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**USAID/Kampala - Pre-Feasibility  
Study for A Kampala Stock Exchange**

**Final Report**

**May 27, 1992**

*Price Waterhouse*



May 27, 1992

Warren Weinstein  
AID/AFR/MDI  
Department of State  
320 21st Street, NW  
Washington, D.C. 20523-0018

Dear Warren:

We are pleased to present five copies of the Draft Final Report, Pre-Feasibility Study for a Kampala Stock Exchange, prepared by Mr. Robert Bishop. The objective of this engagement was to provide assistance to USAID/Kampala and the newly formed Kampala Stock Exchange in assessing the feasibility of such a venture. We present for your review Mr. Robert Bishop's findings and recommendations.

The information is based on interviews with USAID/Kampala officers and members of the Ugandan business community.

We appreciate the opportunity to be of service to you on this important assignment. Please feel free to call us if you require any further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Breen', with a stylized, cursive flourish.

J. Richard Breen  
Director,  
Financial Sector Development Project

cc: Sandra Frydman, USAID/PRE/PD  
Keith Sherper, USAID/Kampala

## Pre-Feasibility Study for A Kampala Stock Exchange

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## **I. Executive Summary**

In a preliminary feasibility study of the of the newly formed Private Kampala Stock Exchange (KSE), Price Waterhouse found that some of the basic conditions for the establishment of this financial institution already existed, or had the potential for being fulfilled. This report recommends that USAID lend its assistance to the KSE, pending Ugandan participation in the effort. This recommendation is supported by the fact that members of the government and private business community in Uganda have expressed a strong commitment to developing the financial infrastructure necessary for a functioning market-driven economy. These individuals firmly believe that a market-based economy will improve the standard of living for all Ugandans.

While general public opinion among private and public sector backers supports a market economy and the development of the exchange of tradable securities, several factors impede the immediate development of such an exchange. They include: unreliable accounting standards, low savings rates, and general and widespread weakness of the economy. In order to develop the current skeletal financial sector to one of a functional capital market, existing institutions need to be strengthened. This report recommends the provision of training and technical assistance to the Ugandan private sector as a means of helping strengthen those institutions.

Given the ideological drive for public participation in the private sector, some limited public distribution of securities is likely to result within the next three years. It will probably not be large enough to sustain active auction type trading, but rather a lower level of trading infrastructure.

In his report, the consultant, Mr. Robert Bishop, sets forth seven basic requirements for a stock exchange, and elaborates specifically how the Kampala Stock Exchange should meet those requirements. The area of primary emphasis is securities industry education. To that end, the KSE is promoted as the ideal vehicle for training future professionals in the securities industry. Recommendations are made for the seed education of approximately 30 individuals from industry and academia, primarily university faculty in business and finance. Instruction would ideally be found locally, but could also be arranged through USAID. The key to this training is its adaption to local needs and conditions.

## **II. Background**

### **A. Scope of Work and Methodology**

At the request of USAID/Kampala, the PRE/Financial Sector Development Project (FSDP) was engaged to assess the newly formed Kampala Stock Exchange (KSE), and to identify any assistance USAID could consider to support or promote the KSE initiative. The assignment was designed to be a one week reconnaissance mission, and not a comprehensive analysis.

The methodology employed primarily involved conducting interviews. The consultant visited a number of government officials and ministers, as well as the Central Bank Governor. Meetings were also arranged with the insurance association, the chairman of the manufacturers association, and the Rotary Club. A seminar of 200 attendees was organized, and radio, television and press interviews were set up through media contacts.

After the identification of potential sources of tradable securities, including: (a) government debt instruments, (b) privatized parastatals, (c) packaged custodial properties, (d) distribution of government owned shares in banks with 51% foreign ownership, and (e) presently closely held businesses, the following questions were raised:

- o Would distributed capitalization of any of these potential sources be large enough to support an exchange-type centralized market?
- o Would such distributions be successful as indicated by the level of domestic savings, potential investor confidence and willingness, and/or favorable conditions for foreign participation?
- o What is the likely timing for any of these potential sources to become real?

