THE CAPITAL MARKET AND ECONOMIC GROWTH AND DEVELOPMENT OF GHANA

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Presentation Outline

1. Introduction – why financial markets
2. Brief economic theory and empirical findings
3. Economic output and stock market activities – Others versus Africa
4. A focus on an African country – Ghana
   – Sectors of economic activities versus GSE activities
5. Concluding remarks & Recommendations

1.0 Introduction – capital markets

- Active and patronized capital markets engender economic activity (buying and selling) much like active and patronized markets for goods and services;
  - think about the village with thriving market days (weekly);
- What would investors like to see in a capital market to want to do business there?
  - Orderly and fast conduct of business (rules);
  - Lots of buyers and sellers – liquidity;
  - Ready availability of pertinent and verifiable information about securities and projects;
  - Reasonable transaction costs
  - Etc!

1.0 Introduction – capital markets

- Rules take on extra importance because market participants only go home with <u>pieces of paper</u>;
- Suppliers of funds expect firms they invest in to be well run – good corporate governance;
- Corporate governance continues to receive serious attention world wide;
- Sound corporate governance encourages efficient use of resources:
  - ➢ provides for accountability by those in whose hands resources have been entrusted;
  - ➢ results in improving standard of living for all (growth and development).

1.1 Economic theory

- Importance of finance in economic growth - Schumpeter (1912), Goldsmith (1969) and McKinnon (1973);
- Main argument - financial sector helps mobilise savings for the production process and for investment activities by firms, hence economic growth;
- Channels through which financial development influences economic growth include
  - Increased level financial intermediation due to <u>reduced transaction costs;</u>
  - Easier access to avenues for <u>risk reduction</u>; and
  - Increased efficiency in (scarce) resource allocation;
- <u>Endogenous growth theory</u> - financial markets can help put the economy on a higher growth path permanently by improving the average productivity of capital;
- Stock markets provide services different than/from banks and make investments more liquid.

1.1.1 Empirical findings

- Empirical findings have not all been in the same direction;
- In support of **positive relationship** between economic output and level of financial development are:
  - **King and Levine** (1993) - studied 80 countries;
  - **Arestis, Demetriades and Luintel** (2001) - Findings for France, Germany and Japan are stronger than for United Kingdom and United States;
  - **El-Wassal (2005)** studied 40 emerging economies;
  - **Uyanga and Suruga (2008)** 112 countries. Results hold for both lower and middle income counties, as well as upper middle and high income countries;
  - **Filer, Hanousek and Campos (1999).** Strong support particularly for less developed countries;
  - **Oskooe (2010) Iran** - short-run stock market plays an important role as a leading economic indicator of future economic growth.

1.1.1 Empirical findings - 2

- **On the contrary**, a number of studies have cautioned against promotion of stock markets on grounds that that they may
  - lead to increased macroeconomic instability,
  - undermine group banking system that has worked well in some markets,
  - encouraging counter-productive corporate takovers,
  - financial markets are prone to failures
- Singh (1995, 1997), Stiglitz (1994), Shleifer and Summers 1988), Morck et al. (1990)
- Naceur and Ghazouani, 2007; could not determine any significant relationship, particularly in developing countries.

1.1.1 Empirical findings – Africa

- Adenuga (2011) - stock market development promoted economic growth in Nigeria during the period of analysis.
- Adjasi and Biekpe (2006). 14 African countries
  - low income African countries and those with less developed stock markets need to grow more and develop their markets to elicit economic gains from stock markets;
- Aboagye (2005). 15 sub-Saharan Africa countries
  - stock market indicators are not having significant impact on output and suggests that this may be due to the poor macroeconomic environment;

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ECONOMIC OUTPUT AND THE STATE OF STOCK MARKETS – AFRICAN COUNTRIES VERSUS OTHERS

TOTAL VALUE OF stocks traded as % of GDP						GDP (PPP) per capita
	2008	2009	2010	2011		Current USD - 2011
Canada	117.8	92.7	86.6	87.6		40,420
Denmark	61.9	47.8	46.1	45.1		40,933
Germany	85.7	39.1	42.8	48.8		39,456
Japan	121.2	83.3	78	70.9		33,668
South Korea	157.4	189.6	160.3	182.1		29,834
Switzerland	287.1	156.2	157.4	140.8		51,227
UK	244.9	155.8	133.3	121.5		35,598
US	450.2	336.3	211.2	205.1		48,112
CHINA	61.8	100.3	80.3	46.3		8,400
CIV	1.3	0.6	0.6	0.5		1,789
Ghana	0.5	0.2	0.3	0.3		1,871
Kenya	4.7	1.6	3.4	2.6		1,710
Mauritius	4.2	3.7	3.7	4.6		14,420
Namibia	0.2	0.3	0.2	0.1		6,801
Nigeria	9.6	2.7	2.3	1.7		2,533
Tanzania	0.1	0.2	0.1	0.1		

