Attractiveness of African stock markets for foreign investors: An analytical perspective

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Celia Becker
Africa Regulatory and Business Intelligence Executive, ENS, South Africa

Celia Becker

__Celia Becker__ is an Africa Regulatory and Business Intelligence Executive at ENS, a law company with more than 600 lawyers and offices in seven African jurisdictions providing tax and legal services across Sub-Saharan Africa. She specialises in advising large multinationals expanding into the region on the tax-efficient structuring of investments, country risk profiles and tax and regulatory compliance requirements of countries throughout the region. She travels extensively on the continent and has practical experience advising in respect of 26 African jurisdictions. Celia is a South African qualified chartered accountant with a Master's degree in international tax. She started her career as an international tax adviser at a Big 4 accounting company and spent six years at a multinational construction company as Country Risk Director. She is a member of the South African Institute of Chartered Accountants (SAICA) and is a regular contributor of African jurisdictional content to various publications. Celia has lived and worked in Luxembourg, Mauritius and Rwanda. She is currently based in Johannesburg (South Africa).

Abstract

Africa appears to be an appealing investment destination, with African stock markets offering foreign investors the gateway to tap into the continent's potential growth opportunities. Despite the significant growth and development of stock markets on the continent in recent decades, however, there remain some obstacles to overcome. This paper aims to examine the challenges faced by African stock markets which diminish their appeal to foreign investors and assess regional integration as a potential solution. Key takeaways: (1) African stock markets are often inadequately regulated and exhibit limited size, depth and liquidity, compounded by high currency volatility, prohibitive trading costs and macroeconomic and political instability, making them less attractive to foreign investors; (2) policy makers and regulators in developing countries should focus on fostering the development of vibrant and liquid public equity markets that are well regulated by creating a favourable market ecosystem through legislation, tax incentives and other measures to encourage listings; (3) for financial markets to operate effectively, they must exist within a comprehensive supportive framework encompassing legal, economic and political elements and coordinated monetary policies, potentially through currency zones; (4) the regional integration of stock exchanges can facilitate global integration, and some progress has been made in this regard. African stock markets remain weakly integrated, however, and economic integration initiatives are still hampered by low intra-African trade and inadequate infrastructure; (5) while the African Continental Free Trade Area (AfCFTA) lays a solid foundation for economic integration, African countries should allocate additional resources to implement the AfCFTA and ensure increased intra-Africa trade to assist in making its stock markets more attractive to foreign investors and potentially launching a continental exchange in the future.

Keywords: Africa, intra-African trade, liquidity, operational inefficiencies, macroeconomic and political instability, regional integration, regulatory control, stock market, vulnerability extreme events

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*ENS,
P.O. Box 783347,
Sandton, 2146
Johannesburg,
South Africa
Phone: +27 82 886 8744;
E-mail: cbecker@ENSafrica.com*

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AFRICA AS INVESTMENT DESTINATION

At first glance, Africa appears to be an appealing investment destination with favourable prospects and multiple opportunities to be explored. Not only is the continent rich in natural resources, such as minerals, oil, gas and agricultural land, it is currently experiencing a massive population boom. Home to 17 per cent of the world's inhabitants, Africa's population growth rate has been among the highest in the world for several decades.

At the current growth rate, it is expected that Africa's population will reach close to 2.5 billion by 2050, totalling more than 25 per cent of the world's population, and by the end of the century will account for as much as 40 per cent of the global populace.[1] With a youthful and rapidly increasing population, Africa has the potential to benefit from a 'demographic dividend', where a large working-age population can drive economic growth and productivity. The region is also experiencing rapid urbanisation and a burgeoning middle class, creating an expanding consumer market for goods and services.

Many African countries are classified as emerging markets or frontier economies, offering greater growth potential and higher returns than traditional markets. African economies are diversifying, with new sectors such as telecommunications, consumption and infrastructure developing rapidly and providing access to growth. The continent is also witnessing a digital revolution, with the rapid adoption of mobile technology and the emergence of innovative solutions in fintech, e-commerce and others.

Investing in Africa presents a promising outlook with the potential for high returns, diversification and positive socio-economic impact. African stock markets offer foreign investors the gateway to tap into the continent's economy and leverage potential growth opportunities. But just how attractive are these markets to foreign investors?