This study was conducted by Mr. Robert Bishop, retired Senior Vice President of the New York Stock Exchange. Since his retirement, Mr. Bishop has provided his assistance to stock exchanges in various developing countries.

In addition to fulfilling the terms of the scope of work (Appendix A.), the consultant also supplied the Exchange with substantial operational advice as well as a written report. The report refers to his book, Model Basic Rules for a Stock Exchange, which Mr. Bishop also furnished, with permission to copy and adapt as rules for the Kampala Stock Exchange.

## **B. The Economic Environment and the Kampala Stock Exchange**

Every sector of the Ugandan economy is weak, and consequently both government and private businesses are operating under severe capital shortages. Banks have insufficient loan resources to alleviate capital needs, yet there is little other financial infrastructure. While officially recorded deposits demonstrate that savings levels are too low to generate loan resources, "mattress savings" are likewise viewed as insufficient to finance any public distributions of securities.

Despite these financial weaknesses, there is very strong support among Ugandans for a market-oriented economy. In this context, the Private Kampala Stock Exchange was formed recently by a group of Ugandans, including the former Governor of the Central Bank. The President of Uganda, Mr. Museveni, has approved the initiative and the group has requested assistance from USAID.

The Kampala Stock Exchange is a legally constituted entity currently in the "limited by guarantee" form but with consideration being given for a change to a "limited by shares" form. Consideration is also underway to create a Kampala Securities Broker/Dealer Association in cooperation with the Stock Exchange.

While general public opinion among private and public sector backers supports a market economy and the development of the exchange of tradable securities, several factors impede the immediate development of such an exchange. They include: unreliable accounting standards, low savings rates, and general and widespread weakness of the economy.

There are presently no broadly distributed securities in Uganda and consequently no trading of securities or intermediaries for this purpose. The Kampala Stock Exchange exists as a legal entity, but is operational only in promoting the idea that Uganda should have broadly held tradable securities in its evolving market-driven economy.

There are currently only five companies (principally owned by the Uganda Development Corporation) which have shares in publicly distributable form. Share ownership by others is only one or two percent and there is no trading facility.

Given the ideological drive for public participation in the private sector, some limited public distribution of securities is likely to result within the next three years. It will probably not be large enough to sustain active auction type trading, but rather a lower level of trading infrastructure.

### **III. Requirements for a Stock Market in Kampala**

This section of the report sets forth seven basic requirements for a Stock Exchange, and elaborates specifically how the Kampala Stock Exchange should meet these requirements. These necessary elements concern: structure, membership, listing and trading, standards of conduct, post-trade processing, discipline, and financing. Each is described below.

#### **A. Structure of a Stock Exchange**

The narrow meaning of the word "stock" is an ownership interest in a corporation. But the term "stock exchange" confers the broader meaning of a secondary marketplace where all orders to buy or sell tradable securities are brought together to compete with each other and therefore result in trades at the best achievable price. An organization named a "stock exchange", however, is not necessarily confined to operating only in a trading mode. It can also operate in the broader activity of capital markets, governing brokering and dealing in less centralized ways, organizing distribution of primary issues of securities, or conducting markets in more advanced forms of financial instruments such as options, futures, repurchase agreements, etc.

In the past, stock exchanges have been organizations controlled and organized by broker/dealers. In modern times it has become clear that although most stock exchanges are and should be private sector controlled businesses, they are also quasi-public facilities which form a very important part of the infrastructure of a national economy. They are of vital interest not only for broker/dealers but also for listed companies, and for both institutional and individual security owners. Moreover, an even broader public interest has been expressed in most countries by laws authorizing self-regulatory stock exchanges and regulating securities industry practices to various degrees.

In the modern environment, stock exchanges have augmented their power and credibility by including representatives of listed companies and investors as well as broker/dealers in their governing body. Both in reality and in the public's eyes, rules and practices of the stock exchange are then balanced in the interest of all its constituents. Financial support by listed companies and investors for both operations and market liquidity of the exchange is also more forthcoming when these groups are represented in its governance.

