London
Stock Exchange Group

LSEG Africa Advisory Group

Report of Recommendations

Attracting passive investment flows to African markets

Our thanks

We extend our thanks to the participating students from the University of Cambridge for their contributions to the research, carried out as part of the Cambridge Judge Business School MBA Students Project, GCP 2018.

Foreword

Welcome to the launch of a series of report recommendations from London Stock Exchange Group (LSEG). They were conceived nearly three years ago with the founding of our LSEG Africa Advisory Group (LAAG), which was designed to provide a platform for regular and collective dialogue through which to develop stronger relations with senior decision-makers, regulators and business leaders across the continent. I'm honoured to have been LAAG's Chairman for the past year and to have seen at first hand its commitment to provide thought leadership on the direction of policy and activity.

Let me start by offering my personal gratitude to its members, who continue to work (on a pro bono basis) to identify ways in which African capital markets could be expanded and enhanced, with our help and support. The work was carried out in conjunction with academic input from Cambridge Judge Business School and the involvement of many other stakeholders in London and across Africa, so this has been a genuinely collaborative effort with one key objective in mind: to create mutually beneficial situations, in partnership with local market infrastructures, by which to increase global investment flows and create deep and sustainable capital markets for Africa.

I believe we all share that same mission and hope that by sharing these recommendations, we offer not only practical advice and constructive solutions, but can also, ultimately, influence policy through shared engagement – with your help.

Three years ago, LAAG started to look at some of the specific challenges (and opportunities) associated with structural and capacity constraints to growth in African markets. Based on prominence and urgency, five key topics and workstreams were shortlisted, and these now form the basis of these papers. In summary, they address capital raising challenges for SMEs, developing the green bond market for infrastructure projects and developing offshore local currency bond markets, as well as focusing on the importance of country market classification and corporate information dissemination.

We should be clear from the outset that, while no effort has been spared to ensure empirical grounding, our research and conclusions are not intended to be either exhaustive or all-inclusive. In many cases, the most appropriate actionable suggestions and policy recommendations are also not new. But we do see value in pulling them together and presenting them in this usable format.

In conclusion, our intention is that these reports should initiate discussion and of course, LSEG remains ready and able to play its role. We look forward to bringing you on board too and we will appreciate all further interest and feedback.

Suneel Bakhshi
Chairman, International Advisory Groups
London Stock Exchange Group

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1. Executive summary

Passive investment funds are key instruments in supporting the depth of African capital markets. These funds track the performance of a financial index, with a longer-term view of receiving a return by following the upward trend in the market.

A key factor in determining the levels of passive investment flows that countries receive rests upon their country classification (Developed, Emerging or Frontier Markets). This paper looks into the reasons behind the low level of passive funds reaching Africa and observes the effects of a country classification upgrade in greater detail.

The following challenges have been identified as hindering passive flows into African markets:

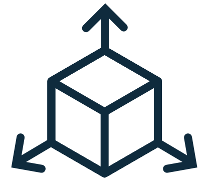
- **Lack of understanding among African stakeholders around the benefits of a country classification upgrade**
- **High transaction costs and insufficient levels of liquidity**
- **Limited research coverage of African equities, leading to unfamiliarity among global investors.**

Based on these challenges, the following recommendations have been suggested:

- **Engage with an index provider in upgrading market status by following a framework that tracks and fosters market development**
- **Regulators should adopt supportive legislation**
- **Enhance international marketing campaigns to raise awareness**
- **Develop a deeper domestic institutional equity market.**

2. Introduction

Over the past 16 years, Africa has maintained an average GDP growth rate of 5%, outperforming the global average by about two percentage points per annum.



18.9%

The cumulative aggregate growth rate in assets under benchmark in exchange-traded funds over the past decade, making them one of the fastest-growing asset types

In order for the continent to continue its sustained growth, domestic capital markets must develop in line, enabling greater employment and wealth creation within the economies across the whole continent. Passive funds have been identified as a key form of capital for Africa, providing support to its economies by providing access to investors worldwide.

2.1. The rise of passive investing

Exchange-traded funds (ETFs) and index funds are the main investment instruments used for benchmarked passive investing. Introduced 25 years ago, ETFs are now one of the fastest-growing asset types in the financial markets, with a cumulative aggregate growth rate in assets under benchmark (AUB) of 18.9% over the past decade. As of March 2018, assets under management (AUM) in ETFs and exchange-traded products (ETPs) globally stood at US$4.9tn, invested across more than 5,000 ETPs on more than 70 different exchangesin 56 countries.

In comparison with active net inflows, the last five years have seen a gradually shifting trend to more passive investment strategies in Emerging Markets.