1.2 ECONOMIC OUTPUT AND THE STATE OF STOCK MARKETS – AFRICAN COUNTRIES VERSUS OTHERS

- Without a doubt, African countries lag far behind in both per capita GDP and ratio of stock market activity to GDP

Table 2: GDP per Sector of the Ghanaian economy and GSE Activities

GHANA: NOMINALGDP (New Series: 2006 = 100)					
	(GHS Million)				
ITEM	2010	2011	2012	GSE%	Ratio
AGRICULTURE	12910	14155	15548	17.65	0.11%
1.1. Crops	9422	10650	11932		
Cocoa	1392	1996	2261		
1.2. Livestock	873	1004	1165		
1.3. Forestry and logging	1614	1549	1418		
1.4. Fishing	1001	952	1033		
2. INDUSTRY	8294	14307	18592	6.39	0.03%
2.1. Mining and quarrying	1013	4690	5956		
o.w. petroleum	178	3746	4645		
2.2. Manufacturing	2941	3711	4490		
2.3. Electricity	266	325	332		
2.4. Water and sewerage	368	467	495		
2.5. Construction	3706	5114	7319		

1.3 A CLOSER LOOK AT GHANA

- **Table 2**: **GDP per Sector of the Ghanaian economy and the GSE**
- What do we see? Ratios are miniscule!
- **POSITION**: ratios are indicative of the work that needs to be done – **to increase stock market the activity in the various sectors of the economy!**
- How? Increasing trading activity in currently listed securities?
- It may help, but that impact would be small!
- **Ratio would be much improved if there were more listings on the GSE**;
- Aware of many previous efforts by the GSE & co;
- ***Why are the listings still so few?***

An attempt to increase the Ratio!

- ***Are there companies waiting/available/willing/able … to be listed?***
- A little exercise – let us all cast our minds to economic agents that operate in the sectors of the Ghanaian economy;
- I like AGRIC and know a bit about cocoa farming;
- Would it make sense to try to talk the typical cocoa farm owner (entrepreneur) to list on the GSE?
- First, what does he (usually male) know about listing on a stock exchange?
- Suppose with some cajoling, he becomes positively predisposed to listing;
- Currently, he works this SMALL farm himself, possibly with the assistance of people he can control as farmhands.

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An attempt to increase the Ratio! - 2

- To list would mean to increase the size of the farm!
  - Onto WHO'S LAND?
- Buyout his adjacent farmer? Will that neighbour sell?
- That farmer probably wont sell, so what kind of agreement can they enter into to pool forces?
- Will this agreement be between him and the other farmer only, or will it involve their descents, many yet unborn?
- This is **family land**, remember!
- Suppose the other farmer agrees to sell to Farmer 1 (call him OFFICER)
- OFFICER now has a bigger farm to manage. Probably can no more work it by himself.
- He must hire more farm hands. Farm hands are Ghanaians (foreign farm hands are no more available).

An attempt to increase the Ratio - 3

- For each minute that OFFICER is not watching, the farmhands idle about; come to work late; spend time watching “further and better particulars on pink sheets”;
- OFFICER knows this, because at the end of the cocoa season he can compare his <u>output</u> when he was working the SMALL farm alone versus the now bigger farm with farm hands.
- Per person productivity on the small farm was better.
- He is told he can own a part of an even bigger farm and advised to raise money on the GSE;
- So OFFICER now has co-owners. Together, they constitute themselves into a **Board**, and appoint a **Lead farm-hand supervisor** with **Assistants** to be supervised by the board;
- He finds co-board members are not as <u>keen</u>, nor do they <u>know</u> as much about cocoa farming!
- Lead Supervisor and Assistants want <u>more pay, not tied to the productivity</u>, etc!

An attempt to increase the Ratio - 4

- That is not all, this **board** that is not working hard (in OFFICER's view) now tells him
  - He cannot make decisions alone – he loses control
  - He must share the dwindling profits per capita with them;
  - They must incur costs and report the farm operations to SEC/GSE quarterly;
  - They must also disclose profits (operating data) to SEC/GSE;
  - OFFICER cannot hire his nephews at will instead of persons unknown to him/her, etc.

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CONCLUSION

- OUR POINT: to flag mountains of structural, cultural and attitudinal challenges that must be overcome !!!!!
- Still deep down we believe that bigger and well tilled farms with conscientious farm hands will be the way forward.

CONCLUSION

- I am on the side of positive link between capital markets and growth.
- Practice of good corporate governance helps attain benefits of listing which include
  - Opportunity to diversify wealth of the initial (sole) owner
  - Increased liquidity of securities
  - Facilitates raising of new capital; etc

- Even the likes of Singh, Stiglitz, etc appear not to be saying no

RECOMMENDATION

- Let us all think about how to solve the challenge faced by OFFICER!

1. STRUCTURAL ISSUES to be overcome – land turner system
2. Work ethics and attitudes among farmers
3. Education of entrepreneurs
4. Fashioning out a conscientious board of directors
5. Etc.