This report's recommendation to the Kampala Stock Exchange is that its Board of Directors be comprised half of broker/dealers, one quarter of listed company executives, and one quarter of institutional and individual investor representatives. Either of the latter two groups could include their professional advisors - attorneys or public accountants.

## **B. Membership**

**Membership in an exchange should be open to all individuals and corporations who are engaged in the business of being securities broker/dealers, and who otherwise meet Exchange standards of liquid capital, educational and professional experience of personnel, and business conduct. In a developing economy, it is usually helpful to have the banking community included among members of the stock exchange - more often, however, through broker/dealer subsidiaries due to the difference between typical banking and broker/dealer capital requirements.**

**Members should be the only entities with direct access to the trading markets of an Exchange. Member access can be expressed by qualifying either individual members or their partners, or officers or employees of member firms, to engage in the trading auction or negotiation.**

**Members are frequently but not always owners of the Exchange. This is because Exchanges frequently are formed by already functioning broker/dealers who gain the greatest business advantage from establishing a central market. In Kampala, however, the Kampala Stock Exchange has been given legal, but not yet operational existence by a group of leading businessmen. These businessmen are convinced, as is the government, that mobilization of citizen savings for productive enterprise in a market driven economy is the best route to improving the standard of living of Ugandans. Consequently, they are founding a privately operated public utility of the capitalistic system - a necessary component of financial infrastructure, just as important as a roundabout is to a highway system, or pumping stations are to a water system, whether privately or government owned.**

**Exchanges should be not-for-profit organizations minimizing expenses and maximizing services to their broker/dealers, listed issuers and investor constituencies, all of whom are the true profit-seeking parts of an enterprise system. Exchanges themselves should therefore be subject to minimal or no taxation.**

**In the context of Ugandan law, the Kampala Stock Exchange might give serious consideration to remaining a corporation, limited by guarantee, in order to minimize taxation. It could raise start-up capital by issuing debt instruments to interested parties with the understanding that such debt and appropriate interest may not be repaid unless the business of the Exchange permits it, perhaps in ten years time. Purchase of such debt would be a speculative act of Ugandan business patriotism, and may be an attractive route and incentive for donor support.**

This method of organization would permit the shareowners to ask the members and listed issuers to nominate their recommended percentage of the Board of Directors, and to establish a nominating committee of their own to choose investor representatives.

### C. Listing and Trading of Securities

In an environment where no tradable securities presently exist, and it is likely that distributions large enough to sustain an auction market are some time away, the Kampala Stock Exchange should not feel obligated to list every security whose trading is to be controlled by Exchange rule. The formality and cachet of listing should be postponed until the quality it implies is achieved by issuers.

By appropriate rules, the exchange should instead control ethics and procedures of such trading from the beginning (even though it may be negotiated, within member offices, or primary distribution trading). Auction trading can be expected to move through successive stages from Call market to Continuous trading.

The quality seal of Exchange listing should be reserved for securities with issues large enough for reasonable auction pricing and straightforward company disclosure. The Kampala Stock Exchange will need to make practical compromises with such standards pending the upgrading of Ugandan accounting and auditing standards and corporate law. But it should lend its influence to such improvement.

Additionally, the following example of Ugandan optimism about an Exchange's utility is noteworthy: during meetings with representatives from the Bank of Uganda, and during an all-day KSE seminar, the question was raised about the possibility of bringing in another consultant (through USAID) to examine commodity futures. During the seminar there was an additional observation that contract farming is another alternative to the problems of the nation's principal business: farming. The Kampala Stock Exchange structure might eventually serve as a framework for hedging agricultural risks by commodities future contracts. USAID should encourage and assist this endeavor.

### D. High Standards of Conduct in the Exchange Community

Ethical business conduct by all persons in the Exchange membership family is vital to quality listing standards.