THE DEVELOPMENT OF AFRICAN STOCK EXCHANGES

Stock markets on the continent have experienced significant growth and development in recent decades. The number of stock exchanges has grown from only five in Sub-Saharan Africa and three in North Africa in 1989 to 38 exchanges with a combined market capitalisation of US$1.6tr by 2022.[2]

The largest exchanges are in South Africa, Nigeria, Morocco and Egypt, but there are also smaller exchanges in countries such as Kenya, Mauritius and Ghana (see Table 1). Of particular interest are the regional stock markets on the continent: the *Bourse Regional des Valeurs Mobilieres* (BRVM), domiciled in Abidjan, which services all eight member countries of the West African Economic and Monetary Union (*Union Economique et Monétaire Ouest Africaine* [UEMOA]): Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo; and the *Bourse des Valeurs Mobilières de l'Afrique Centrale* (BVMAC), based in Gabon and servicing Cameroon, the Central African Republic, Chad, Equatorial Guinea, Gabon, and the Republic of the Congo.

The African Securities Exchanges Association (ASEA) was founded in 1993 to lobby for and promote the role of African stock exchanges as catalysts for regional economic growth. It has the objective of empowering member exchanges to be significant drivers of economic and societal transformation in Africa. ASEA works closely with its member companies (currently including 26 exchanges) to champion common areas of interest, such as capacity building, market development and advocacy.

CHALLENGES FACED BY AFRICAN STOCK MARKETS

Despite the significant progress and advancement of African stock markets, there remain some obstacles to overcome. An analysis of the state of African stock markets by

Table 1: The ten largest stock markets in Africa by market capitalisation, 2022

1	South Africa	Johannesburg Stock Exchange (JSE)	1,171.75	237
2	Nigeria	Nigerian Stock Exchange (NGX)	91.43	173
3	Morocco	Casablanca Stock Exchange (MASI)	53.71	75
4	Egypt	Egyptian Stock Exchange (EGX)	38.85	239
5	Botswana	Botswana Stock Exchange (BSE)	31.02	23
6	Kenya	Nairobi Securities Exchange (NSE)	16.11	59
7	West Africa	*Bourse Régionale des Valeurs Mobilères* (BRVM)[3]	10.50	46
8	Mauritius	Stock Exchange of Mauritius (SEM)	8.57	89
9	Tanzania	Dar es Salaam Stock Exchange (DSE)	6.70	22
10	Ghana	Ghana Stock Exchange (GSE)	6.46	30

Source: World Bank DataBank: Word Federation of Exchanges Database

Senbet and Otchere[4] highlighted various challenges faced by these markets, most of which remain relevant today. African stock markets continue to grapple with ineffective regulatory control, liquidity constraints and fragmentation, which is often compounded by currency volatility and macroeconomic and political instability.

Ineffective regulatory control

Well-established and enforced financial sector regulations protect investors' rights and can significantly reduce the utilisation of insider information, market manipulation and inadequate financial disclosure. African stock markets have been characterised by weak regulation, which has a major impact on the confidence of both local and international portfolio investors. Senbet and Otchere[5] highlight that Sub-Saharan Africa has the highest percentage of private wealth held abroad, ranging from 30 to 40 per cent, as compared to 8 per cent in Latin America and 3 per cent in East Asia.

A 2018 study examined the impact of regulatory quality on stock market development in 12 selected African countries, making use of annual sample data for the period 1996–2016. It confirms that quality regulation exerts a positive impact on stock market development and concludes that Africa requires extensive policy reforms to effectively regulate financial markets and enhance investors' confidence in the region.[6]

In the recent past many African stock exchanges have strengthened their regulatory oversight to ensure compliance with international standards and best practices, including implementing stricter listing requirements, improving disclosure requirements and monitoring trading activities to prevent market abuse. Collaborating with international organisations such as the World Bank, International Finance Corporation (IFC) and International Organisation of Securities Commissions (IOSCO) provides access to expertise, resources and technical assistance to support governance reforms by African exchanges. These improvements in governance frameworks contribute to the overall development and credibility of African stock exchanges, but certain regulatory gaps still remain

Limited size, depth and liquidity

The performance of a stock market is measured by a number of key factors, including the transparency of the stock prices of listed companies, the frequency of stock trading and the overall market capitalisation. These elements are encapsulated in the efficiency, liquidity and size of the stock market respectively. A recent study[7] of the development of the Nigerian, Nairobi and Johannesburg

Stock Exchanges, three major frontier markets in Sub-Saharan Africa, found that, in general, stock markets in Africa are largely underperforming compared to advanced and other emerging markets.

