LEGAL ASPECTS OF CORPORATE FINANCE: THE CASE FOR AN EMERGING STOCK MARKET

(Volumes One and Two)

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by

Kenneth Kaoma Mwenda

Formerly Lecturer in law in the University of Warwick, UK
The World Bank, Washington D.C., USA.

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[1] The curriculum of the Oxford two years postgraduate Bachelor of Civil Law degree, which comprised Parts I (coursework) and II (thesis), has now been split into two sequential Masters degrees - a one year postgraduate Bachelor of Civil Law degree (BCL), and a one year research Master of Philosophy degree (MPhil). Thus, my BCL thesis, standing in its own right, is now the equivalent of Oxford's newly introduced MPhil degree.

DECLARATION

Except where otherwise indicated, this PhD dissertation is the above candidate's own work and no part of it has already been accepted, nor is being concurrently submitted, for a degree of this university or elsewhere. Part III of this dissertation, consisting of three chapters, was adopted from an earlier thesis by this author. The adopted chapters were part of a thesis submitted to, examined in and accepted by the University of Oxford, in partial fulfilment of the requirements for the award of the postgraduate Bachelor of Civil Law degree. In this Ph.D. dissertation, those chapters have been revised extensively to cover new developments in the law.

Part I of this dissertation, consisting of two chapters, does not form part of the Oxford BCL thesis. In addition, Part II, consisting of two chapters as well, does not form a component of the BCL thesis. Furthermore, Part IV of this dissertation is not developed from the BCL thesis. All in all, more than three-quarters of this work is not drawn from the BCL thesis.

ABSTRACT

This work argues that the development of the Lusaka Sock Exchange into a competitive stock market has been constrained by a number of factors which include inadequate liquidity on the market and weaknesses in the legal framework for regulating public distribution of securities in Zambia. Proposals to overcome these constraints are spelt out in the work. The need to establish a regional stock exchange and promote multiple listings and cross-border trade in securities - so as to stimulate increased liquidity on markets in Eastern and Southern Africa - is noted. The study also provides a comparative analysis of the law in Zambia and that in jurisdictions such as the United Kingdom.

DEDICATION

My hands are ever toiling, my mind is ever seeking the horizons of knowledge. Dear Lord, I cannot fully express my gratitude and indebtedness... I will always praise thy Holy name, Selah.

To dad and mum, Joseph T. Mwenda and Esther M. Mwenda, this work, like many of my other works, is dedicated to you. You started it all. Dad, your studies at the Universities of Toronto and Saskatchewan inspired me to get to the heights that I have reached.

"To know wisdom and instruction,
To perceive the words of understanding,
To receive the instruction of wisdom,
Justice, judgement, and equity;
To give prudence to the simple,
To the young man knowledge and
discretion -
A wise man will hear and increase
learning,
And a man of understanding will attain
wise counsel,
To understand a proverb and an enigma
The words of the wise and their riddles.
The fear of the LORD is the beginning of
knowledge,
But fools despise wisdom and instruction."

The Book of Proverbs 1:1-7.

PART I

GENERAL INTRODUCTION

CHAPTER ONE

INTRODUCTION: SETTING THE LAW IN CONTEXT

The introductory chapter examines the question of whether the legal framework for public distribution of securities in Zambia, adopted in 1993, has facilitated the development of a competitive stock exchange. It is argued in the thesis that the legal framework has not provided adequate incentives to stimulate increased liquidity and market development of the Lusaka Stock Exchange.[1] The high priority placed by the Zambian Government on the privatisation of state-owned enterprise underscores the idea of setting up the Lusaka

[1] As will be seen in Chapter Three, the main reason behind this view is that the Lusaka Stock Exchange and the regulatory framework for public distribution of securities in Zambia were designed primarily to facilitate the privatisation of state owned enterprises. In setting up the exchange and establishing the regulatory framework, other interests in the market, such as those that do not relate to privatisation, were not a determinant variable. As argued in the Conclusion Chapter of the thesis, this feature explains why other market interests were not provided with the same incentives as the privatisation programme (see also the text of an *Interview* with Dr Abraham Mwenda, then Director of Financial Markets at the Bank of Zambia, as provided in the Appendices to the thesis. Dr. Mwenda indicated that a bond market was lacking in Zambia partly due to the structure of the regulatory framework).

Stock Exchange. Shortcomings such as inadequate liquidity and poorly drafted statutory provisions serve only to support the view that the Lusaka Stock Exchange and the regulatory framework were hurriedly set up to deal with the privatisation programme.[2] But as explained in Chapter Three, not all securities in state owned enterprises were off-loaded on the Lusaka Stock Exchange.[3] Against this background, we now turn to look at the road-map of chapters in the thesis.

1.1. CHAPTERS IN THE THESIS:

The thesis is divided into four main parts. Part I of the thesis deals with the general introduction. Part II looks at empirical evidence on constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. Part II also makes a case for the introduction of a regional stock exchange in Eastern and Southern Africa and the promotion of multiple listing and cross-border trade in securities. Part III looks at the efficacy of the legal framework for public distribution of securities in Zambia and supports the idea for a regional stock exchange and the promotion of multiple listing and cross-border trade in securities. A number of constraints on the Zambian legal framework, pointing towards the case for a regional stock exchange and multiple listing and cross-border trade, are identified. The final part, Part IV, deals with the general conclusions.

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[2] See results of the field study conducted by this author, as set out in Chapter Three of the thesis, *infra*.

[3] See generally *Ibid*.

Part I

Chapter Two spells out the attractiveness of emerging capital markets and identifies some of the constraints facing investors on these markets. The chapter also provides a general survey of some of the important literature on emerging stock markets in the world today. This analysis provides a theoretical background against which arguments in the subsequent chapters are analysed. Indeed, a number of new theories have been written on emerging capital markets and these are analysed in Chapter Two.

Part II

Chapter Three provides empirical evidence on constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. This analysis brings out, among other things, evidence on the market capitalisation of the Lusaka Stock Exchange.

Chapter Four argues that the setting up of a regional stock exchange in Southern and Eastern Africa, which co-exists with national stock exchanges, and the promotion of multiple listing and cross-border trading in securities would help to overcome constraints such as the liquidity problem on the Lusaka Stock Exchange. This view is advocated as a suitable solution in contrast to the idea of having tiny stock exchanges all over Africa.

Part III

Chapter Five examines the first piece of legislation to be enacted in Zambia on the regulation of public distribution of securities. The Stock Exchange Act 1970 is analysed and some of the constraints on the legal framework under that statute are highlighted. Indeed, Chapter Five spells out the main weaknesses of the 1970 and 1990 Stock Exchange Acts. In addition, Chapter Five shows why the Stock Exchange Act 1970 and the Stock Exchange Act 1990 were enacted and repealed, respectively, without a single stock exchange being set up in Zambia.

Chapter Six examines some of the constraints on the legal framework for public distribution of securities under the Securities Act 1993. The Securities Act 1993, which repealed and replaced the Stock Exchange Act 1990, introduced many innovations in Zambia's securities law. These new developments include statutory provisions on insider dealing and other forms of stock market abuses. All these features are addressed in Chapter Six.

Chapter Seven looks at the regulation of financial intermediaries and argues that this is an important means of promoting investor protection both in Zambia and on the proposed regional stock exchange. Fiduciary duties of financial intermediaries are examined and so is the extent to which small investors can participate on the market.

Part IV

Chapter Eight provides general concluding remarks. These remarks summarise the arguments made in the study and provide recommendations on the setting up of an effective securities regulatory framework that could help in the development of a competitive stock market.

1.2. AIM AND OBJECTIVES OF THE STUDY:

The aim and objectives of the thesis are to understand the reasons behind, and the shortcomings associated with, the setting up of the Lusaka Stock Exchange.[4] The thesis identifies a number of constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. Proposals are spelt out to address these constraints. The need to overcome the liquidity problem on the Lusaka Stock Exchange by moving towards a regional stock exchange and by promoting multiple listings and cross-border trade in securities is identified. To achieve this goal, we argue that a legal framework must provide for the establishment of a regional stock exchange and for the promotion of multiple listings. But how will the regional stock exchange be structured? The answer to this question raises a number of interdisciplinary issues. As Lee observes:

> "... the answer to the question of what is an exchange is complex. Not only does the question need to be interpreted in many ways, responses to each of these interpretations require intuitions and expertise from many different spheres of knowledge and experience, including those of business, economics, law, and regulation. Each of these different arenas has its own complexities and puzzles, and is constantly changing. Furthermore, there are many subtle ways in which these various fields interact with each other."[5]

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[4] More particularly, an examination of the efficacy of the legal framework for public distribution of securities on the Lusaka Stock Exchange.

[5] R. Lee, What Is An Exchange? The Automation, Management, and Regulation of Financial Markets, (Oxford: Oxford University Press, 1998), p. 3.

Therefore, to answer the question of how a regional stock exchange can be set up presupposes a further inquiry on issues being pursued in this thesis. It must be observed that the thesis is not about examining the intricacies of economic and finance theory on the structure of a stock exchange or how it functions administratively. Rather, this work looks at the legal and regulatory issues relating to the setting up of a regional stock exchange and how a legal framework for securities regulation could be structured. Once this view is appreciated, it becomes easier to grasp the context in which the thesis is developed. Indeed, studies on the financial economics of stock markets cover issues such as quantitative analyses on market efficiency of stock markets, capital asset pricing models, portfolio management and investment risk analysis, arbitrage techniques, and investment appraisal techniques. By contrast, a legal and regulatory perspective focusses less on such an approach. Rather, it is the efficacy of the legal framework and the policy objectives underpinning the legal rules that are discussed. Economic analyses are only referred to in an effort to explain the legal rules.

In Chapter Four of the thesis, we have explained in great detail how a regional investment code under the Common Market for Eastern and Southern Africa (COMESA) could provide for matters such as: (a) the establishment and structure of the regional stock exchange; (b) the co-ordination of securities regulation between the national stock exchanges and the regional stock exchanges; (c) listing rules on the regional stock exchange; (d) rules to govern cross-listings on the regional stock exchange and the national stock exchanges (*e.g.* rules on disclosure obligations); (e) the competent authority for authorising trade on the regional stock exchange; (f) dispute settlement and regulation of securities advertisements on the regional stock exchange; and (e) control of market abuses taking place either on the regional stock exchange or in cross-listings on the regional and the national stock exchanges. Indeed, these are some of the issues that concern a regulatory framework for public distribution of securities, in contrast to issues arising, say, in financial economics on how a stock exchange is structured internally or how trading bids are executed on the floor. That said, a question arises with regard to multiple listings: how would the legal framework under a COMESA common investment code provide for multiple listings and cross-border trade in securities?

Chapter Four of the thesis spells out that the legal framework that would be set up under the COMESA common investment code would, in the main, deal with cross-listings between the regional stock exchange and the national stock exchanges. The framework would also provide rules to govern certain forms of transactions between national stock exchanges. In particular, such rules would cover such matters as insider dealing across national boundaries. With regard to matters such as information disclosure in cross-listings on two national stock exchanges that would be left to the respective stock exchanges. It is hoped that with the process of harmonisation of listing rules by Eastern and Southern African countries now almost complete,[6] there will be comparability of listing rules between countries.

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[6] Electronic mail from Mr. Charles Mate, Chief Executive and General Manager of the Lusaka Stock Exchange, Lusaka, Zambia, 3rd June, 1999. Under the auspices of the African Stock Exchanges Association, a number of Eastern and Southern African countries have made great progress in harmonising their listing rules.