Major reasons for this significant trend towards passive flows include:

— **Passive strategies require a fraction of the management fees required for active investing, leading to higher net returns**

— **In the US and other Developed markets, no active manager has been able to consistently outperform the benchmark indexes over three to five years. (In major markets, funds that outperformed their benchmark have not done so consistently. For example, 35% of European equity funds outperformed during 2011–12, but only 8% outperformed over a longer horizon of six years)**

— **Limited volumes of research and coverage on Frontier economies are available for active investing, making passive investing much more practical in these economies.**

Although passive flows globally have seen exponential growth over the past decade, only a small amount of this growth has reached African markets, despite the potential returns and diversification opportunities that exist for investors in Africa. Analysis of literature and primary research reveals that African equities prove hard to reach, with global investors having minimal exposure through passive investment vehicles.

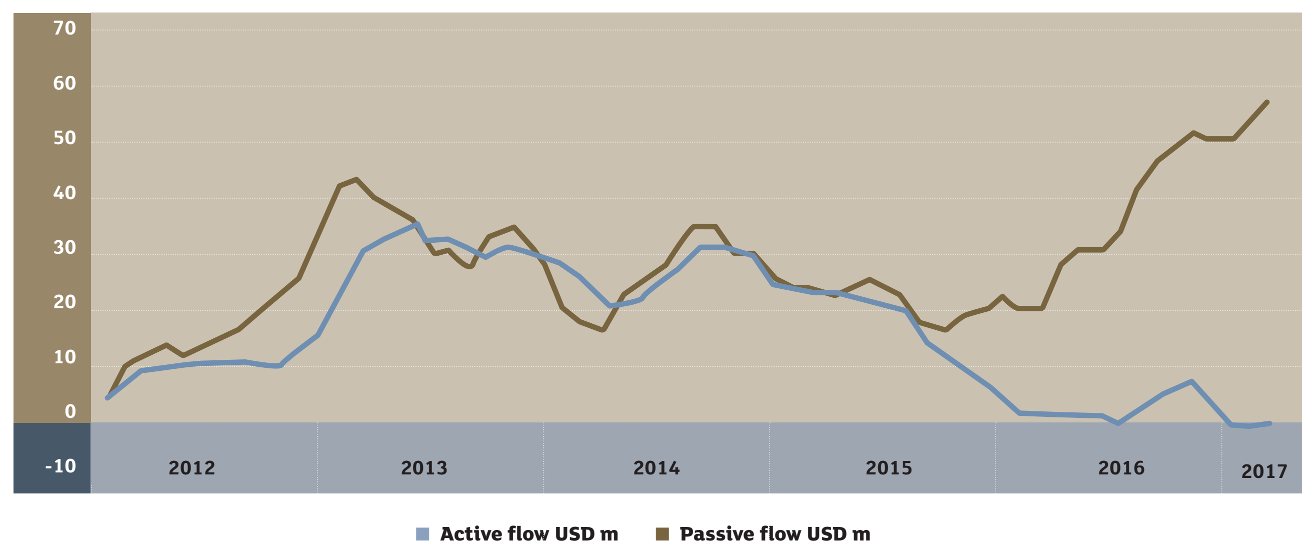
2.2. The role of country classification in enhancing passive flows

Often misunderstood or underestimated, country classification (into Developed, Emerging or Frontier Markets) has been identified as one of the leading factors that contribute to the amount of passive funds a country receives. Gaining a status automatically exposes a country to vast pools of funds, which increase substantially the more senior the status is. It is estimated that more than US$1.3trn is benchmarked to the FTSE Global Equity Index Series alone, which covers securities in 48 different countries based on Developed, Advanced Emerging and Secondary Emerging status. US$265bn tracks FTSE Developed Indexes and US$130bn AUB tracks FTSE Emerging Markets Indexes.

Further, a country's classification status signals confidence in a market and points to a level of sophistication through adherence to certain objective criteria required to achieve a given status. Later, this paper looks in more depth at the market classification upgrade for Qatar and what this could mean for its economy. (Although this paper recognises that Qatar is in a different economy class compared with the African countries, it is the aspiration of this market, placing country classification upgrade as part of its national strategy, that it aims to showcase.)

FIGURE 1

Passive vs active investing in Emerging Markets (2012–2017)



Source: FTSE Russell data

> "A country's classification status signals confidence in a market and points to a level of sophistication through adherence to certain objective criteria required to achieve a given status"

3. Barriers to enhancing passive flows into African markets

44

African countries are currently not classified by FTSE Russell, and so are not included in any of the global passive flows tracking Frontier and Emerging Markets

3.1 Lack of understanding among African stakeholders around the importance and benefits of country classification upgrade
A further constraint on passive flows into African equity markets can be attributed to a lack of focus on the key criteria needed for a country classification upgrade. To narrow the scope of examination, our research has focused on Frontier Markets with the potential to reach Emerging Markets status.