An important part of good business conduct is proper educational preparation for the work each professional is to perform. The Kampala Stock Exchange will also have to make some practical compromises given the realities of educational opportunity available in Uganda. Creating an adequate financial education for the Exchange community

should be a major continuing objective. Careful supervision within each member firm is equally important to good business conduct.

#### E. Post Trade Processing of Securities Transactions

The primary mission of stock broker/dealers is the "marketing" and trading of securities, primarily through customer interface and skillful negotiation of trading price. Post-trade processing of transactions is just as important, but more routine. This involves recordkeeping, custody of customer funds and securities, transfer of securities, collection of dividends, etc. Members' financial exposure due to employee infidelity arises largely from poorly managed post-trade processing. Unfortunately, a good manager of securities sales and trading is usually bored by and inattentive to the routine of processing.

It is therefore recommended that the Kampala Stock Exchange contract with a strong bank to do post-trade processing for all members. This would reduce costs for members, and would convert fixed expenses to variable cost expenses. The former are troublesome in a securities industry subject to substantial volume fluctuation. As the Exchange grows, such centralization can render unnecessary the elaborate clearance and settlement system which is a costly subsidiary activity of many exchanges.

#### F. Discipline and Disputes

It is hoped that it will be many years before the Stock Exchange needs to discipline any person in the employ of its members, or before customers bring serious complaints about member conduct to the Exchange. But the Exchange should provide for the inclusion of two specific powers in its area of authority: the power to discipline after fair procedure any person or entity in the Exchange community, and the power to adjudicate by arbitration disputes within the community or between the Exchange and its customers.

#### G. Financing the Exchange

The operational Exchange should become self-financing. But in its pre-operative and start-up stages, the Exchange will need increased financing from interested parties who may realize future benefits, i.e. government and private donors. USAID policy, for example permits gifts of equipment, training, and technical support, but not of operating expenses.

#### **IV. Conclusions and Recommendations to USAID**

A general conclusion is that strengthening the Kampala Stock Exchange could be one of Uganda's first steps toward improving its living standards through a market-driven approach. A stock exchange would mobilize savings for productive enterprise and serve as a market for the financial instruments which would result. The Kampala Stock Exchange initiative should therefore be supported by USAID.

The extent of USAID assistance to the Kampala Stock Exchange should be related to the Mission's assessment of the timing and nature of privatization and its future hard information on the imminence of any of the potential sources of securities distribution. It should further be dependent on evidence of local support as demonstrated, for example, by partial Ugandan financing of any project which USAID intends to set up.

In general, the role of the Kampala Stock Exchange and the Kampala Securities Broker/Dealer Association in the near term future is twofold: first to educate their personnel for a future capital market infrastructure, and second to encourage the issuance of tradable instruments, both by existing stronger private businesses and financial institutions, and through privatization of appropriate government enterprises.

Concern should also be given to the longer term by establishing new structural, ethical and operating standards which will be appropriate from the time of first trading to the indefinite future.

The specific conclusions and recommendations presented below emphasize the need for securities industry education, recommend an approach to the hiring of staff, and indicate a few possible problems to avoid.

##### **A. Seed Education of Securities Professionals**

As its first educational task, the Exchange should seek to establish a formal system for training the professionals who will be needed in the securities industry. This would include the following subjects: principles of corporate organization, law, finance, reading and analysis of financial statements, methods and operation of securities markets, related economics, techniques of selling intangibles, etc. Training for the various specialties of the securities professions is highly developed in advanced economies. There are good study outlines and textbooks from which Uganda can select the basic parts appropriate for local conditions.

Any training by American instructors in Uganda should be supplemented by the participation of experienced Ugandans. The consultant met with three such Ugandans:

a retired Shearson Lehman stockbroker with Mid-East experience, a former Mid-East commodities broker, and a bank chairman who appears to be an expert in underwriting and securities analysis.