Investors tend to have greater confidence in large stock markets, because they represent a broader array of equity investment options. Yet the size and depth of African stock markets pale in comparison to that of other markets. By 2020 there were only 1,251 companies listed on African stock exchanges, as compared to 2,347 entities listed on the London Stock Exchange and 2,933 on the Nasdaq. North African stock exchanges account for 397 listed companies and Sub-Saharan African exchanges for 854, with companies listed on the JSE constituting almost 40 per cent of companies listed on Sub-Saharan African stock exchanges. Even the two regional exchanges on the continent are very small; on the BRVM there were just 46 listed entities, and on the BVMAC, only four listed companies in 2020.[8]

A concerning trend is the decrease in the number of initial public offerings (IPOs) and the size of capital raisings in Africa, despite a significant increase in IPOs in the rest of the world since 2021. Equity capital raised in the Sub-Saharan market has decreased by about 73 per cent from 2020 to 2021 and, on the JSE, the number of de-listings has exceeded the number of listings during each of the preceding five years. The rest of Sub-Saharan Africa is experiencing a similar trend, which stakeholders ascribe to low valuations, high compliance costs and an onerous regulatory burden.[9]

Most of the African stock markets are dominated by a few large companies, with trading activity primarily focused on a handful of stocks representing a considerable share of the total market capitalisation. In addition, markets on the continent have historically had minimal participation from retail investors. Although this trend has been changing, mainly driven by technological innovations, many retail investors are still not very active. Between 2019 and 2022, 97 per cent of the approximately two million registered share accounts on the Nairobi Stock Exchange (NSE) was dormant.[10] Furthermore, many African exchanges have been grappling with a lacklustre local investor base. The participation of domestic investors in a stock market plays a crucial role in establishing international credibility. When Africans exhibit hesitancy towards investing in their own local stock markets, it undermines confidence and credibility on a global scale.

A key requirement for a well-functioning stock market is liquidity, or the ease with which a stock can be converted into cash.[11] High levels of liquidity in stock markets ensure that there are enough buyers and sellers in the market at any given time, allowing transactions to be executed quickly and at a fair price, without significant price fluctuations. The ratio of total value of shares traded on the exchange to gross domestic product (GDP) measures the market trading activity relative to the size of the economy, whereas the ratio of total value of shares traded to the total capitalisation of the market (known as the 'turnover ratio') provides a useful measure of the market's overall trading activity relative to the size of the stock market itself.[12] A low turnover ratio indicates inadequate liquidity in the market, where minimal transaction volumes may influence the stock market price index and lead to increased volatility.

The average market capitalisation of listed companies in Africa was at 63.6 per cent of GDP in 2020, as compared to almost 100 per cent of GDP in East Asia and the Pacific. North Africa had a market capital capitalisation of 17.4 per cent and Sub-Saharan Africa 86 per cent of GDP. When excluding South Africa, the market capitalisation for the rest of Sub-Saharan Africa drops to 12.7 per cent of GDP, which is at the bottom of the rankings. Research by the European Investment

Bank (EIB)[13] also found that most African stock exchanges have a lower turnover ratio than other stock exchanges in emerging economies. As illustrated in Table 2, with the notable exception of the JSE and the Egyptian Stock Exchange (EGX), even the ten largest African exchanges display limited liquidity, which can make it difficult for investors to buy and sell securities.

Currency volatility

Fluctuations in the value of local currency can affect the returns on investment when translated into a foreign investor's domestic currency, making it difficult for investors to accurately assess and manage investment risks. Currency volatility can also increase transaction costs for foreign investors, while managing currency risk through hedging contracts such as forward contracts or options is often challenging and costly in markets with high levels of currency turbulence.

A study by Senbet and Otchere[14] indicates that currency depreciation does indeed have a negative effect on the performance of African stock markets. The ongoing prevalence of high currency volatility in African economies exacerbates the risk associated with African stocks, thereby presenting a further barrier to foreign investors.