At present, only 10 countries in Africa are classified by FTSE Russell, with two Emerging (Egypt and South Africa) and eight Frontier Markets. Taking a look at the entire continent, 44 countries are left unclassified, which means that over 80% of Africa's countries are not included in any of the global passive flows tracking Frontier/Emerging Markets.

Looking at broad-based Emerging Market funds, at present Africa attracts an estimated 7.5% of the total passive investments, of which South Africa attracts 7.4% of total flows and Egypt the remaining 0.1%. In terms of Africa alone, combining Emerging and Frontier Markets, South Africa accounts for 75% of the passive flows captured by this analysis, with only two more countries being relevant: Nigeria (11%) and Egypt (10%). African countries have limited understanding of how to increase the level of passive funds towards their respective markets. This is further exacerbated by a particular misunderstanding around the effect of a country classification upgrade: the perception that having a larger share of a smaller pool of funds is more advantageous than upgrading to a higher country classification, where a country ends up with a smaller share of a much larger pool of funds.

FIGURE 2

FTSE classification of African countries (March 2018)

ADVANCED EMERGING	SECONDARY EMERGING	FRONTIER
SOUTH AFRICA	EGYPT	BOTSWANA
		CÔTE D'IVOIRE
		GHANA
		KENYA
		MAURITIUS
		MOROCCO
		NIGERIA
		TUNISIA

FIGURE 3

Africa attracts 7.5% of global emerging markets funds

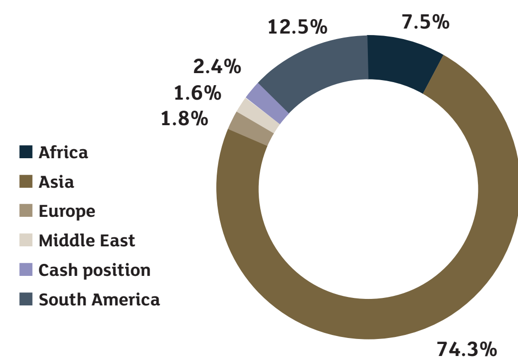
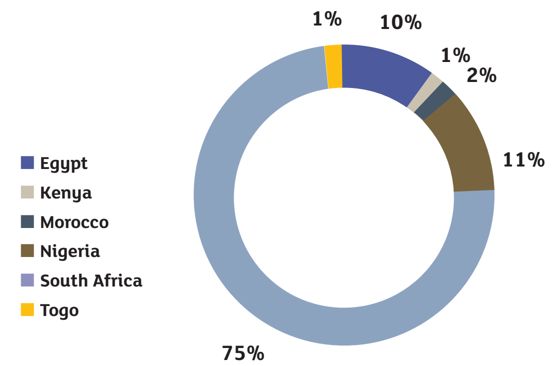


FIGURE 4

Split of Emerging/Frontier passive funds by African country



Source: Judge Business School, University of Cambridge analysis based on publicly available information for ETFs included in analysis sample (2018)

3.2 High transaction costs and insufficient level of liquidity
The African markets that are currently assigned Frontier status meet all the Frontier criteria but do not meet the requirements for 'Liquidity' and 'Transaction Costs' that need to be fulfilled in order to be considered for promotion to Secondary Emerging Market status. Figure 5, below, shows the state of Africa's classified capital markets, according to FTSE Russell, as of March 2018.

