work towards interconnectivity and integration. CoSSE could also benefit from leveraging the support of the private sector and donor community, especially regional financial institutions, to support capital market integration.

Harmonisation of listing procedures

Technically, an integrated regional financial market can improve the liquidity, efficiency and competitiveness of the region's national stock exchanges. Harmonising listing procedures generally makes the process of listing shares and raising finance in different countries easier and raises SADC's profile as a destination for all forms of investment. While integrating regional financial markets is a long-term goal of SADC, in the short term, national policymakers are required to devise coherent strategies based on the recognition that the national interests of members are best served through cooperation. Efforts to harmonise the activities of regional stock exchanges present various challenges that, if not resolved, can undermine progress.

Political support for CoSSE's activities

The 2015/16 updated interconnectivity project showed that cross-border trading is possible. A project of this nature and magnitude requires political will to bring about the necessary regulatory harmonisation efforts and raise the capital needed required for the interconnectivity infrastructure. In general, harmonisation and regionalisation projects suffer because of political risk concerns and, in some countries, the fear of losing independence. Admittedly, CoSSE has not eliminated all the obstacles to cross-border trading. Regulatory impediments to cross-border trading can only be resolved if there is political will and government buy-in for regional integration and harmonisation. CoSSE therefore needs to make a concerted effort to lobby SADC structures for financial and political support. Moreover, a political champion of the interconnectivity project who can help to raise funds in the donor community and private sector is indispensable.

Cross-border trading

Cross-border trading, whether done manually or technologically, will give corporates and governments the opportunity to raise capital across SADC by allowing investors on one exchange to buy shares easily on other exchanges within SADC. Ultimately, the region's capital markets will become more efficient and liquid, which will improve regional savings,

48 Alvarez AM & K Kalman, 'Emerging Stock Markets and the Scope for Regional Cooperation', Paper, 79. Geneva: UNCTAD (UN Conference on Trade and Development), 2004.

investment and integration. There are two options to consider: an incremental process of technologically linking those exchanges that are capable of linkages now; or linking the CMA countries first since there is already free movement of capital within this subregion.

Access to information

Brokers need access to information about prices, trading and opportunities in each SADC country. Therefore, there is a need to improve and enhance the offerings of the SADC Brokers' Network, which should be used to provide such information to brokers in addition to being a formal and centralised regional platform where brokers can safely contact each other and easily open accounts with one another for cross-border trading purposes. The SADC Brokers' Network can be used to monitor regional cross-border trading and conduct a baseline study with the aim of building a business case for technological interconnectivity in the long run and greater harmonisation in the region.

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