Vulnerability to extreme events

Emerging stock markets provide great opportunities for investment growth and risk diversification; however, they are often more vulnerable to extreme market events.

An examination of the performance of African stock markets before and after the global financial crisis of 2007–2009[15] found that although African stock markets outperformed those in Asian and Latin American countries before the crisis, during the crisis (January 2008–February 2015) they experienced the sharpest declines in average returns, alongside heightened levels of total and systematic risk. African stock markets also displayed weak recovery rates, most of them being unable to return to their pre-crisis index levels and recording lower average returns since the peak of the global financial crisis. Interestingly, a 2023 study[16] found that emerging and developed markets were affected by the COVID-19 pandemic on a similar scale.

OPERATIONAL INEFFICIENCIES

Cumbersome administrative procedures for company listings, high transaction fees and the slow adoption of technology serve as significant obstacles to the advancement of African stock exchanges.

Table 2: Liquidity indicators for Africa's ten largest stock exchanges, 2022

1	South Africa	Johannesburg Stock Exchange (JSE)	26.7	57.8
2	Nigeria	Nigerian Stock Exchange (NGX)	2.4	0.5
3	Morocco	Casablanca Stock Exchange (MASI)	5.7	2.3
4	Egypt	Egyptian Stock Exchange (EGX)	28.9	2.4
5	Botswana	Botswana Stock Exchange (BSE)	0.3	0.4
6	Kenya	Nairobi Securities Exchange (NSE)	2.2	0.3
7	West Africa	*Bourse Régionale des Valeurs Mobilères* (BRVM)	Not available	Not available
8	Mauritius	Stock Exchange of Mauritius (SEM)	2.8	1.9
9	Tanzania	Dar es Salaam Stock Exchange (DSE)	0.4	0.0
10	Ghana	Ghana Stock Exchange (GSE)	1.0	0.1

Source: World Bank DataBank: Word Federation of Exchanges Database

High trading costs

High trading costs can undermine the efficiency, liquidity and accessibility of stock exchanges, ultimately hampering their development and effectiveness as key drivers of economic growth and investment.

The United Nations Economic Commission for Africa (UNECA)[17] reports that fees and taxes on most African securities exchanges, including brokerage commissions, exchange fees for clearing and settlement and securities transfer taxes, impose a notably heavier burden compared to similar rates in other developing countries. Transaction costs in many developing countries are less than 1 per cent of the value of the trade, with Peru, for instance, charging levies of 0.46 per cent and Thailand 0.57 per cent. The fees in Uganda and Rwanda of 4.1 per cent and 3.4 per cent, respectively, are significantly higher.

In countries with smaller stock exchanges, high brokerage commission fees are often attributed to the limited number of licensed brokers and relatively low trading activity. In addition, a 2022 study[18] found that transaction fees of African stock exchanges are also considerably higher than in developed economies. For example, unlike the London Stock Exchange (LSE), where an upper limit applies to the fees due by prospective companies that want to list, in the BRVM and the Stock Exchange of Mauritius, the transaction fee is an uncapped percentage of the transaction value.

Slow adoption of technology

The implementation of electronic systems can contribute to reducing the costs and inefficiencies of manual systems and enhancing trading activity and liquidity in a stock market through accelerated operations. This becomes particularly important as African stock exchanges contemplate regional consolidation of markets, as discussed below. Without automation, this would be a challenging task.

A study of 11 African stock markets for the period 2008–17[19] found a positive correlation between the adoption of information and communication technologies (ICT) and stock market development and economic growth. This is evidenced by an observed increase in variables such as market capitalisation, number of listed companies, value of stock market trades and the stock market turnover ratio.

Many African stock exchanges have already started to adopt technology to upgrade and modernise their trading systems prior to 2020, and the COVID-19 pandemic acted as an additional catalyst for digital transformation.[20] To date, the majority of Africa's ten largest stock exchanges have implemented electronic trading and/or clearing and settlement systems. The JSE's fully automated electronic trading system, called the Millennium Exchange, was launched in 2012, upgrading and modernising the previous trading platform, while the Nigerian Stock Exchange (NGX) adopted Nasdaq's X-Stream Trading platform in 2013.