It is important, however, to point that the success of a market such as the regional stock exchange of Eastern and Southern Africa can only be judged on the basis of the aims and objectives of the exchange. Every market, depending on its aims and objectives, has its unique characteristics and the degree of success varies widely. For example, in the case of the London Stock Exchange, Lee observes:

> "The internal organisation of the London Stock Exchange (LSE) exemplifies the complexity of the formal governance structure typical of many exchanges. Its Memorandum of Association lays down thirty 'objects' for the company, the first eight of which are the most relevant for its activity as a stock exchange."[7]

In the case of the proposed regional stock exchange in Eastern and Southern Africa, the objectives and aim behind the setting up of this market will, to a larger extent, determine the basis upon which to measure the success of the market. As argued in Chapters Three and Four, some of the reasons behind the idea of a regional stock exchange and that of promoting multiple listings include the view that many national stock exchanges lack market-depth and are severely constrained by liquidity problems. The inadequacy of liquidity on a number of these markets has resulted mainly from heavy reliance on privatisations as a source of capital growth. Thus, the intended goals in advocating for the concept of a regional stock exchange and the idea of multiple listings is based on the need

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[7] See R. Lee, What Is An Exchange? The Automation, Management, and Regulation of Financial Markets, *op. cit*, p. 18.

for African countries to integrate their stock markets. The integration of the lion markets of Africa, as this thesis argues, is expected to yield better economies of scale, enhanced liquidity and market depth, and provide for improved efficiency. Indeed, the stronger the competition becomes, in securities trade in the region, the higher the likelihood of achieving higher levels of transparency and efficiency within the region. But, as we have argued above, to facilitate such region-wide efforts there is need to have in place an efficient and effective regulatory framework. It is against this background that this thesis attempts to provide a legal analysis of such region-wide efforts.

No attempt is made in this thesis to examine off-the-market transactions in Zambia other than to highlight some of the reasons why such transactions exist and how these transactions constrain the development of the Lusaka Stock Exchange. Generally, the analysis of the off-the-market transactions falls outside the scope of this study. In Zambia, off-the-market transactions could include the over-the-counter transactions that used to take place before the Lusaka Stock Exchange was set up. Also, these transactions could include a number of privatisation activities taking place off the Lusaka Stock Exchange.

Since the main arguments advanced in this work are grounded in the legal aspects of corporate finance and the term 'corporate finance' covers a broad range of topics,[8] it is acknowledged here that generally, corporate finance law divides into two main areas.[9]

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[8] See below.

[9] See for example, F.H.I. Oditah, "Capital Structure and Forms of Corporate Finance," BCL Corporate Finance Law Course Outline, (Oxford: University of Oxford, Hilary Term 1993), p. 1.

These areas are the regulation of capital markets and the two main forms of corporate finance; that is, debt financing and equity financing. In this work, the analysis of the legal aspects of public distribution of securities in Zambia relates to the regulation of capital markets.

1.3. AN OUTLINE OF CHAPTER ONE:

We have already provided a road-map of subsequent chapters in the thesis. Following below is a section on the general background to the legal regulation of public distribution of securities in Zambia. This discussion helps to set the law in its political and socio-economic context. As Nkrumah observes, law does not operate in a vacuum and its importance must be related to the overall importance of the people.[10]

The background analysis is followed by a section on the scope of the study. Thereafter, sources of the law are identified. The background analysis, together with the literature review that falls after the section on the sources of the law, provide a basis upon which we

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In identifying the difficulties associated with defining the term 'corporate finance law', T. Stocks, Corporate Finance: Law and Practice, (London: Longman, 1992), preface, observes: "The subject 'Corporate Finance' seems shrouded in mystery, a perception which is enhanced by difficulty in definition. Business does not stand still, it changes creating strain and tension within the prevailing legal and regulatory system. Such a dynamic environment produces this difficulty in definition. Problem solving involves a search for viable solutions where the only constraints are law and regulation and the ingenuity of businessmen and financial advisers. Articulation of these solutions removes the mystery and opens a fascinating topic to a wider audience."

[10] K. Nkrumah, Journal of African Law, Vol. 6, No. 2, (1962), p. 105.

formulate and state the problem under investigation. Thereafter, the thesis underlying our work is presented. The rationale supporting this thesis, together with the significance of the study and the research methods employed in the collection and analysis of data, are then spelt out.

1.4. BACKGROUND TO THE REGULATION OF CORPORATE FINANCE:

Economic development in Zambia can be addressed under three successive heads. Each head deals with a particular historical epoch. However, before we look at why and how the changes in national development strategies occurred, we will identify below the respective historical epochs relating to economic development in Zambia. These epochs will be addressed in their order of time.

Developments In The Post-Colonial Zambia:

After Zambia attained political independence on 24th October 1964, she adopted most of the economic polices, institutions and structures left behind by the colonial masters. This economic development strategy is referred to as the accommodation development strategy. It is called 'accommodation' because it accommodates the capitalist institutions and structures of the colonial masters.

A few years later, after abandoning the accommodation development strategy – that is, sometime between 1969 and the late 1970's - Zambia turned to the re-organisation development strategy. Under the re-organisation development strategy, the Zambian government embarked on a number of reformist policies to break away from colonial and capitalist systems of development. As we shall see below, most of these changes were superficial and cosmetic in nature, allowing the State to take over from major private investors as the main capitalist instead. The era of State capitalism in Zambia saw the nationalisation of many privately owned mines and business entities. Ten years later, Zambia decided to abandon the re-organisation strategy for another development strategy.[11] The adoption of this new development strategy was in essence a re-introduction of the accommodation development strategy. Although there are some minor differences between the accommodation development strategy adopted after Zambia attained political independence and the accommodation development strategy re-introduced in the early 1980's,[12] both development strategies are driven by the free-market forces ideology.[13] From the early 1980's, through to the year 2000,

[11] See M. Bratton, "Economic Crisis and Political Re-alignment in Zambia", in J. A. Widner (ed.), Economic Change and Political Liberalisation in Sub-Sahara, (London: John Hopkins University Press, 1994), pp. 101-12. See also below.

[12] These include the view that IMF and World Bank are major players in the international economy and thus dictate the pace and direction of economic development in many developing countries. In contrast to the re-introduction of the accommodation development strategy in the early 1980's, at independence and in the years that followed shortly thereafter, the Zambian government was not influenced by the IMF and World Bank economic reform proposals to introduce the accommodation development strategy. See generally M.C. Musambachime, "Privatisation of State-Owned Enterprises In Zambia: 1992-1996. A Model For Africa?" unpublished seminar paper (presented to the Department of History at the University of Namibia, Namibia on June 2, 1997); M.S. Khan, P. Montiel and N.U. Haque, Adjustment with Growth: Relating the Analytical Approaches of the World Bank and IMF, (The IBRD, Discussion Paper, Development Policy Issues Series, 1986); and B. Onimode (ed.), The IMF, The World Bank and African Debt: The Social and Political Impact, (Vol. 2) (London: Zed Books-IAA, 1989).

[13] The cold-war is over and most of the African allies of the former communist regimes in Eastern Europe have now turned to capitalism as the panacea for their economic problems.

Zambia has steadily embarked on the re-introduction of the accommodation development strategy.[14]

The changes in the national development strategies were accompanied by the enactment of various pieces of legislation, which codified most of Zambia's economic policies towards the attraction of international private capital. For example, the enactment of the Industrial Development Act 1977 reflected the entrenchment of state capitalism and the promotion of the re-organisation development strategy. The enactment of the Stock Exchange Act 1990 and the Investment Act 1991 (repealing and replacing the Investment Act 1986, which had succeeded the Industrial Development Act 1977) reflected some attempts to depart from the re-organisation development strategy. Finally, the enactment of the Securities Act 1993, to repeal and replace Stock Exchange Act 1990, and the enactment of the Privatisation Act 1992, plus the repeal of the Investment Act 1991 by the Investment Act 1993, reflected the policy of the Zambian government to re-introduce the accommodation development strategy in Zambia.

Economic Reforms And Zambia' s Development Strategy:

In 1968 and 1969, respectively, the Mulungushi and Matero economic reforms were introduced.[15] These reforms brought about major changes to Zambia's development

[14] See below.

[15] See generally K. Kaunda, Towards Economic Independence, ('Matero Declaration'), (Lusaka: ZIS, 1969); K. Kaunda, Zambia's Economic Revolution, ('Mulungushi Declaration'), (Lusaka: ZIS, 1968).

strategy.[16] Whereas the Mulungushi economic reforms dealt with issues of the Zambian government taking-over a number of privately owned manufacturing and commercial enterprises in Zambia, the Matero economic reforms dealt with aspects of the Zambian government taking-over the copper mining companies in the country.[17] Both these economic reforms introduced state capitalism to Zambia.[18] Indeed, state capitalism was introduced and entrenched through the implementation of the re-organisation development strategy.[19] As Rothchild and Curry observe on countries that adopt the re-organisation development strategy:

> "At the same time, they manifest a predilection for reformist policies that attempt to humanise and rationalise the existing domestic and international orders. As such they fall midway between the poles of accommodation and transformation, seeking the advantages of the former in the uninterrupted inflow of skill, capital, and enterprise from the Western world, and seeking the advantages of the latter in the achievement of self-fulfilling values on rapid Africanisation, pan-Africanism, and limited nationalisation of foreign industries."[20]

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[16] See B. Turok, "The Penalties of Zambia's Mixed Economy," in B. Turok (ed.), Development in Zambia: A Reader, (London: Zed, 1979), pp. 71-86; see also D. Rothchild and R.L. Curry, Jr., Scarcity, Choice and Public Policy, (London: University of California Press, 1978), p. 115.

[17] B. Turok, "The Penalties of Zambia's Mixed Economy," in B. Turok (ed.), Development in Zambia: A Reader, *supra*. (n. 16), pp. 71-86.

[18] B. Turok, "The Penalties of Zambia's Mixed Economy," in *supra*. (n. 16), pp. 71-86.

[19] D. Rothchild and L.R. Curry, Scarcity, Choice and Public Policy, *supra*., (n. 16), pp. 115-125, 131-142.

[20] See *Ibid*., pp. 115-125, 131-142.

They also point out that, by contrast, the transformation development strategy has a commitment to breaking the inherited pattern of structural dependency.[21] This commitment is directed at reconverting society to certain traditional ideas, values and life-styles.[22] Most of the countries which adopted the transformation development strategy in Africa followed a Marxist-Leninist communist ideology.[23] Today, with the collapse of communism in Eastern Europe,[24] there are very few 'socialist' states in Africa, Asia and Latin America that have not turned to capitalism as the guiding ideology in their national development. Mozambique, Angola and Guinea were some of the African countries that adopted the transformation development strategy.[25] By contrast, countries such as Kenya, Ghana, Tanzania and Zambia pursued the re-organisation development strategy shortly

[21] D. Rothchild and L.R. Curry, Scarcity, Choice and Public Policy, *supra*., (n. 16), pp. 115-125, 131-142.

[22] See *Ibid*., pp. 115-125, 131-142.

[23] For example, Mozambique, Angola and Guinea Bissau.

[24] The issue whether what was practised in most of the eastern European countries was communism or not is a debatable one. It is the author's view that what transpired in these countries was the implementation of Marxist theories based on subjective interpretations of the science of Marxism-Leninism. Marxism-Leninism, as a science, differs from theories of Marxism. For an elaborate discussion, see K.K. Mwenda, "Land Claims and Mineral Rights in Namaqualand: A Comparative Legal Study," Journal of Public Law, University of South Africa, (1994) Vol. 9, No. 1, p. 86.