If using local teaching resources proves impossible, foreign assistance should be available. The objective should be to teach a core group of Ugandans who could in turn teach others. The core group should include potential stockbrokers, analytic personnel in banks, insurance companies and other financial institutions, and appropriate university faculty. A group of approximately 30 individuals could attend a course in Kampala taught by foreign securities training specialists.

There are at least two U.S. sources for the initial instruction in Uganda. The first is the New York Institute of Finance, which has over 100 years experience in conducting special courses in New York for foreign securities professionals. For at least five years it has also taught such sessions in a variety of countries. The second source would be recruitment of a securities teacher retired from a NYSE member training program or a university. There are not many such individuals, but there are at least three who may be available. The likely organization to work through in seeking such a person would be the International Executive Service Corps (IESC). IESC has recently recruited retired securities executives to teach investment banking and organization of brokerage firms in developing countries. For this seed Uganda training, however, only an experienced securities training professional would be required.

USAID is a potential source of help in financing such a course. If USAID and USIS are asked to watch for opportunities, US consultants and staff coming to Uganda for other purposes might also be invited to give the core group lectures.

In addition, USAID could assist by providing a basic library of securities study material. Any educational program should be supplemented by a lending library of securities and training materials. It is possible that the USIS library in Kampala would be an alternative source of such study material. Establishing a decent library should cost less than \$1,000.

Development of a Ugandan training facility for securities professionals, especially by university faculty, is likely to have a side benefit of producing a Ugandan textbook. In preparation, perhaps two pamphlets of 20-30 pages each could be produced. The first could explain the organization of corporations, types of securities, trading of securities and description of exchange markets. The second would then explain how to read financial statements and elementary principles of securities analysis. These booklets could further serve as basic educational tools for individual investors. The Kampala Stock Exchange is already realizing the benefits of skill in utilizing the public media - as

shown by the press conferences, radio and TV interviews, and financial magazine publications connected with the consultant's visit.

Another training approach is the traditional USAID/USIS technique of sending a few key people to the U.S. and other financial centers to become acquainted with the breadth of securities business there. Such trips are recommended for only one or two stock exchange leaders. Shorter trips to small exchanges for a half dozen or so potential exchange brokers would be appropriate: Nairobi and Mauritius are possibilities. At a somewhat greater distance, Indonesia and Singapore are good candidates and would be within reach of the larger Exchanges in Bombay and Delhi.

Finally, A.I.D. should originate an educational project, perhaps through a centrally funded contract in Washington. With growing A.I.D. emphasis on capital market development, training is needed in every developing country. The recommended project would be a series of video tapes by American instructors equivalent to a university course of one or two semesters. A suggested combination of resources which could produce such a video series would be the following: (a) the Merrill Lynch training school at Princeton, NJ, which has a teaching staff, securities training experience, and video production facilities, in conjunction with (b) the New York Institute of Finance, which has experience in training foreign securities professionals in New York and abroad, plus written training materials, and (3) a securities consultant with experience in securities industry training and developing country exchanges.

More securities educational techniques will prove useful in the more distant future. The most important will be the face-to-face, one-to-one education of customers by securities professionals.

## B. Office and Staff

After establishing a training facility, the next step should be to plan and implement the operation of Exchange facilities. Two phases are suggested: (1) an early administrative office, and (2) the beginning of trading.

First Phase - The Exchange cannot be expected to maintain its present momentum solely with volunteers. An office with a full time executive organizing the education program, promoting listing, and seeking start-up facilities and financing assistance is logical.

The office should be a space similar to the "Institute of Bankers" room, which the consultant visited several times. This office would serve as an executive office with a conference table large enough for Board and committee meetings. Adjoining it should

be a reception office with a secretary. Necessary office equipment would include shelf space for a library of educational material, filing cabinets, desks and chairs, etc.

A budget for transportation, entertainment, messenger service, utilities, advertising for personnel, printing of rule manuals, etc. would also be needed.

It would be very helpful for this office to be located within the premises of some governmental, financial or business office. This effort should have partial local financing as a demonstration of Ugandan support.