In recent years various African capital markets have also started embracing digital tools to stimulate participation from retail investors. Many African exchanges have modernised their websites and introduced trading apps. For example, in June 2020, the Botswana Stock Exchange (BSE) introduced its mobile application, providing most of its web-based trading options. Likewise, the NSE also launched a similar application that year, with a specific focus on retail users. Nevertheless, smaller exchanges, in particular, continue to fall behind international counterparts in adopting the latest technologies, mainly due to inadequate funding. Consequently, the cost and technological challenges associated with trading on many African exchanges and listing companies remain relatively high and contribute to operational inefficiencies.[21]

Macroeconomic and political instability

The stability of the macroeconomic landscape is fundamental to the development of stock markets. Increased macroeconomic and political instability contribute to high volatility in the financial markets, and research has also shown that (macroeconomic) country risk, instead of industry-specific shocks, is the principal cause of variation in stock returns across jurisdictions. Political risk is often associated with the absence of robust institutional frameworks and abrupt adverse changes in government policies, which elevates the risk premium in the stock market.[22]

Large parts of the African continent still experience high levels of political instability due to weak governance structures, inadequate rule of law, corruption, ethnic tensions and conflicts. In addition, African economies are often vulnerable to external shocks such as commodity price fluctuations, global economic downturns and climate-related events. These risk factors act as a significant deterrent to foreign investors.

Quality of corporate governance

Financial openness and institutional quality influence investment.[23] The quality of corporate governance plays a pivotal role in investors' decisions to invest in a listed company and affects the price investors are willing to pay for shares. Research shows that investors are inclined to pay a premium for the stock of a well-governed company compared to one with poor governance, even if both demonstrate similar financial performance. When investors lack trust in corporate governance practices, they tend to devalue their shareholdings, which can adversely affect the company's capacity to raise capital and expand. Credible and transparent corporate governance — which has previously been lacking in Africa — is a crucial element in bolstering the confidence of international investors who are interested in investing in African stock markets.[24]

STOCK MARKET INTEGRATION AS POTENTIAL SOLUTION

The limited depth and liquidity of African markets present significant obstacles to the financial globalisation of the continent. Fostering regional cooperation and integrating the fragmented and shallow markets can serve as an important strategy to overcome the barrier to global integration. Regionalisation of African stock markets should facilitate the mobilisation of both domestic and international financial resources to fund regional enterprises, thereby injecting greater liquidity into the markets.

Financially integrated markets generally mean improved access to substantial groups of potential investors. This typically reduces the cost of equity which, in turn, contributes to increased economic growth. Achieving successful regional integration of stock exchanges, however, requires the harmonisation of legislation, including bankruptcy and accounting laws, and standardising the tax treatment of investments. It also entails the establishment of regional self-regulatory bodies and regulatory exchange commissions, along with coordinating monetary policies, potentially through currency zones. In addition, African stock markets contemplating regional integration should have electronic trading systems and ensure that their accounting reporting, clearance, settlement and depository systems conform to international standards.[25]

Trade and geographic proximity are important drivers of stock market integration. Moreover, the characteristics of stock markets themselves may influence the level of integration. Stock exchanges with comparable size, liquidity and trading-related costs might be in similar developmental stages, potentially leading to improved integration.[26]

Various African jurisdictions have been progressing initiatives in collaboration with international financial institutions to develop regional capital markets. These endeavours seek to establish larger markets, enhance investor appeal, upgrade financial infrastructure and diversify investment opportunities. The Francophone countries of West Africa established BRVM, the first regional stock exchange, in 1998 and in Central Africa, the BVMAC was launched in June 2003. In 2013, the West African Capital Markets Integration Council (WACMIC) was established as the governing body in the Economic Community of West African States (ECOWAS). Its mission is to establish a harmonised regulatory framework for the issuance and trading of financial securities across the region, extending beyond the BRVM. WACMIC includes the commissions and securities exchanges of the UEMOA, Ghana, Nigeria, Sierra Leone and Cape Verde. In East Africa Rwanda, Uganda and Tanzania merged their stock markets and implemented the Capital Markets Infrastructure (CMI) platform in 2020. Burundi has since launched its stock exchange and joined the CMI, which enables investors to trade their stocks electronically across borders through brokers who hold sponsored membership in the market selected for stock purchase.[27]