[25] See generally D. Rothchild and L.R. Curry, Scarcity, Choice and Public Policy, *supra*., (n. 16).

after attaining political independence.[26] On the other hand, countries such as Malawi remained predominantly rooted to the accommodation development strategy.[27]

Changes In The Development Strategies:

While it is true that the newly born post-colonial Zambian state began with policies of retaining foreign private capital,[28] the state began to shift away from this policy objective as a strong nationalist culture emerged and the prices of copper on the world market fell.[29]

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[26] See generally D. Rothchild and L.R. Curry, *supra.*, (n. 16); see also R.H. Green, "A Guide To Acquisition And Initial Operation: Reflections From Tanzanian Experience 1967-74," in J. Faundez and S. Picciotto (eds), The Nationalisation Of Multinationals In Peripheral Economies, (London: Macmillan Press, 1978), pp. 17-70.

[27] See generally D. Rothchild and L.R. Curry, Scarcity, Choice and Public Policy, *supra.*, (n. 16).

[28] This is also evident from the fact that private interests in the mining companies in Zambia - companies which provided the Zambian government with a major source income prior to their privatisations (privatised between 1996-98) - were retained. Furthermore, laws relating to the financial and commercial sectors in Zambia were not reviewed, at least during the first six to seven years after Zambia attained political independence. Also, the decision by a number of white settlers to move to the then Southern Rhodesia (mainly as a result of not wanting to be governed by a government of predominantly black people) meant Zambia had to put in place policies that would continue to attract foreign investors to Zambia. At that time, Southern Rhodesia (now Zimbabwe) was still under white minority rule. For an elaborate read, see P. Meyns, "The Political Economy of Zambia," in K. Woldring, C. Chibaye, *et al,* Beyond Political Independence: Zambia's Development Predicament in the 1980's, (Amsterdam: Mouton Publishers, 1984), pp. 7-21. See also generally O. Saasa, Zambia's Policies Towards Foreign Investment, (Uppsala: Scandinavian Institute, 1987); and M. Bostock and C. Harvey, (eds.), Economic Independence and Zambian Copper, (New York: Praeger, 1972).

[29] B. Turok, "The Penalties of Zambia's Mixed Economy," in B. Turok (ed.), Development in Zambia: A Reader, *supra.*, (n. 16), pp. 71-86; Copper production and export was (and is) the

The state interventions under the Matero and Mulungushi economic reforms[30] slowly introduced State capitalism to Zambia.[31] At the political-economic level,[32] the Zambian government called these economic reforms the introduction of a 'mixed economy'. The term mixed economy entailed a rational mix of socialist and capitalist principles of socio-economic development.

Embracing the IMF/World Bank Structural Adjustment Programme As A Further Development In Zambia's Development Strategies:

The great challenge to Zambia's policy towards international private capital came in the late 1980's. While Zambia's foreign debt crisis was worsening,[33] the IMF and the World Bank, as major international financiers, were recommending that countries that were going

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principal source of income for the Zambia government. Zambia hosts a mono-culture economy which depends heavily on the copper mining industry. Other factors which led to poor performance of the Zambian economy include poor planning and policies resulting from lack of sufficiently skilled human resources on the part of the bureaucrats. Also, research shows that (see generally K.K. Mwenda, The Politics of Company Law in Zambia: A Critical Analysis of the Parastatal Sector, unpublished FCI thesis, Institute of Commerce of England, March 1992) most of the policies were not supported by feasibility studies and that the government take-overs led to political interventions in the economy *e.g.* political appointments to boards of directors in parastatal companies.

[30] See generally texts by K. Kaunda, *supra*, (n. 15), and explanation in *supra*. (n. 29).

[31] For definitions of the term political economy, see B. Putrin, Political Terms: A Short Guide, (Moscow: Novosti Press, 1982), p. 66; and C.K. Wilber, The Political Economy of Development and Underdevelopment, (New York: Random House, 1973), preface.

[32] See K. Kaunda, ('Mulungushi Reforms'), *supra*., (n. 15), pp. 1, 5, 6, 27.

[33] See generally M. Bratton, "Economic Crisis and Political Re-alignment in Zambia", in J. A. Widner (ed.), Economic Change and Political Liberalisation in Sub-Sahara, *supra*., (n. 11), pp. 101-128.

to receive financial assistance from them needed to adopt and implement the 'economic recovery' programmes tailored by these institutions (the IMF and the World Bank).[34] The recovery programmes commonly known as the structural adjustment programme and the stabilisation packages now almost fill libraries in large volumes of literature on the IMF and the World Bank programmes.[35] It is not, however, the purpose of this work to explore that literature. For our immediate purposes, suffice it to say that the IMF and the World Bank proposals mainly emphasise that governments of countries that get loans from the IMF and the World Bank must adopt, *inter alia*, a free-market economy approach in their economic restructuring programmes.[36] This proposal is seen by these financiers as the appropriate way for borrowing countries to raise capital to pay back their loans.[37] The salient features of a free-market economy, as proposed by the IMF and the World Bank, are that there must be minimal state participation in the national economy and that there must be minimal state expenditure on social welfare.[38]

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[34] See generally, M. Bratton, "Economic Crisis and Political Re-alignment in Zambia," in supra., (n. 11), pp. 101-128. See also generally M.S. Khan, P. Montiel and N.U. Haque, Adjustment with Growth: Relating the Analytical Approaches of the World Bank and IMF, (The IBRD, Discussion Paper, Development Policy Issues Series, 1986); B. Onimode (ed.), The IMF, The World Bank and African Debt: The Social and Political Impact, (Vol. 2) (London: Zed Books-IAA, 1989).

[35] See for example texts cited in supra. (n. 34).

[36] See generally M.S. Khan, P. Montiel and N.U. Haque, Adjustment with Growth: Relating the Analytical Approaches of the World Bank and IMF, supra., (n. 34); and B. Onimode (ed.), The IMF, The World Bank and African Debt: The Social and Political Impact, supra., (n. 34).

[37] See generally texts cited in supra. (n. 36).

[38] See B. Onimode (ed.), The IMF, The World Bank and African Debt: The Social and Political Impact, supra., (n. 34), pp. 45-75; see also generally A.M. Mwanza and N. Mwamba, The

In Zambia, the postulates of the IMF and the World Bank relate mainly to the country's re-introduction of the accommodation development strategy. Indeed, the decision by the Zambian government to implement wholly the structural adjustment programme re-introduced the accommodation development strategy. Among other things, the structural adjustment programme pre-supposes that foreign investment is the main prerequisite to economic development. This view serves only to rationalise the proposition that Zambia's policies and legislation on the attraction of international private capital are biased towards the IMF and World Bank structural adjustment programmes. We shall see, for example, in Chapter Six how the World Bank provided technical and financial support in the drafting of the Securities Act 1993 of Zambia.

It is clear that the Zambian government has embarked on an ambitious programme to privatise state controlled companies and to divest the state of its shareholding in these companies.[39] In pursuance of its privatisation objectives, the Zambian government has now set up the Lusaka Stock Exchange. Among other things, this study argues that the Lusaka Stock Exchange was set up primarily to facilitate the privatisation of state owned

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Structural Adjustment Programme in Zambia: Lessons from Experience, (Harare: SAPES Books, 1992).

[39] The Technical Committee on Privatisation in Zambia, Privatisation Programme in Zambia: Strategy and Design, (Lusaka: Ministry of Commerce, 1992), p. 4; *Interview* with D. Herman, Adviser on Publicity and Marketing, Zambia Privatisation Agency, Lusaka, 9th September, 1993.

enterprises in Zambia with the expectation that privatisations will be an incentive to attract foreign investors.[40]

1.5. SCOPE OF THE STUDY AND SOURCES OF THE LAW:

We have already pointed out that this work looks at the regulation of public distribution of securities on the Lusaka Stock Exchange.[41] Thus, other forms of corporate finance such as banking and insurance fall outside the scope of this study.

Given the scope of the study, the main sources of the law include the Companies Act 1921 of Zambia, the Companies Act 1994 of Zambia, the Stock Exchange Act 1970 of Zambia, the Stock Exchange Act 1990 of Zambia, the Securities Act 1993 of Zambia, the Privatisation Act 1992 of Zambia, subsidiary legislation pursuant to the aforesaid pieces of legislation, the common law and some aspects of public and private international law.

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[40] See Investment Guidelines, (Lusaka: Ministry of Commerce, 1993), pp. 2-10.

[41] Although some aspects of mergers and acquisitions may take place on the Lusaka Stock Exchange and that such transactions, like aspects of privatisation, represent a form of public distribution of securities, this study is confined to a much narrower and clearly defined thesis. In this study, no attempt is made to look at mergers and acquisitions. Under the Zambian legal system, mergers and acquisitions are governed by the Code on Mergers and Acquisitions. This code is, indeed, not linked to the thesis in this study. I have examined elsewhere, in a forthcoming monograph, the salient features of the law on mergers and acquisitions in Zambia; see generally K.K. Mwenda, Corporate Finance Law In Emerging Markets: Zambia's Stock Exchange And Privatisation Programme, (forthcoming).

1.6. LITERATURE REVIEW:

This section reviews some of the important literature that has a bearing on the regulation of public distribution of securities in Zambia. The section focuses on two major areas. These areas relate to the literature on the Lusaka Stock Exchange and the privatisation programme in Zambia.

Saasa (1987), reporting on the history of economic development in Zambia, confines his analysis to foreign direct investment and to the Mulungushi and Matero economic reforms. But subsequent developments in the area of foreign investment law and policy in Zambia now include issues relating to the legal aspects of public distribution of securities on the Lusaka Stock Exchange and under the privatisation programme.[42] It is such issues that this work proposes to examine.

In an unpublished dissertation, Mungule (1995) examines the likely impact of the Zambian privatisation programme on the national economy. Musambachime's (1997) unpublished paper, on the other hand, provides a detailed literature review of various aspects of the privatisation programme. Mwanza *et al* (1992) offer an insightful study into the effects of the structural adjustment programme on the Zambian economy. This study documents various experiences of the Zambian people and the Zambian government under the structural adjustment programme. Chief among these experiences are unemployment,

[42] See also the Securities Act 1993 and the Privatisation Act 1992.

wage freeze, reduced state expenditure on social welfare and removal of subsidies on essential commodities such as mealie meal.[43]

Writing on the copper mines in Zambia, Ndulo (1987) provides a detailed study of the history of direct investment in Zambia. He deals mainly with the history of mining rights in Zambia. Ssempebwa (1977) offers an examination of the Industrial Development Act 1977 in the socio-economic context of underdevelopment. Ssempebwa observes that underdevelopment is responsible for the problems that the Act is intended to remedy. As Vernon (1972) points out, the pattern of foreign investment in underdeveloped countries has been largely shaped by the technological achievements in the advanced countries.

Apart from the works reviewed above, there are other reports on foreign investment in Zambia. While Mabula (1981) observes that fiscal incentives in the Industrial Development Act 1977 are, on their own, not sufficient tools to attract foreign direct investment to Zambia, Ailola (1983) provides an exploratory examination of the laws and practices relating to foreign direct investment in Zambia. Watae (1989) observes, however, that there is a need to set up an effective legal framework to govern foreign trade and

[43] For an elaborate view, see generally J. Clark and C. Allison, Zambia: Debt and Poverty, (Oxford: Oxfam, 1989). In Zambia, mealie meal is used to make Nsima, which is the staple food for the Zambian people. In the past, the Zambian government used to subsidies the prices of commodities such as essential foodstuffs. Subsidies on consumer goods did not reduce the production costs on the part of the producers and thus were not an incentive to the producers. Today, the implementation of the structural adjustment programme has led to the removal of subsidies on a number of products and services in the economy.

development in Zambia. Other works relating to corporate finance law in Zambia include a short study by Mwenda W. (1990) on the efficacy of the Investment Act 1986.

Taking a slightly different approach from the studies undertaken by other researchers, Kamwanga (1985) identifies the various legal issues involved in negotiating investment contracts between developing countries and foreign investors. The work looks at Zambia as a case study. Kamwanga observes that the main problem affecting negotiation of foreign investment contracts relates to the substance and degree of supervision of investment contracts. Like other works reviewed here, Kamwanga's study confines to foreign direct investment in Zambia.