Second Phase - When it is apparent that firm listing applications are in preparation, it will be time for the second administrative phase. The conference table in the Executive Office might well serve for the earliest actual trading as well as for mock trading training sessions.

Technical support by a consulting accountant and an attorney will be needed for evaluating listings. Advice will also be needed from a foreign technician experienced in trading and securities records.

### C. Other Issues

Finally, a few words of caution are in order with regard to possible misunderstandings of terminology. The Kampala Stock Exchange has been referring privately and publicly to two intentions which the consultant views as serious possible problems: 1) organizing as a publicly distributed company, and 2) abrogating its responsibilities for the following important functions to a securities dealers association: qualification of broker/dealer members, definition, enforcement and discipline of ethical standards, and dispute arbitration.

Public distribution implies a profit-making organization. The stock exchange business is not likely to be profitable for a long time and should have that objective only for purposes of building capital against loss years, increasing capital equipment and providing education and training.

An intention to raise public capital has been cited for the purpose of building a stock exchange building, with substantial excess space for profitable rental. That is a different business. The only stock exchange owned by investors as a profit making business was that of Taiwan; in 1986 that government encouraged the formation of a competing market because public perception of the existing exchange had become very negative, partly arising from its own policies to increase profit.

With regard to membership qualifications, the statements have been repeated that the Exchange Board has voted to reorganize as a company limited by shares which would be offered to the public so that any Ugandan "can be a member of the Exchange." In fact, and in all other exchanges, the word "member" means a broker/dealer authorized to trade as agent or dealer on the Exchange. Certainly here the word is misused.

There is no need for two organizations in the Ugandan infrastructure to enforce ethical standards. The stated objectives and activities of a Kampala Broker/Dealers Association stem from a well-intentioned misinterpretation of the role of the National Association of Securities Dealers in the United States. The primary role of that organization is to provide computer communication to standardize procedures and regulation for over-the-counter dealer activities that are not on an exchange, and to provide general ethical regulation of broker/dealers who are not exchange members. Consequently, there exist similar ethical rules, enforcement and discipline practices, and arbitration facilities in the U.S. exchanges and the dealers' association. The Securities and Exchange Commission then works to maintain a level playing field between these entities.

Furthermore, the KSE should preclude the perceived and real abuses arising from control by broker/dealers alone by establishing a balanced governance which also represents listed issuers and investors. It would be clearly wrong to leave the determination of ethical standards, enforcement, discipline and arbitration to an organization controlled by broker/dealers alone. This would destroy any semblance of credible Exchange governance, and all perception of fair play.

A market-driven economy needs to be established in the most transparent and straightforward manner possible. By foreseeing some of the errors committed by more developed economies, and thus avoiding some of their most painful "growing pains," the Kampala Stock Exchange will have a better chance for capturing and cultivating the forces necessary for a viable Exchange.

## **Scope of Work**

### **A. Objective:**

To perform a reconnaissance mission of the Kampala Stock Exchange to assess its potential for success and identify and recommend appropriate assistance by USAID/Kampala.

### **B. Background**

The Private Kampala Stock Exchange has been formed recently by a group of Ugandans, including a former Governor of the Central Bank. The President of Uganda, Mr. Museveni, has approved the initiative and the group has requested assistance from USAID/Kampala.

### **C. Statement of Work**

The services of one technical Expert are requested to:

- 1) Assess the initiative undertaken thus far by a group of Ugandans to register and establish a private Kampala Stock Exchange;
- 2) assess the potential for success; and
- 3) identify assistance, if any, the USAID mission should consider to support or promote the stock exchange.

It is estimated that the services of a technical expert will be required for one week in Uganda. A draft trip report will be written and will be submitted to USAID/Kampala by the technical expert before the consultant leaves Uganda.

### **D. Expertise Required**

The consultant should have a strong background in financial market development and particularly strong experience in stock market development and operations in less developed countries. The consultant should be familiar with various methods of facilitating the exchange of equity investments. Familiarity with methods of facilitating the transfer of public shares in SOES to private ownership is highly desirable.