FIGURE 5

FTSE quality of markets criteria (Africa) as at March 2018

CRITERIA	COUNTRY NAMES													
	DEV	ADV EMG	South Africa	SEC EMG	Egypt	FRONT	Botswana	Côte d'Ivoire	Ghana	Kenya	Mauritius	Morocco	Nigeria	Tunisia
World Bank GNI Per Capita Rating, 2015			Upper Mode		Lower Middle		Upper Mode	Lower Middle	Lower Middle	Lower Middle	Upper Mode	Lower Middle	Lower Middle	Upper Mode
Creditworthiness			Speculative		Speculative		Investment	Speculative	Speculative	Speculative	Investment	Speculative	Speculative	Speculative
Market and Regulatory Environment														
Formal stock market regulatory authorities actively monitor market (e.g. SEC, FSA, SFC)	X	X	Pass	X	Pass	X	Pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass
Fair and non-prejudicial treatment of minority shareholders	X	X	Pass		Pass		Pass	Restricted	Restricted	Restricted	Restricted	Pass	Restricted	Restricted
No or selective evidence of foreign ownership restrictions	X	X	Pass	X	Pass	X	Pass	Pass	Restricted	Restricted	Pass	Pass	Pass	Restricted
No objection to or significant restrictions or penalties applied to the investment of capital or the repatriation of capital and income	X	X	Pass		Restricted		Pass	Restricted	Pass	Pass	Pass	Pass	Pass	Pass
Free and well-developed equity market	X	X			Pass		Not Met	Not Met	Restricted	Not Met	Not Met	Not Met	Restricted	Not Met
Free and well-developed foreign exchange market	X	X	Pass		Not Met		Not Met	Not Met	Not Met	Not Met	Not Met	Restricted	Not Met	Not Met
No or simple registration process for foreign investors	X	X	Pass		Restricted		Restricted	Not Met	Restricted	Restricted	Restricted		Restricted	Restricted
Custody and Settlement														
Settlement – rare incidence of failed trades	X	X	Pass	X	Pass	X	Pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass
Custody – sufficient competition to ensure high quality custodian services	X	X	Pass	X	Pass		Restricted	Pass	Restricted	Pass	Pass	Pass	Pass	Pass
Clearing a settlement – T+2/T+3	X	X	T+3	X	+2	X	T+3	T+3	T+3	T+3	T+3	T+3	T+3	T+3
Settlement – free delivery available	X	0	Pass		Restricted		Restricted	Restricted	Not Met	Not Met	Restricted	Restricted	Not Met	Restricted
Custody – omnibus and segregated account facilities available to international investors	X	X	Pass		Restricted		Pass	Not Met	Not Met	Not Met	Not Met	Pass	Not Met	Not Met
Dealing Landscape														
Brokerage – sufficient competition to ensure high quality broker services	X	X	Pass	X	Pass		Pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass
Sufficient broad market liquidity to to support sizeable global investment	X	X	Pass	X	Pass		Not Met	Not Met	Not Met	Not Met	Not Met	Not Met	Restricted	Restricted
Transaction costs – implicit and explicit costs to be reasonable and competitive	X	X	Pass	X	Pass		Restricted	Restricted	Not Met	Restricted	Restricted	Pass	Not Met	Pass
Stock lending is permitted	X		Pass		Not Met		Not Met	Not Met	Not Met	Not Met	Restricted	Restricted	Not Met	Not Met
Short sales permitted	X				Not Met		Not Met	Not Met	Not Met	Not Met	Not Met	Not Met	Not Met	Not Met
Off-exchange transactions permitted	X		Pass		Not Met		Restricted	Not Met	Restricted	Restricted	Not Met	Not Met	Restricted	Not Met
Efficient trading mechanism	X		Pass		Pass		Pass	Restricted	Restricted	Restricted	Restricted	Pass	Restricted	Pass
Transparency – market depth information/visibility and timely trade reporting process	X	X	Pass	X	Pass	X	Pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass
Derivatives														
Developed Derivatives Market	X	0	Pass		Pass		Pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass

3. Barriers to enhancing passive flows into African markets (continued)

Lack of liquidity – very low annual turnover is a feature of African exchanges – means that shares traded on an African exchange (excluding the Johannesburg Stock Exchange) rarely change hands. Most African exchanges suffer from significantly low levels of liquidity, with the annual turnover percentage (turnover velocity) ranging from 5–10%. FTSE Russell, for example, would not create an index unless at least three securities pass the liquidity test.

As a result of generally low capital mobility across African markets, shares are held with a long-term view. This gives rise to a lower free float in comparison to larger Emerging and Developed Markets. For example, the average investable percentage of the available African indexes is 54%, compared with the 85% investable percentage of the UK listed market.

There is also supporting evidence that, whereas in Developed Markets, where profits from passive investing beat those from active investing, active fund managers investing in African countries are able to outperform the benchmarks due to mispriced securities – one of the consequences of low liquidity. This has deterred investors from investing passively in Africa – and, worse still, at times it has encouraged speculative short-term trading, tarnishing companies' balanced equity growth.

High transaction costs in African markets are the other strong deterrent for investors, as they have a negative impact on net profits. Alongside stamp duty and capital gains tax, transaction costs on African markets are a direct result of the low market activity.

As Figure 7 (opposite) illustrates, the functioning of Africa's capital markets can create a negative feedback loop. While low transaction costs and high liquidity are needed for higher market participation to take place, it is actually higher market participation that will improve those two factors.