I have examined elsewhere, the salient features of the law relating to securities trading in Zambia.[44] In that study, I have provided a critical analysis of the legal rules governing trade on Zambia's stock exchange and under the privatisation programme. In the present work, the privatisation bit has been abandoned and the part on the stock exchange has been re-written to include a number of materials on the prospects of setting up a regional stock exchange and introducing multiple listings and cross-border trade in securities. I have also introduced empirical evidence on a number of constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. This evidence forms the bases upon which recommendations for the setting of a regional stock exchange and the promotion multiple listings and cross-border trade in securities are made. In contrast

[44] See generally K.K. Mwenda, Investment Law In Zambia: The Stock Exchange And Privatisation, (Oxford: University of Oxford, unpublished postgraduate BCL thesis, 1994).

to my Oxford BCL thesis, this doctoral work further develops a fuller, original and richer contribution to the study of corporate finance law in Zambia.[45]

The Context In Which The Thesis Is Developed:

As in many other African countries, in Zambia there have been several political and economic developments that have impacted on corporate and securities laws. A number of these developments are addressed in the present work. To illustrate, given that regional integration has become a popular phenomenon in most parts of the world today,[46] how does the law, say, on public distribution of securities respond to such matters? Regional integration in Eastern Africa and Southern may have the technical means to provide Zambia and her neighbouring countries with a solution to the liquidity constraints faced by a number of stock markets in these countries. The setting up a legal framework for regulating public distribution of securities in Eastern and Southern Africa is one way of promoting the development of competitive capital markets in the region. The adoption and implementation of this proposal would help to overcome a number of constraints faced by

[45] As stated on the 'Declaration Page' of this thesis, this doctoral work contains five chapters which are not found in the Oxford BCL thesis (that is, Chapters One, Two, Three, Four and Eight of this doctoral thesis). In addition, the chapters that also appear in the Oxford BCL thesis (now appearing as Chapters Five, Six and Seven of this doctoral thesis) have been substantially revised and enlarged to cover recent developments in the law. New theories on public distribution of securities in emerging stock markets are also covered.

[46] This is seen in the setting up of institutions such as the Economic Commission for Africa, the North America Free Trade Area, the Southern Africa Development Community, the Common Market for Eastern and Southern Africa, the East African Economic Community, the European Union and many more.

stock markets in Africa. Indeed, inadequate liquidity has been a major constraint on the development of markets such as the Lusaka Stock Exchange.

1.7. STATEMENT OF THE PROBLEM AND THE UNDERLYING THESIS OF THE STUDY:

Based on the historical background to the development of the legal framework, and in the light of what has been presented above, the problem under investigation can now be stated as follows:

> *Has the legal framework for public distribution of securities in Zambia provided adequate incentives to lead to the development of a competitive stock exchange in Zambia?*

In addressing this problem, we adopt a contextual approach to the study of law. This approach explains why, for example, in Chapter Three we introduce empirical evidence to identify and analyse some of the important constraints affecting the efficacy of the regulatory framework for public distribution of securities in Zambia. Indeed, if the answer to the statement of the problem is that the legal framework, among other factors, has had some influence on the development of a competitive stock exchange in Zambia, then the underlying thesis for the study can be stated as follows:

Faced with various constraints, the legal framework for public distribution of securities in Zambia, among other factors, has had limited success in facilitating the development of a competitive stock exchange in Zambia.

The underdeveloped state of the Lusaka Stock Exchange is here tied to the issue of constraints on the legal framework.

1.8. SOME REASONS SUPPORTING THE THESIS:

There are various reasons that explain the rationale behind the above thesis. In the history of the Zambian legal system, the political economy has been a major factor influencing the development of corporate and securities laws.[47] In certain instances, as was shown in the case of the Stock Exchange Act 1970, the Stock Exchange Act 1990 and the Securities Act 1993, there has been hasty enactment of legislation to codify policies promulgated by the international capitalists (*i.e.* the IMF, the World Bank, and the donor agencies).[48] The influence of the international political economy in the development of Zambia's securities and corporate legislation has been a serious constraint in as far as 28addressing the socio-economic and political realities of the Zambian context is concerned. Foreign economic models have been adopted in these laws. The so-called 'enabling' legislation is now being

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[47] This has already been established above.

[48] See for example, R. Penza, Minister of Commerce, Daily Parliamentary Debates, 18th June 1992, p.114, debating the Privatisation Bill 1992, where he argues that since the Zambian Government has agreed to the terms of the structural adjustment programme, the Government must ensure that it does everything possible to fulfil conditions laid down by the IMF and the World Bank.

sought to implement various economic models. As a result, very limited regard is given to the adaptability and suitability of these institutional arrangements to the local conditions. In many cases, this has presented itself as a constraint on the development of efficient legal rules.[49]

1.9. SIGNIFICANCE OF THE STUDY AND LIMITATIONS TO THE STUDY:

Significance of the study:

The significance of this study rests on a number of factors. First, the study points out some of the important constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. These constraints, as established above, limit the contribution of the legal framework to the development of a competitive stock exchange in Zambia. Secondly, the study spells out important recommendations to overcome the constraints.

Thirdly, the study provides a conceptual and theoretical framework through which the problem under investigation is analysed. The study relates theory to practice in the regulation of public distribution of securities in Zambia by showing how evidence from the field work links the various constraints on the legal framework to the inability of the framework to contribute effectively to the development of a competitive stock exchange in Zambia. Finally, only when our recommendations are weighed against constraints on the

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[49] See E.F. Ssempebwa, "Law in the Context of Underdevelopment: A Comment on the Industrial Development Act 1977," Zambia Law Journal, (1975-1977), Vol. 7-9, p. 85.

legal framework can policy-makers and legislators begin to appreciate the practicality of a number of proposals in this work.[50]

1.10. COLLECTION AND ANALYSIS OF DATA:

This section outlines the main features of how empirical data for this work was collected and analysed. Although both primary and secondary sources of data were utilised, this section mainly concentrates on collection and analysis of empirical data.

When collecting empirical data we used interviews as one of the research tools. Both structured and unstructured questions were used. All interviews were recorded and the recordings were later transcribed. The results from the interviews were then analysed manually, together with other findings from the research questionnaires. A restricted number of interviewees were selected from a pool of respondents that responded to questionnaires. All interviewees, except the few that are outlined below, were selected randomly. The use of a random sampling method was adopted to minimise subjectivity in the selection of interviewees. Although a partial random sampling method was adopted, more than 80 per cent of the respondents were selected randomly. The more than 80 per cent figure here contrasts with a minority figure of less than *20 per cent* respondents who

[50] However, in undertaking this project a number of limitations were experienced. Some limitations arose by design and could thus be controlled while others could not be controlled. On the one hand, limitations which could be controlled included having a reasonably well focused scope of the study and confining our arguments to the main thesis. On the other hand, other limitations related to financial constraints in undertaking the fieldwork and lack of co-operation from some sources contacted for the data (the latter factor limited the range of empirical investigation).

were *not* picked randomly. This partial random sampling does *not* in any significant way present 'serious' threats to the scientific validity of the research methodology. Indeed, persons that were not drawn from a random sample, and who constituted the less than 20 per cent sample, are chief executives of institutions that are part of the subjects of this study. These institutions play an important role in the financial sector of the Zambian economy. As such, the research methodology was designed to have the chief executives chosen without use of a random sampling method, in case such a method ended up omitting names of the executives.

The 20 per cent that were selected without use of a random sampling method consisted of the following:

- the chief executive of the Lusaka Stock Exchange;
- the chief executive of the Zambia Privatisation Agency;
- the chief executive of the Securities and Exchange Commission; and
- the chief executive of the Common Market for Eastern and Southern Africa.

The chief executive of the Lusaka Stock Exchange and the chief executive of the Securities and Exchange Commission were reached and they provided helpful responses to our research questionnaires and interview questions. On the other hand, although the chief executive of the Zambia Privatisation Agency could not be reached because the Zambia Privatisation Agency declined to provide any interviews due to government policy on the matter, the Zambia Privatisation Agency provided a lot of useful information contained in their reports and publications. In the case of the Common Market for Eastern and Southern Africa, the chief executive could not be reached as he was out of the country. However, the Director of Legal Services and one of the senior consultants provided a lot of useful information.

Other respondents to the research questionnaires included top market players on the Lusaka Stock Exchange, financial institutions (*e.g.* banks, insurance companies and pension funds) and financial intermediaries. This study also benefited from the theory and practice documented on public distribution of securities on developed stock markets such as the International Stock Exchange.

Generally, the limitation on the number of interviewees that were selected and interviewed was necessitated by factors such as time constraints and limited financial resources. Also, since the research was primarily based on corporate law, which is mainly legislation and case law driven, there was no need to adopt a highly technical and sociological approach in the interviewing techniques.

CHAPTER TWO

EMERGING STOCK MARKETS AND A CASE FOR THEIR ATTRACTIVENESS

This chapter provides an overview of important theories relating to public distribution of securities on emerging markets such as the Lusaka Stock Exchange. A number of new theories have been written on emerging capital markets. Such theories help to explain some of the constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. The influence of these constraints provides further indications why the legal framework, among other factors, has had limited success in facilitating the development of a competitive stock exchange in Zambia.

It is argued in this chapter that whereas the attractiveness of emerging markets includes views such as emerging markets represent a fast growing part of the world economy, emerging markets have delivered superior returns, emerging markets provide further diversification of global portfolios, emerging markets are attractively valued, emerging markets represent huge marketplaces, and emerging markets are underweighted in global portfolios, the problems associated with emerging markets include the views that these markets experience constraints such as inadequate liquidity, restrictive regulations on banking systems, restrictive regulations on investment of pension assets and heavy reliance on privatisations as a source of capital growth. In general, however, the advantages of investing in emerging markets, when contrasted with the disadvantages of investing in these markets, show that there is a good case for investing in emerging markets. As Porter observes:

> "Over the past few years, investor interest in the world's emerging markets has expanded significantly. This interest has been fuelled by the relatively high returns recorded by emerging markets and by their perceived potential for large returns in the future."[1]

Barry and Lockwood also note:

> "Emerging capital markets (EMs) recently have attracted the attention of global investors and scholars alike. The markets are characterised by high average returns, high volatility, and excellent diversification prospects in combination with portfolios from developed markets."[2]

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[1] M.T. Porter, "Closed-end Emerging Country Funds Review," in K.H. Park and W. Van Agtmael, (eds), The World's Emerging Stock Markets, (Chicago: Probus Publishers, 1993), p. 459.

[2] See C.B. Barry and L.T. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995), p. 15.

2.1. A DEFINITION OF EMERGING CAPITAL MARKETS (EMs):

Generally, there is no universally accepted definition of emerging capital market.[3] In this work, the term 'emerging capital market' is used loosely to mean the same thing as 'emerging stock market'. We are mindful, however, of the fact that the term 'capital' could involve various combinations of debt and equity securities. Also, 'capital' could be constituted by equity securities only or by debt securities only. The same would be true if we were to examine the meaning of the term 'stock' as it applies in the context of the title 'emerging stock markets'.[4] The broadness and similarities in what constitutes stock and capital explain why we use such terms as 'emerging capital market' and 'emerging stock market' interchangeably. In the strict legal sense, however, the two terms are somewhat different. In practice, they are hardly distinguishable. Although there are other forms of capital markets, which by contrast are not stock markets, these markets fall outside the ambit of this work and they include institutions such as merchant banks. In this work, the type of capital markets that we are concerned with are emerging stock markets. In particular, we are concerned with Zambia's Lusaka Stock Exchange and prospects of setting up a regional stock exchange in Eastern and Southern Africa.