The African Union Agenda 2063 serves as a roadmap for the continent's transformation, aimed at enhancing global competitiveness and achieving inclusive, sustainable development for its member nations. Recently, the African Continental Free Trade Area (AfCFTA) was established with the aim of establishing a single and liberalised market, facilitating the movement of capital and people, supporting investment, and deepening the economic integration of the continent. This has brought fresh optimism for the establishment of a continent-wide economic integration framework, but achieving the full potential of AfCFTA is still hampered by low intra-African trade, inadequate infrastructure, poor trade logistics networks and volatile financial markets.

Aniche[28] suggests an initiative for regional integration centred on creating a pan-African stock exchange that could facilitate cross-border mergers; however, the successful establishment of a pan-African stock exchange necessitates improved integration among African stock exchanges. In 2020, the ASEA launched its flagship African Exchanges Linkages Project (AELP), designed to link the continent's leading exchanges and increase cross-border investment, aligning with the objective of the African Union's Agenda 2063 to promote the free flow of capital and investment. The AELP Link platform, enabling brokers in one jurisdiction to transmit orders by investors to an executing broker in another market, became operational in July 2021 and its pilot phase links seven stock exchanges and some 30 brokers.

The AELP provides an opportunity for a larger, deeper and more liquid market; a wider pool of financial resources; reduced transaction and operational cost; improved visibility and enhanced return on investment; reduced risk exposure for the investor community; capacity building and communication; and enhanced capital-raising options for the private sector. There is, however, a potential for the concentration of activity in the largest, most liquid exchanges, potentially overshadowing smaller markets. In addition, notable differences persist among countries in terms of operational regulation and legislation, which creates a barrier to integration.[29]

Developing and harmonising Africa's capital markets could not only enhance investment in local stock exchanges, but also facilitate trade across the continent and mitigate non-tariff trade barriers. African stock markets still lack robust integration, however, with minimal information flow between them. Further action is required to ensure the integration of African stock markets before launching a continental exchange. While the AfCFTA lays a solid foundation for linear economic integration, African countries should allocate additional resources to implement the AfCFTA and ensure increased intra-Africa trade.[30]

CONCLUSION

In recent decades, foreign investors have increasingly recognised opportunities in African markets, largely due to some improvements in the governance frameworks, transparency and efficiency of exchanges, which have been bolstered by enhanced digitisation.[31] Nevertheless, many African stock exchanges still face significant challenges that increase investor risk. These markets are often subject to ineffective regulation and exhibit limited size, depth and liquidity, compounded by high currency volatility, prohibitive trading costs and macroeconomic and political instability, making them less attractive to investors.

Policy makers and regulators in developing countries should focus on fostering the development of vibrant and liquid public equity markets which are well regulated. Creating a favourable market ecosystem through legislation and other measures can encourage the listing of both private and state-owned local companies.[32] Offering incentives such as tax breaks for listing on stock exchanges could enhance market liquidity and trading volume, thereby promoting greater market depth. During the initial stages of market development, it is essential to establish a robust regulatory framework with straightforward and transparent listing requirements having relatively low barriers to entry and affordable compliance costs. As the market evolves and its supporting infrastructure advances, these requirements could be progressively enhanced to elevate the quality of listed companies and safeguard investors' interests.

For financial markets to operate effectively and deliver the anticipated broader economic advantages, they must exist within a comprehensive supportive framework encompassing legal, economic and political elements. This framework should provide assurances and safeguards for both domestic and foreign investors, ensuring the protection of their investments throughout the entire investment life cycle, including currency conversions, trading, settlement and repatriation. Unfortunately, many of these factors lie outside the direct sphere of influence of African stock markets themselves.

The regional integration of stock exchanges can facilitate global integration and some progress has been made in this regard. African stock markets remain weakly integrated, however, and economic integration initiatives are still hampered by low intra-African trade and inadequate infrastructure. While the AfCFTA lays a solid foundation for economic integration, African countries should allocate additional resources to implement the AfCFTA and ensure increased intra-Africa trade. This should assist in making its stock markets more attractive to foreign investors and potentially launching a continental exchange in the future.

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