FIGURE 6

Source: Cambridge analysis based on publicly available information for ETFs included in analysis sample

Listed companies and liquidity of African markets

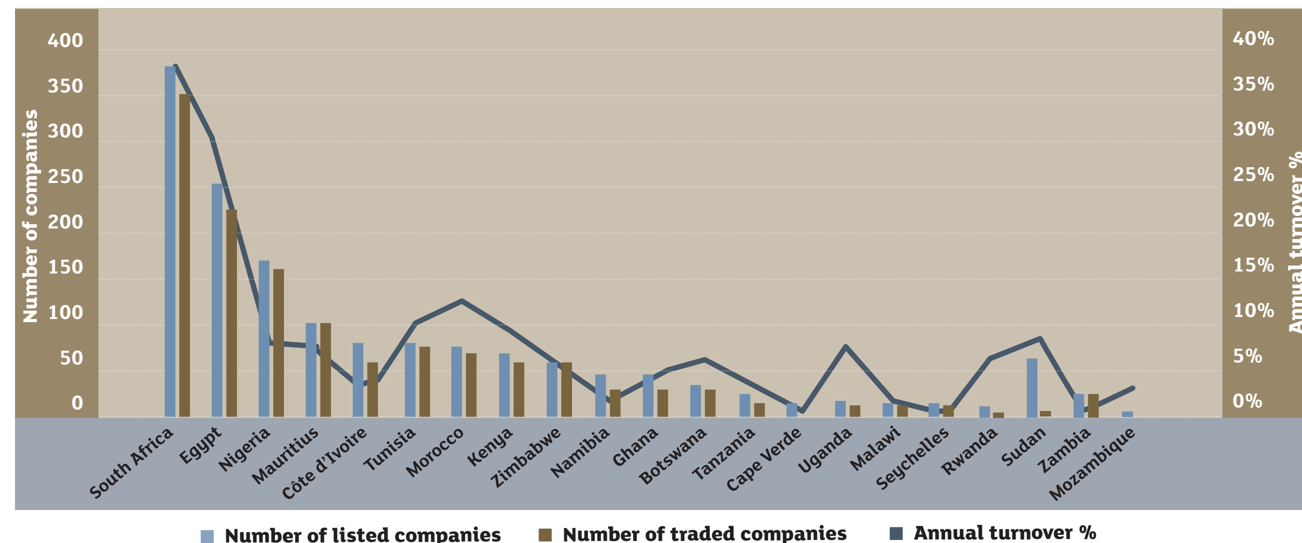
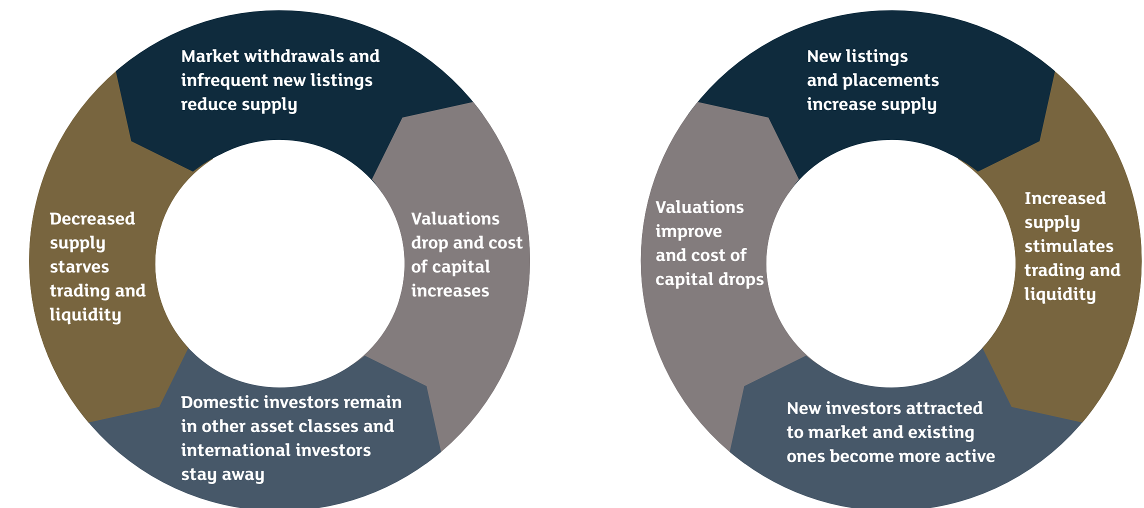


FIGURE 7

Negative feedback loop resulting from high transaction costs and insufficient liquidity