The International Finance Corporation (IFC) defines an emerging market as one which is found in a developing country.[5] By contrast, investors tend to focus their attention and

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[3] See *Ibid*., p. 16.

[4] See Chapter Six, *infra*.

[5] See generally, International Finance Corporation, Emerging Markets Factbook, (Washington: International Finance Corporation, 1994). See also C.B. Barry and L.T. Lockwood "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, *supra*., (n. 2) p. 16.

investments on a more narrow definition than that emphasised by the International Finance Corporation.[6] Investors generally focus their attention and investments on a definition that emphasises those developing countries in which capital markets are advancing in size, activity, or sophistication.[7] Interestingly, however, on the definition provided by the International Finance Corporation, Barry and Lockwood observe:

> "It follows the World Bank's guideline that a developing country is one with low-to-middle income, which in 1992 meant a per capita GNP (Gross National Product) of less than US $8,356. The IFC maintains a database including security prices on 26 markets out of the 169 countries that qualified as low-to-middle income in 1992."[8]

The Economist newspaper, by contrast, usually lists the following twenty-five countries as countries where emerging markets are located:[9]

1. China
2. Hong Kong
3. India

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[6] See C.B. Barry and L.T. Lockwood, *supra.*, (n. 2) p. 16.

[7] See *Ibid.*, p. 16

[8] See *Ibid.*, p. 16. For authoritative sources from the IFC, see The World Bank Group, Resource Guide For Businesses, (The World Bank: Washington DC, 1998), p. 22; and, see generally, IFC, Emerging Stock Markets Review: Performance, Valuations, and Constituents Of IFC Daily Index Markets, (Washington DC: International Finance Corporation, August 1998).

[9] See the section on Emerging-Market Indicators in the weekly issues of the Economist newspaper. The list shown above was extracted from issues of the Economist from 20th April 1996 to 30th January 1998.

4. Indonesia

5. Malaysia

6. Philippines

7. Singapore

8. South Korea

9. Taiwan

10. Thailand

11. Argentina

12. Brazil

13. Chile

14. Colombia

15. Mexico

16. Venezuela

17. Greece

18. Israel

19. Portugal

20. South Africa

21. Turkey

22. Czech Republic

23. Hungary

24. Poland

25. Russia

The criteria used by the Economist newspaper to arrive at the above list is somewhat not clear. The above list includes only one African country, South Africa. Other markets in Africa are not included on the Economist newspaper list. A good number of the stock markets listed as emerging markets by the Economist newspaper are located in the poorer parts of continental Europe, such as Greece and Eastern Europe, while others are located in the Far East and in Latin and South America.

Although it could be argued that the Economist newspaper does not regard Zambia, and many other African countries, as having markets at all, that view alone does not preclude us from analysing justifications, if any, behind the criteria used by the Economist newspaper. Indeed, as pointed out above, there is hardly any evidence to suggest the basis upon which the Economist newspaper determines what constitutes an emerging stock market. Such a feature cannot be over-looked as it sheds some light on how a number of theories on emerging markets are conceived. Generally, there is an overlap between markets identified by some as 'emerging' and those identified by others as 'developed'. A good example here is the classification by the International Finance Corporation and that by the Economist newspaper as 'emerging' the markets of Taiwan, Korea, Mexico, South Africa, Malaysia and Thailand, all of which had year-end 1993 market capitalisations in excess of US $100 billion.[10] By contrast, the International Finance Corporation classifies as 'developed' nine mostly European markets with capitalisations less than US $100 billion.[11] At the time that the International Finance

[10] See C.B. Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, *supra*., (n. 2), p. 16.

[11] See *Ibid*., p. 16

Corporation was compiling data on emerging markets and developed markets, Italy, one of the G-7 nations, had a smaller market capitalisation than five emerging markets.[12]

Clearly, there is need to have a well defined criteria on which the classification of emerging stock markets is based. If such a criteria were to be spelt out, perhaps, a number of African stock markets would qualify as emerging markets. The evidence presented above on Italy shows that in reality some emerging markets can be significant in size. However, given the volatility of business on these markets, it is difficult to say with precision which is or is not an emerging market. As a result of lack of clarity in the definition of emerging markets, we will take a departure from the restrictive lists provided by the Economist newspaper and the International Finance Corporation (IFC). Instead, we will argue that the term 'emerging market' covers mainly stock markets in developing countries which have not yet developed to the same levels of sophistication and market capitalisation as stock markets in a number of developed countries.

[12] See *Ibid.*, p. 16. See also generally, International Finance Corporation, Emerging Markets Factbook,

2.2. THE EMERGING LION MARKETS OF AFRICA:[13]

"The old collectivism, nationalisation and aid from Comecon (the association of Soviet-oriented nations) that most African states dashed for after independence in the Sixties has been shelved since the late Eighties in favour of privatisation and markets.

A whole new batch of emerging markets has been launched in recent years on a continent that until now has only been represented by South Africa (which is often classed among 'European emerging markets')."[14]

In most of the literature on emerging markets, the lion markets of Africa are rarely listed alongside the tiger markets of the Far East or the puma markets of Latin and South America.[15] There does not seem to be any plausible explanation to justify the exclusion of some of Africa's stock markets from the category of emerging markets in the world. As one commentator observes:

"But the lion markets of Africa are now developing in such a way that investors interested in emerging markets can no longer ignore them.

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supra., (n. 5).

[13] Whereas the term 'lion markets' refers to stock markets of Africa, the term 'tiger markets' refers to stock markets of the Far East. 'Puma markets', on the other hand, are stock markets located in Latin and South America. The use of 'animal' metaphors here, as is characteristic in a number of works on emerging markets, illustrates the importance of each of the animals mentioned above to the wildlife of the regions to which these animals belong. The lion is associated by many writers with the jungle in Africa and the puma with the forest of Latin and South America whilst the tiger is seen as an animal that is mainly found in Asia and other parts of the Far East.

[14] Evening Standard Newspaper (UK), Thursday 11 July 1996, p. 35.

While South Africa remains bigger by far than all the rest put together, there are already 16 emerging markets in Africa and more on the way."[16]

Indeed, by July 1996 Senegal, Uganda and Tanzania had already signalled that they were planning to launch stock markets by the end of 1996.[17] Following below is figure 2.2.1, illustrating the growth in the number of stock markets in Africa and the growth in the business on these markets. Below figure 2.2.1 is figure 2.2.2 showing the top twenty players on the lion markets of Africa.[18]

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[15] For a similar view, see Evening Standard Newspaper (UK), *supra*., (n. 14), p.35.

[16] See *Ibid*., p. 35.

[17] See *Ibid*., p. 35.

[18] The information presented here is valid as at Thursday 11th July 1996. See Evening Standard Newspaper (UK), *supra*., (n. 14), p.35.

Country	Quoted Companies	Market Value
Botswana	12	£260m
Egypt	718	£4.3bn
Ghana	18	£1.3bn
Ivory Coast	31	£562m
Kenya	56	£1.2bn
Malawi*	-	-
Mauritius	39	£1.2bn
Morocco	44	£4bn
Namibia**	21	£8.4bn
Nigeria	182	£1bn
South Africa	646	£165bn
Sudan	34	£30m
Swaziland	4	£220m
Tunisia	21	£2.6bn
Zambia	8	£300m
Zimbabwe	65	£1.4bn
*Just starting. **Local quotes include Standard Bank of South Africa.		

Fig. 2.2.1. Lion Markets of Africa: Their Capitalisations and Quoted Companies.

Source: Nedcor Securities, *The Stock Markets of Africa*, (London: Nedcor Securities, 1996), quoted in Evening Standard Newspaper (UK), Thursday, 11th July 1996 p. 35.

Company	Country	Business	Market Value
Ashanti Goldfields	Ghana	Mining	£1.1bn
Delta Corporation	Zimbabwe	Drinks	£280m
Barclays Kenya	Kenya	Banking	£190m
Zambia Sugar	Zambia	Sugar	£130m
ZCCM	Zambia	Mining	£125m
Bindura Nickel	Zimbabwe	Mining	£115m
Brooke Bond Kenya	Kenya	Food	£110m
Standard Chartered	Kenya	Banking	£100m
BAT Kenya	Kenya	Cigarettes	£90m
Kenya Commercial Bank	Kenya	Banking	£85m
Barclays Zimbabwe	Zimbabwe	Banking	£85m
Zimbabwe Sun	Zimbabwe,	Restaurants, Hotels	£82m
Hippo Valley	Zimbabwe	Food	£82m
Bamburi Portland	Kenya	Building Materials	£70m
Biohom Ivory Coast	Ivory Coast	Food	£70m
Sechaba	Botswana	Beer	£65m
Nigerian Breweries	Nigeria	Beer	£65m
Nestle-CI	Ivory Coast	Machinery	£60m
Total Kenya	Kenya	Oil	£60m
Firestone (EA)	Kenya	Tyres, rubber goods	£58m

Fig. 2.2.2 Twenty Top Players On The Lion Markets.

Source: Nedcor Securities, *The Stock Markets of Africa*, (London: Nedcor Securities, 1996), quoted in Evening Standard Newspaper (UK), Thursday, 11th July 1996 p. 35.

Threats Of Monopolistic Tendencies On The Lion Markets Of Africa As A Constraint On The Development Of Emerging Markets:

It is now feared that many local companies on Africa's lion markets will not be able to compete favourably with such giant conglomerates as the South African Anglo-American Corporation Ltd and De Beers Ltd.[19] Compared with the market values of each of the top

[19] *Ibid*., p. 35.

players on the lion markets of Africa, the market value of Anglo-American Corporation (alone), by 1996, was tagged at UK£9 billion and that of De Beers at UK£7 billion.[20]

In Zambia, there are strong indications that Anglo-American Corporation Ltd., which previously owned most of the shares in the copper mining companies prior to the government take-overs,[21] is likely to buy most of the shares in ZCCM Ltd (Zambia Consolidated Copper Mines Ltd. is now being privatised).[22] Shares in ZCCM Ltd are cross-listed on the Lusaka Stock Exchange, the International Stock Exchange in London and the Paris Bourse.[23] Also, shares in ZCCM Ltd are traded on the secondary market in the United States in the form of American Depository Receipts.[24]

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[20] See Nedcor Securities, The Stock Markets of Africa, (London: Nedcor Securities, 1996), p.4; Financial Times, FT500, Thursday January 1996; Evening Standard Newspaper (UK), Thursday 11 July 1996, p. 35.

[21] On economic reforms in Zambia that led to the Government take-overs in the copper mining industry, see Chapter One, *supra*.

[22] *Letter* from the Lusaka Stock Exchange Chief Executive, Mr. C. Mate, to this author sent via electronic mail and dated 26 September 1996. See also Lusaka Stock Exchange, Understanding the Stock Market, (Lusaka: Lusaka Stock Exchange, 1996), p. 1. Although ZCCM Ltd was not privatised at the time when information in the above table was prepared, as a public company, it had some of its shares traded on various stock exchanges in the world; see below. This explains, for example, why ZCCM Ltd appears among the top 20 players on Africa's lion markets.

[23] See explanation in *supra*., (n. 22). See also C. Mate, Chief Executive of Lusaka Stock Exchange, "How To Promote Development of Zambian Stock Market," in Financial Mail of Zambia 9th April 1996 p.1, an article responding to this author's article that appeared in Financial Mail of Zambia, 2nd April 1996.

[24] See *letter* from the Lusaka Stock Exchange Chief Executive, Mr. C. Mate, to this author sent via electronic mail and dated 26 September 1996.

Generally, the lion markets of Africa appear set for faster growth now that privatisation of state owned enterprises in a number of African countries is underway. Indeed, price-earnings multiples[25] have fallen from three figures to single figures since proper stock exchanges where launched in countries such as Zambia, Zimbabwe, Egypt and Nigeria.[26] This provides opportunities for foreign investors to invest in Africa.