Vicious cycles are triggered by:
- **Weak or uncertain economic conditions**
- **Uncertain domestic and/or regional political backdrop**
- **Stagnant pool of investable assets**

Virtuous cycles are underpinned by:
- **Stable or improving economic conditions**
- **Stable or improving political and social institutions**
- **Growing pool of investable assets**

54%

The average
investable percentage of the available African indexes, compared with a figure of 85% of the UK listed market

3.3. Limited research coverage of African equities

Finally, the lack of equity research in African equities has historically led to limited awareness of the African markets among global investors. To put this in perspective, even if the BRIC countries have three times more stocks listed collectively than the US, the number of analysts covering BRIC stocks is less than a third compared with that of the US. Passive strategies therefore allow for more investments to reach these companies with less coverage.

4. Country classification as the gateway to attracting passive investment

4.1 The process behind a country classification upgrade
Global investors have a preference for markets that can be classified relative to others, and that are easy to access. To achieve this distinction, an index provider or country classification agency places countries in four development categories, using a transparent and evidence-driven process and a structured framework: Developed, Advanced Emerging, Secondary Emerging and Frontier. External advisory committees (which include representatives of the largest fund managers) ensure that the criteria used to determine country classification meet the needs of global investors. By classifying countries according to objective criteria, and engaging with stock exchanges, regulators and central banks in those countries where the market is being considered for potential promotion or demotion, the process provides portfolio managers and asset allocators with a clear view of expected future index evolution.

For a country's classification to be determined, the level of development of the local capital markets is assessed. Countries that wish to be upgraded therefore need to demonstrate that they fulfil certain criteria, such as low transaction costs and efficient regulatory environment. The quality of market criteria take into account the quality of regulation, the dealing landscape, custody and settlement procedures and the presence of a derivatives market. This process involves sending a comprehensive questionnaire to the market (stock exchange and regulatory authorities) covering 21 criteria (see Figure 5, page 9) that can be objectively judged and compared. Responses received in the questionnaire allow the agency to balance the local view of the market against the perceptions and experiences of advisory committee members who trade in that market. Normally, an agency also seeks engagement with the local authorities on areas where changes may need to be made to meet international standards.

4.2 The importance of a country classification upgrade to the market
The classification of markets is a major step in the process of index construction. Markets of comparable size, liquidity and other parameters are often aggregated in indexes that help investors to understand the investment opportunities available in these market groupings. Country classification-based indexes enjoy strong coverage through issuance of ETFs that track their performance. For example, Vanguard's FTSE Emerging Markets ETF has more than US$80bn in assets tracking the FTSE Emerging Markets Index. Based on global indexes that follow country classification, if an African country was in the Emerging or Frontier grouping, it could potentially have access to US$1.5tn AUB tracking Emerging Markets indexes and more than US$650m AUB tracking Frontier Markets indexes, not taking into account the potential country- and region-specific ETFs that could be launched to give more direct exposure to African markets. The reclassification of China A Shares is a good example. Following the announcement that China A Shares were to be reclassified to be included in Emerging Markets indexes, HSBC issued a China A Shares ETF in July 2018. This example is also highly relevant to Africa in that it signposted an important step in the development of China's capital markets and reflected long-term reforms that had been implemented over the past few years.

Reclassification from Frontier Market to Emerging Market also leads to a country's inclusion in the Global Equity Index Series (GEIS). In other words, if FTSE upgrades a country from Frontier Market status to Emerging Market status, qualifying stocks from the upgraded country will be included in both the FTSE Emerging Market Index and FTSE GEIS (as well as indexes that form subsets of GEIS, such as the All World Index), potentially attracting benchmarked funds from an even larger pool of investors. In addition to inclusion in broad Emerging/All-World indexes, a country's upgrade brings it under the global investor spotlight as signalling confidence. Global investors who hold Emerging Market indexes will be essentially forced to take a view on a country, given that they will be holding assets that track local market performance following the rebalancing of the index. This may lead to more direct investments into a country, based on the research that these investors will need to conduct into new markets.

Aside from the direct impact of passive funds, it is important to consider the wider effect country classification actually has on a domestic market. By fulfilling criteria for the better functioning of the markets, African countries ultimately develop their own local capital markets, leading to increased domestic activity such as more issuances and stronger local investor participation. However, based on primary research conducted for this paper, there is a common misperception that, following an upgrade to a higher country classification, the reduction in relative index weighting compared with the previous higher weighting within a lower country classification index will result in reduced capital flows entering the local economy. Given that there is over 2,000 times more capital tracking Emerging Market indexes than Frontier Market indexes, having a lower weighting within the Emerging Market indexes would in fact result in significant capital flows within an economy.