Possible Modes Of Penetrating Africa's Lion Markets:

Foreign investors can penetrate the lion markets of Africa through a number of strategies. As one commentator observes:

> "... there are three ways for British investors to get into Africa outside South Africa.
>
> They can buy a British company focused there such as Lonrho, which is currently planning a three-way split to float off its Lonrho Africa trading, sugar and newspaper arms.
>
> They can invest through well-established funds like Barings Simba Fund, GT Africa Fund or Trans Zambezi Investments, which are all pledged to limit South African shares to a minority of their holdings.

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[25] Price-earnings multiples, like price earnings ratio, is a part of the everyday vocabulary of investors in the stock market. Unfortunately, some financial analysts are confused about what price-earnings ratio and multiples really signify. High price earnings ratio and low multiples often show that investors think that the company has good growth opportunities, that its earnings are relatively safe and deserve a low capitalisation rate, or both. However, companies can have high price-earnings ratios (and low multiples) not because price is high but because earnings are low. A company which earns nothing ('earnings per share' are often called EPS; thus EPS=0, here) in a particular period will have an infinite price earnings ratio as long as its shares retain any value at all. For a detailed reading, see R.A. Brealey and S.C. Myers, Principles of Corporate Finance, (New York: Mcgraw-Hill, 1991), pp. 60-62.

[26] See Evening Standard Newspaper (UK), Thursday 11 July 1996, p. 35.

> Or they can buy shares direct through London or local brokers such as Nedcor."[27]

2.3. NEW CHALLENGES TO THE EMERGING MARKETS DEBATE:

Given that there is no universally accepted definition of emerging markets, these markets vary widely in their structure, performance, prospects and principal features. In 1984, Gupta undertook a study on the role that the structure of financial markets plays in a number of developing countries.[28] His findings indicated that financial markets have sometimes encouraged development and at other times have resulted from development. A similar study was undertaken by Barry in 1986 on Hong Kong, Korea, Singapore and Taiwan and it revealed the same findings.[29] In trying to appreciate all these studies, we must bear in mind some of the constraints affecting the efficacy of the legal framework(s) for public distribution of securities in emerging markets.

Poor Financial Reporting And Limited Access To Information As A Constraint:

Barry and Lockwood observe:

> "In many developing nations, security markets are either lacking entirely or are poorly developed. Further, financial reporting may be unreliable and access to company information highly limited. In such nations, banks and other financial intermediaries take on especially

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[27] See *Ibid.*, p. 35

[28] See generally K.L. Gupta, Finance and Economic Growth in Developing Nations, (London: Groom Helm, 1984).

[29] See generally C.B. Barry, "Financial Institutions and Markets and the Economic Development of Four Asian Countries," in Recent Developments in Capital Markets in Turkey: Proceedings of the OECD - CMB Conference, (Istanbul: Capital Market Board, 1986).

important roles. In order to secure investment capital from banks, firms often must concede a strong role for the lenders, such as presence on the Board of Directors and access to inside information. In a market in which asymmetric information is especially problematic, the market can break down altogether without some way in which providers of capital can gain access to information and a degree of control."[30]

The unique environment in which emerging markets find themselves necessitates the adoption of a novel approach to the study of capital structuring (by companies) in emerging markets. Indeed, restrictions on investment behaviour such as those described above can adversely affect the market value of a company[31] while at the same time placing a limit on possible streams of debt financing available to companies. Such market imperfections can influence the choice between debt financing and equity financing on an emerging market.

Inadequate Liquidity As A Constraint On The Development Of Emerging Markets:

Another illustration of market imperfections in emerging stock markets is that these markets (*e.g.* the Lusaka Stock Exchange) are relatively illiquid[32] and are heavily regulated.[33] How does a company raise its finance on such a market? Under the 'traditional' view of capital

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[30] See C.B Barry and L.J Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995), [*supra*., (n. 2)], p. 17.

[31] See J.C. van Horne, Fundamentals Of Financial Management, (London: Prentice-Hall, 1983), p. 436.

[32] This issue is addressed in detail in Chapter Three.

[33] See A. Demirguc-Kunt and V. Maksimovic, Capital Structures in Developing Countries: Evidence from Ten Countries, Policy Research Working Paper 1320, (Washington: The World Bank Policy Research Department, July 1994), p. 3.

structure, it is the level of leverage[34] that forms an important factor in determining the overall cost of capital[35] and the total market value of a company.[36] As the level of leverage increases over moderate debt ranges the average cost of capital falls because of the lower cost of debt capital compared with equity capital.[37] This helps to explain some of the reasons behind decisions of companies, whether to make fresh issues of shares to the public (*e.g.* through public distribution of equity securities on the stock exchange), or to use debt finance as an alternative source of corporate finance or to have a rational mix of both debt and equity finance. Under the traditional view,

> "It was assumed that moderate amounts of debt did not add significantly to the risks attached to holding equity, so that initially the company would not have to offer higher returns to its

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[34] Leverage, sometimes referred to as 'gearing', refers to the level of debt in the capital structure of a company. For an elaborate discussion, see E.F. Brigham, Fundamentals of Financial Management, (Chicago: The Dryden Press, 1986), pp. 495-500; R.M. Bowen, L.A. Daley, and C.C. Hubber, Jr., "Evidence on the existence and determinants of inter-industry differences in leverage," Financial Management, (Winter 1982), 10-20; J.M. Gahlon and J.A. Gentry, "On the relationship between systematic risk and the degrees of operating and financial leverage," Financial Management, (Summer 1982), 15-23; G. Donaldson, "New Framework for Corporate Debt Capacity," Harvard Business Review, (March-April 1962), 117-131; and G. Donaldson, "Strategy for Financial Emergencies", Harvard Business Review, (1969), 67-79.

[35] A company's cost of capital is the average rate of return required by investors in the company's securities. See L. Schall and C.W. Haley, Introduction To Financial Management, (New York: McGraw-Hill Book Co. 1980), pp. 191-192.

[36] See generally S.H. Archer and C.A. D'Ambrosio, The Theory of Business Finance: A Book of Readings, (New York: Macmillan, 1967); E. Solomon, "The Arithmetic of Capital Budgeting Decisions," Journal of Business, 29(2), (1956), 124-129; A.A. Robichek and S.C. Myers, Optimal Financing Decisions, (Englewood Cliffs: Prentice-Hall, 1965); M. Bromwich, The Economics of Capital Budgeting, (London: Penguin Education, 1976).

shareholders. This would cause the weighted-average cost of capital to decline, thus increasing the value of the company. As the proportion of debt in the capital structure rises, two things happen: first, the equity shareholders realise that their investment is becoming riskier and therefore demand a higher rate of return from the company; second, lenders advancing to an already geared company will also recognise increasing risk on their investment as the level of gearing rises and expect a higher rate of return on succeeding tranches of debt advanced."[38]

Despite claims by the traditionalists that the overall cost of capital is initially reduced by introducing debt into the capital structure,[39] it is clear that as the level of debt increases the total cost of capital no longer decreases.[40] Instead, it eventually begins to rise again at higher levels of debt.[41] Views have been expressed that if the traditional view of capital structure is accepted, then there is a level of gearing for each firm at which the cost per unit of capital is at its lowest point.[42]

"Managers would therefore have to identify this optimum level of gearing and ensure that their company maintained its capital structure at this level. There does seem to be an element of irrationality in the traditional view in that equity shareholders are expected to ignore an element

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[37] See above.

[38] J.M. Samuels, F.M. Wilkes and R.E. Brayshaw, Management of Company Finance, (London: Chapman and Hall, 1990), p. 445.

[39] *Ibid.*, p.445.

[40] See M.H. Miller, "Debt and Taxes," Journal of Finance, 32, (1977), 261-276; S.C. Myers, "The capital structure puzzle," Journal of Finance, 39, (1984), 575-592.

[41] See the readings and exact pages cited in *supra.*, (n. 40).

[42] See J.M. Samuels, F.M. Wilkes and R.E. Brayshaw, Management of Company Finance, *supra.*, (n.38)., p. 445.

of risk. It is questionable whether investors would be prepared to accept the same rate of return from companies in similar industries with different levels of gearing. In fact, this lies at the heart of the MM (Modigliani and Miller) analysis ..."[43]

Restrictive Regulations On Banking Systems As A Constraint:

Other market imperfections in emerging markets include matters such as developing countries imposing constraints on their own banking systems. Here, high reserve requirements or strong restrictions on where banks must place their reserves have been promulgated by many developing countries.[44] As Barry and Lockwood observe:

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[43] Ibid., p. 445.

[43] See J.M. Samuels, F.M. Wilkes and R.E. Brayshaw, Management of Company Finance, *supra*., (n.38), p. 144. We will not delve into intricacies of the Modigiliani and Miller hypotheses on capital structuring since that is not the concern of this study. For detailed readings on the Modigiliani and Miller Hypotheses, see F. Modigliani and M.H. Miller, "The cost of capital, corporation finance and the theory of investment", American Economic Review, 48, (1958), 261-296; and F. Modigliani and M.H. Miller, "Taxes and the cost of capital: a correction", American Economic Review, 53, (1963), 433-443. See also S.C Myers, "The Capital Structure Puzzle," in K. Ward, Strategic Issues in Finance, (Oxford: Butterworths-Heinemann, 1994), pp. 261-282, which covers much ground on the *static trade-off* theory and the *pecking order* theory; F. Black, M. Jensen and M. Scholes, "The capital asset pricing model: some empirical tests", in M.G. Jensen (ed.), Studies in the Theory of Capital Markets, (New York: Praeger, 1972); E.F. Fama and J. Macbeth, "Risk return and equilibrium: empirical tests," Journal of Political Economy, 71, (May-June 1973), 607-636; and R. Roll, "A Critique of the asset pricing theory's test; Part I: On past and potential testability of the theory," Journal of Financial Economics, 4(2), (March 1977), 129-176.

[44] C.B Barry and L.J Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995), [*supra*., (n. 2)], p. 17. See also generally P.J. Montiel, P.R. Agmnor and N.U. Haque, Informal Financial Markets in Developing Countries, (Oxford: Blackwell Publishers, 1995). In Zambia, for example, the collapse of Meridian Bank Ltd., a local bank that had rapidly grown into a multinational

"In Mexico in the mid-1980's, for example, banks were required to maintain over 70% of their assets in Mexican government securities. At an extreme, such restrictions and limits can lead to the development of large informal credit markets."[45]

In many other developing countries informal credit markets have been a major source of funds and they often exist to enable investors to avoid financial reporting and related costs such as taxation.[46] Furthermore, informal markets develop in response to cultural traits, such as the desire that a family be viewed as self-sufficient because it runs an informal credit market or it has easy access to such a market.[47] In the case of Zambia, like in many other developing countries where institutions such as venture capital funds[48] are relatively new, the issue whether banks have been providing loans to companies intending to buy shares on the Lusaka Stock Exchange or if such companies have had access to informal credit markets raises interesting questions. We will examine some of these issues later.[49]

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corporation with offices in the United Kingdom and the United States, saw the repeal of the existing banking legislation in Zambia and the replacement of that law with a new banking code, the Banking and Financial Services Act 1994. This move was meant to strengthen the banking regulatory system in Zambia, which among other things, now includes stronger emphasis on investor protection. Furthermore, the Bank of Zambia Act 1985 does require banks to place a statutory stipulated minimum as reserves by way of demand deposits in current account in the Bank of Zambia.

[45] C.B. Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, *supra*., (n. 2), p. 17.

[46] See *Ibid*., p. 17.

[47] See *Ibid*., p. 17.

[48] For a definition of venture capital funds see Chapter Eight, *infra*.

[49] See Chapter Three, *infra*.