5. Case study: Qatar – what is a reclassification worth?

Qatar's reclassification to an Emerging Market by FTSE Russell in 2015 provides a good example that African markets could potentially follow to reach a higher classification and benefit from the international recognition an upgrade brings.

In 2008, Qatar was classified as a Frontier Market when the FTSE Russell country classification scheme was expanded to include Frontier status. Qatar represented over 35% of the overall Frontier Market index – a significant weighting. However, due to a number of criteria that it was unable to fulfil (see Figure 8), it was unable to be classified as an Emerging Market.

In 2011, FTSE Russell and the Qatar Stock Exchange (QE) commenced active engagement, conducting regular meetings over a two-year period in order to ascertain progress against the outstanding criteria.

As shown in Figure 8, Qatar achieved steady progress against the FTSE Quality of Markets criteria, and in September 2013 it was included in the FTSE Watch List for possible reclassification from Frontier to Secondary Emerging Market status.

FIGURE 8

FTSE Quality of Markets – Qatar (2008-2015)

CRITERIA	Secondary Emerging	Frontier	2008	2013	2015
World Bank GNI Per Capita Rating			High	High	High
Market and Regulatory Environment			Investment	Investment	Investment
Formal stock market regulatory authorities actively monitor market (e.g. SEC, FSA, SFC)	X	X	Pass	Pass	Pass
No objection to or significant restrictions or penalties applied on the repatriation of capital and income	X	X	Pass	Pass	Pass
Custody and Settlement					
Settlement – rare incidence of failed trades	X	X	Pass	Pass	Pass
Custody – sufficient competition to ensure high quality custodian services	X		Pass	Restricted	Pass
Clearing a settlement – T+2/T+3	X	X	T+3	T+3	T+3
Dealing Landscape					
Brokerage – sufficient competition to ensure high quality broker services	X		Pass	Pass	Pass
Liquidity – sufficient broad market liquidity to to support sizeable global investment	X		Restricted	Restricted	Pass
Transaction costs – implicit and explicit costs to be reasonable and competitive	X		Restricted	Pass	Pass
Transparency – market depth information/visibilty and timely trade reporting process	X	X	Pass	Pass	Pass

5. Case study: Qatar (continued)

1%
The weighting given to Qatar when it joined the Emerging Market index in 2016

Productive engagement continued for another two years and in September 2015, FTSE Russell announced the reclassification of Qatar from Frontier to Secondary Emerging Market status with effect from September 2016, with Qatar's ultimate weighting at just over 1% in the Emerging Market index. Additionally, to assist global index trackers, the addition of Qatar to the FTSE GEIS was managed in two 50% tranches.

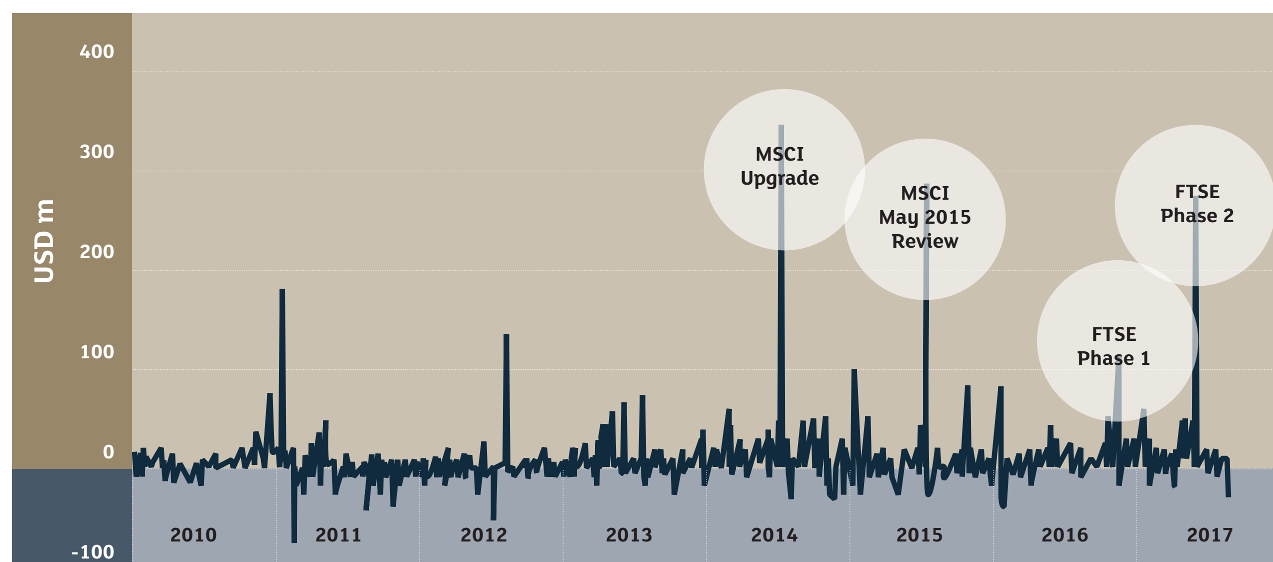
Some of the key reforms that QE undertook within the local market that helped Qatar reach the higher tier status were (based on the 'restricted' points in Figure 8 on page 13):