Restrictions On Investment Of Pension Assets As A Constraint:

In many developing countries, the investment of pension assets is highly restricted.[50]

> "For example, investment may be limited to local government securities... pension assets are limited to domestic investment because a goal of the plan is to aid in the mobilisation of capital sources to support the nation's growth. When such restrictions are imposed, they increase the risks faced by workers because the domestic economies in many developing nations are very narrow and are exposed to high local market risk. Thus, an explicit trade-off is enacted between the needs of the nation for capital on the one hand and the desire to reduce pension-holder risk on the other."[51]

Privatisations And How They Have Influenced The Setting Up Of Emerging Capital Markets:

Writing on the London Stock Exchange, Briston observes:

> "It is clear that the Stock Exchange developed in order to meet two demands. First, the increased issue of securities of a long-term or permanent nature required a market for the purchase and sale of these securities, so that their holders could liquidate their investments in the short-term. Also the expansion of industry during the nine-teenth century necessitated the discovery of new sources of finance. One of the main such sources was the Stock Exchange... The two major functions of the Stock Exchange are thus the provision of a market for the

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[50] See C.B Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995), [*supra*., (n. 2)], p. 17.

[51] See *Ibid*., pp. 17-18.

purchase and sale of securities and the provision of capital for the purposes of industry and Government, both central and local."[52]

Stapley also observes that the stock exchange plays two vital, inter-linked, roles within a country's economy.[53] These roles are to enable government and industry to raise capital with comparative ease and to provide a secondary market where existing investors can sell and where prospective investors can buy.[54] However, in contrast to the development of a number of advanced stock markets, the growth of many emerging markets has been triggered by the need for developing countries to undertake privatisation programmes.[55] A number of goals have been identified as objectives of the privatisation process in developing countries.[56]

> "One goal is maximum economic efficiency of the resulting enterprises. A second goal may be to raise revenues for the state to address deficits. Another goal in the case of newly open economic systems is to permit the people of the nation to participate in ownership. A fourth goal is to establish an active secondary market for securities. The various goals suggest

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[52] R.J. Briston, The Stock Exchange and Investment Analysis, (London: George Allen and Unwin Ltd., 1973), pp. 34-35.

[53] N.F. Stapley, The Stock Market: A Guide For The Private Investors, (Cambridge: Woodhead-Faulkner, 1986), p. 16.

[54] *Ibid*., p. 16.

[55] See for example A. Galal, L. Jones, P. Tandon and I .Vogelsang, "Synthesis of Cases and Policy Summary," in Proceedings of the World Bank Conference on the Welfare Consequences of Selling Public Enterprises, (Washington: World Bank, 1992); and generally, International Finance Corporation, Privatization Principles and Practices: Lessons Of Experience Series, (Washington D.C., 1995).

[56] See generally International Finance Corporation, Privatization Principles and Practices: Lessons Of Experience Series, *supra*., (n. 55).

alternative mechanisms for the privatisation of enterprise. For example, an auction process in which the enterprise is sold to the highest bidder would tend to lead to ownership by the organisations best equipped to operate the entity and would tend to maximise the price of the assets sold. But it would also tend to exclude from ownership most of the people of the nation, and it has often been met with charges of favouritism or corruption."[57]

Generally, the privatisation of state owned enterprises in many countries has been approached differently. Each country's approach has been determined by various factors such as country-specific needs and conditions. The path followed for privatisation of sate owned enterprises in Eastern Europe, for example, has been a function of political concerns as much as of economic concerns.[58] Ultimately, the key element of the privatisation process in Eastern Europe has been the provision for active shareholder groups.[59] In Africa,

> "According to World Bank data, of the 6,430 state owned enterprises before 1990, 3,840 (or over half) had been privatised by the end of 1996. Although complete figures for the proceeds are not available, at least US$ 2.7 billion was realised.
>
> These figures tend to disguise some of the serious obstacles encountered in the privatisation process: political resistance, technical problems and the lack of sufficient domestic and international finance.

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[57] C.B. Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, *supra*., (n. 2), p. 23.

[58] See M. Boycko, A. Shleifer and R.W. Vishny, "Voucher Privatisation," Journal of Financial Economics, 35, (1994), 249-266.

[59] See *Ibid*., pp. 249-266.

Zambia, often cited as an example by the World Bank, is a case in point ..."[60]

In Zambia, suffice it to say that the introduction of a stock exchange, as empirical evidence will show in Chapter Three, was primarily targeted at facilitating the privatisation of state owned enterprises.[61]

The Integration Of Emerging Markets As An Important Means To Overcoming Some Of The Constraints:

Generally, emerging markets have become more integrated with global capital markets over time.[62] The reasons for this development vary from the size, structure and activity of the markets to the pricing characteristics of these markets. Emerging markets are also likely to become more integrated as they remove capital market restrictions. These restrictions are of many sorts. They include restrictions on foreign ownership of shares[63] and restrictions on investment of pension assets.[64] The integration of emerging markets must be seen as

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[60] United Nations, Development Business, Vol. 21, No. 494, (16th September 1998), p. 17.

[61] See also R. Penza, Daily Parliamentary Debates, 18th June 1992, p. 104; and see research questionnaire results (Appendix K, question 4).

[62] See L.S. Speidell and R. Sappenfield, "Global Diversification in a Shrinking World," Journal of Portfolio Management, (1992), 57-67; F. Longin and B. Solnik, "Is the Correlation in International Equity Returns Constant 1960-1990?" Journal of International Money and Finance, 14, (1995), 3-26.

[63] See C.B. Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, *supra*., (n. 2), p. 20. See also W. Bailey and J. Jagtiani, "Foreign Ownership Restrictions and Stock Prices in the Thai Capital Markets," Journal of Financial Economics, 36, (1994), 57-87. For a discussion of foreign investor participation on the Korean Stock Exchange prior to 1991, see C.S. Cheung and J. Lee, "Integration vs. Segmentation in the Korean Stock Market," Journal of Business, Finance and Accounting, 20, (1993), 267-273.

[64] See above.

complementing our recommendation to have a regional stock exchange set up in Eastern and Southern Africa.

2.4. MAKING A CASE FOR EMERGING MARKETS:

Traditionally, emerging capital markets in Africa, Asia and Latin and South America were seen as 'mini-markets' or 'little casinos'.[65] We have shown above statistics on the market capitalisation of most of Africa's stock markets. The figures indicate that a number of African lion markets can no longer be thought of as 'little casinos'. Indeed, following below are two charts showing first, the growth of emerging markets world wide, in terms of market capitalisation (*i.e.* US$ billions), and secondly, the performance of emerging markets matched with that of developed stock markets, in terms of growth in GDP.

[65] M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, (Chicago: Probus Publishers, 1993), [*supra*., (n. 1)], p. 460.

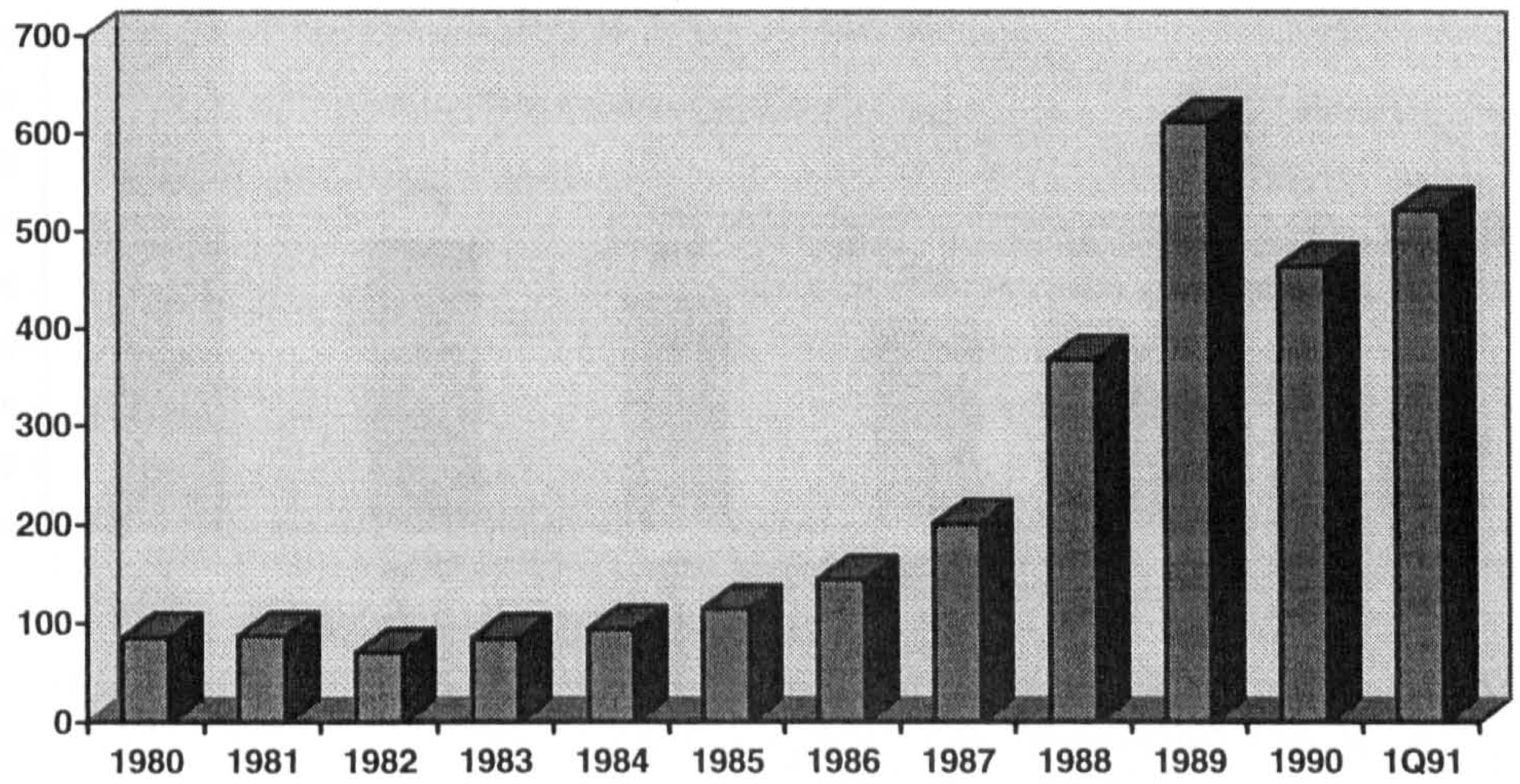

Fig. 2.4.1. Eleven Years' Growth of Emerging Markets.

Source: International Finance Corporation, quoted in M.T. Porter, "Closed-End Emerging Country Funds Review," in K.H. Park and W. Van Agtmael, The World's Emerging Stock Market, (Chicago: Probus Pub. 1993), p. 460.