- **Ensuring that the registration process for new investors was operating efficiently**
- **Working with local brokers to ensure there was sufficient capacity/liquidity to manage the projected inflows around the rebalance**
- **Conducting a system stress test on its infrastructure to ensure it could manage the increased capacity around the rebalance**
- **Ensuring that overdraft facilities were in place**
- **Arranging marketing and media coverage promoting the market.**

Upon inclusion in both MSCI's and FTSE's Emerging Market index, QE enjoyed unprecedented levels of foreign investor interest as passive funds portfolio rebalancing led to massive volume spikes.

FIGURE 9

Qatar Exchange nationality trading summary net foreigners USD



6. Recommendations

Over the course of this paper, it has been established that for African markets to attract global passive flows, local capital markets need to strive to achieve a higher country classification status.

Local policy-makers, regulators and market infrastructures, supported by development finance institutions and financial services firms, need to take coordinated measures to address key shortcomings in African capital markets that would serve as a barrier to achieving this. The below recommendations have therefore been established.

6.1. Engage with an index provider in upgrading market status by following a framework that tracks and fosters market development

Country classification upgrade can be a long and onerous process and support from an experienced institution is often required. African regulators and stock exchanges are therefore encouraged to work with an index provider's country classification team. Working alongside an experienced partner with a reliable and relevant framework would encourage markets to advance as they follow clear guidelines and focus on specific problem areas. This would help them to identify achievable steps and solutions to address common issues such as lack of liquidity, and to learn from lessons faced by similar markets.

Simultaneously, investors would also track and compare the development and performance of African markets, gaining confidence in the market as they watch it develop. As a country successfully upgrades its status, its market would observe not only an inclusion into potential trillions of new passive flows, but also increased liquidity through the attraction of institutional and international investors, improved capital inflows and better reputation.

6.2. Regulators should introduce supportive legislation

Alongside African markets' adherence to country classification frameworks, it is crucial that local regulators promote an investing environment that will combat illiquidity and high transaction costs. The below actions are recommended for regulators:

- **Reduce transaction costs, stamp duty and capital gains tax (to increase competition in brokerage services)**
- **Encourage wider retail investor participation through an education programme, and ease the opening of trading accounts to develop a diverse investor base**
- **Strengthen corporate governance and listing standards to improve shareholder rights, investor protection and confidence in the market**
- **Encourage new listings to come to the market and encourage listed entities, such as family- and state-owned companies, to reduce their controlling interest, thereby increasing the number of shares available in the market (free float)**
- **Incentivise local financial institutions to invest in the capital markets; for example, pension funds and insurance companies**
- **Introduce system/infrastructure enhancements that provide accurate, timely pre/post trade and reference data (corporate actions).**

> "It is crucial that local regulators promote an investing environment that will combat illiquidity and high transaction costs"

6. Recommendations (continued)

6.3. Enhance international marketing campaigns to raise awareness

The government should consider strengthening its international reputation through external marketing of the domestic market, such as carrying out global roadshows and capital markets days and promoting the issuance of more sovereign instruments overseas. This will help to increase the international investment community's familiarity with the country.

6.4. Develop a deeper domestic institutional equity market

Many African equity markets are dominated by individual retail investors. While this creates an important sense of democratised capital and wealth distribution, it actually curtails the flow of international institutional capital, which seeks out markets influenced by the behaviour of other institutional capital managers adhering to similar investment discipline and stewardship codes. This restricts the growth potential of African markets. African regulators should develop legislation that seeks to increase equity participation through mutual funds managed by professional fund managers. Mutual funds can increase investor participation by:

— Lowering transaction costs through economies of scale

— Offering investment diversification for investors.

Finally, development of a deep mutual funds market creates a stronger institutional market, increasing the propensity of crowding in overseas institutional capital mutual funds. There are added peripheral benefits related to increasing savings rates and deepening financial inclusion in certain countries.

> "African regulators should develop legislation that seeks to increase equity participation through mutual funds managed by professional fund managers"

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