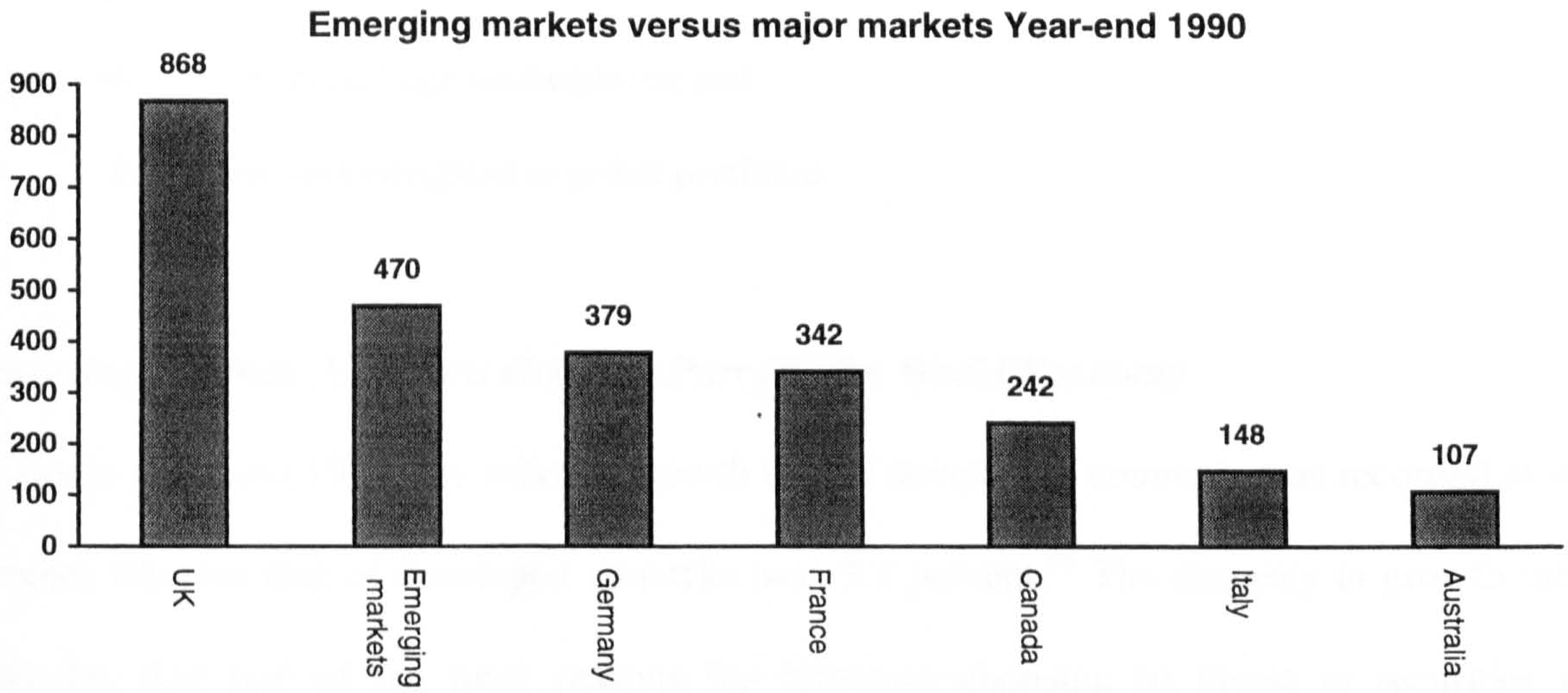

Fig. 2.4.2. Emerging Markets versus Major Markets Year-End 1990.

Source: International Finance Corporation, quoted in M.T. Porter, "Closed-End Emerging Country Funds Review," in K.H. Park and W. Van Agtmael, The World's Emerging Stock Market, (Chicago: Probus Pub. 1993), p. 461.

Figure 2.4.2 shows that taken together, emerging markets are bigger than the markets of Germany, France and Canada. Investors gradually are turning their attention to this increasingly important asset class.[66] Porter identifies six main reasons which explain why emerging capital markets are seen as attractive by investors.[67] Emerging markets -

(a) represent a fast growing part of the world economy;

(b) have delivered superior returns;

(c) provide further diversification of global portfolios;

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[66] See *Ibid*., p. 461.

[67] See *Ibid*., p. 460.

(d) are attractively valued;

(e) represent huge marketplaces; and

(f) are underweighted in global portfolios.

Emerging Markets As A Fast Growing Part Of The World Economy:

Between 1965 and 1989, the average growth rate of developing countries was recorded at 4.7 percent whereas that of developed countries was 3.1 percent.[68] The disparity in growth rates indicates that one of the main reasons for investors choosing to invest in securities on emerging markets is that such markets offer the potential strength of corporate earnings.[69]

Emerging Markets And Their Delivery Of Superior Returns, Plus Their Potential For Further Diversification Of Global Portfolios:

The second reason why investors are interested in investing in securities on emerging markets is that these markets are known to have delivered superior returns.[70] The markets offer potential high returns and empirical evidence suggests that generally emerging markets have outperformed developed markets over-one, two-, five-, and ten-year periods.[71] The third

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68 M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, (Chicago: Probus Publishers, 1993), [*supra*., (n. 1)], p. 460.

69 See International Finance Corporation, Investment Funds In Emerging Markets: Lessons of Experience Series, (Washington D.C, 1996), pp. 12-15.

70 See M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, *supra*., (n. 1), p. 461.

71 See M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, (Chicago: Probus Publishers, 1993), [*supra*., (n. 1)], p. 461.

important point to note about the attractiveness of emerging markets is that these markets can provide further diversification of global portfolios.[72] Emerging markets have exhibited above-average returns with enormous volatility individually, yet these markets have shown low correlations with the United States market and with each other.[73] This explains the importance of investing not only in securities on developed markets, but also in securities on emerging markets.

Emerging Markets And The Attractive Valuation Of Equity Securities:

The fourth point in favour of emerging markets is that besides having good growth characteristics, emerging markets offer attractive equity valuations when measured by the yardsticks used in developed markets, such as price-to-earnings and price-to-book value ratios.[74] Research also shows that by the end of 1990, as a percentage of Gross Domestic Product (GDP), capitalisation of the 20 largest emerging markets was 32 percent compared with 50 percent - 60 percent for developed countries.[75]

The Relaxation Of Fiscal Barriers And Exchange Control Regulations As An Incentive:

The argument for potential growth of emerging markets is further buttressed by the fact that the liberalisation of economies in developing countries and the relaxation of foreign investment barriers (such as tax laws and exchange control regulations) could attract investments which

[72] See *Ibid.*, p. 461.

[73] See International Finance Corporation, Investment Funds In Emerging Markets: Lessons of Experience Series, *supra.*, (n. 69), pp. 12-15.

[74] See M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, *supra.*, (n. 1), p. 461. See also above.

[75] See M.T. Porter, *Ibid.*, p. 461.

might trigger the expansion of stock markets in developing countries. For many developing countries, the main focus in attracting private capital is foreign investment.[76] This is evidenced mainly by the relaxation of a number of barriers to foreign investment in countries such as Zambia and Kenya.[77]

Some Free Market Economy Policies And Their Contribution Towards The Development Of Emerging Markets:

The sixth point that supports the case for emerging markets is that developing countries are overcoming historical objections to foreign investment by increasingly beginning to appreciate the benefits of open markets and private initiative.[78] Many are recognising that equity markets are integral to economic development and that foreign investment can act as a source of long-term capital. This trend should continue as long as the world's commercial banks consider themselves overextended in developing countries.[79]

> "Chile, for example, has shown what a Latin American economy can do if free enterprise is given a chance and state controls are dismantled. It has converted foreign debt to equity, encouraged development of private pension funds, and amended tax laws to provide greater investment incentives. As a result, the country has enjoyed strong growth since 1985. Mexico,

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[76] See below.

[77] See generally Nedcor Securities, The Stock Markets of Africa, (London: Nedcor Securities, 1996), [*supra*., (n. 20)].

[78] M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, *supra*., (n. 1), p. 461.

[79] See International Finance Corporation, Foreign Direct Investment: Lessons of Experience, (Washington D.C., 1997), pp. 80-88.

Turkey and Brazil are examples of countries that have opened up and seen their stock markets surge."[80]

There is no doubt that generally developing countries represent huge marketplaces in the global economy. This explains why the World Bank projects that:

"...by the year 2025, 85 percent of the world's population will reside in developing countries. Yet, industrialised countries account for 74 percent of the world's GDP. Developing countries will have huge markets to be satisfied. It is forecast that much of LDC economic growth will be domesticated - not export based."[81]

A view has been expressed too that many large Third World countries, including India, Brazil, and China will not need to export to grow.[82]

Investment Opportunities In Under-represented Global Portfolios As An Incentive:

In general, emerging markets are underrepresented in global portfolios.[83] As Porter observes:

"...emerging markets' share of world GDP is 12 percent, but they account for only 5 percent of world market capitalisation. This gap is likely to narrow over time because domestic demand - not foreign demand - traditionally has been the force behind the past performance of developing

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[80] See M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, *supra*., (n. 1), p. 461.

[81] See *Ibid*., p. 461.

[82] See *Ibid*., p. 461.

[83] *Ibid*., p. 461.

stock markets. As global investors become aware of the tremendous opportunities in Third World Markets, the flow of new equity from capital exporting countries such as Japan should increase."[84]

Some Studies On The Market Efficiency Of Emerging Markets Indicate The Attractiveness Of These Markets:

Most of the market efficiency tests that have been carried out on emerging markets indicate that these markets do not fall into the category of weak-form market efficiency.[85] Besides, despite some of the constraints affecting the efficacy of the legal framework(s) for public distribution of securities in emerging markets, these markets cannot by that fact alone be said to be inefficient. Some of these constraints may indicate, instead, that the asset pricing models on which these tests are based are inadequate.[86] Indeed, a number of studies undertaken on the market efficiency of emerging stock markets show, for example, that the pricing mechanisms

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[84] Ibid., p. 461.

[85] See C.B Barry and L.J. Lockwood, C.B. Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, supra., (n. 2), p. 21. For an elaborate read on the semi-strong form tests of emerging markets see for example, M. Herrera and L.J. Lockwood, "The Size Effect in the Mexican Stock Market," Journal of Banking and Finance, 18, (1994), 621-632. On the meaning of the term 'market efficiency', see R.A. Brealey and S.C. Myers, Principles of Corporate Finance, (New York: Mcgraw-Hill, 1991), [supra., (n. 25)], p. 290. R.A. Brealey and S.C. Myers observe: "When economists say that the security market is efficient, they are not talking about whether the filing is up-to-date or whether desktops are tidy. They mean that information is widely and cheaply available to investors and that all relevant and ascertainable information is already reflected in security prices." The concept of efficient markets is a by-product of a chance discovery on how stock and commodity prices behave. In other words, prices of securities on an efficient market follow a *random walk*.

[86] See M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), The World's Emerging Stock Markets, supra., (n. 1), p. 21.

of these markets are usually affected by the volume of trade in securities on a particular day or in a particular season.[87] There is limited similarities between the seasonalities in developed country stock markets and that in emerging stock markets. The reason for this view is simple. Emerging stock markets, like developed country stock markets, have their distinct institutional characteristics. Also, emerging markets are relatively segmented and have until recently not been adequately integrated with each other and with developed country stock markets. Promoting multiple listings and cross-border trade in securities would be one way to integrate emerging markets.

2.5. CONCLUSION:

This chapter has provided an overview of some of the important theories relating to public distribution of securities in emerging markets. The chapter argued that although there are a number of risks associated with investing in emerging markets, the advantages of investing in these markets outweigh the disadvantages. Indeed, the advantages provide for great investment opportunities in a part of the world economy that is growing at a fast pace.

It was also argued, among other things, that imperfect market conditions can affect the capital structure decisions of many corporate investors in emerging markets. Today, imperfect market

[87] See for example R. Aggarwal and P. Rivoli, "Seasonal and Day-of-the-Week Effects in Four Emerging Stock Markets," Financial Review Studies 1, (1988), 541-550; M. Gultekin and N.B. Gultekin, "Stock Market Seasonality: International Evidence," Journal of Financial Economics, 12, (1983) 469-481; S. Claessens, S. Dasgupta and J. Glen, "Return Behaviour in Emerging Markets," World Bank Economic Review, 9, (1995), 131-151; A. Corhay, G. Hawawini and P. Michel, "Seasonality in the Risk-Return Relationship: Some International Evidence," Journal of Finance, 42, (1987), 49-68.

conditions obtain in many capital markets. These conditions, or rather market constraints, can affect the contribution of the legal framework for public distribution of securities to the development of a competitive stock exchange in a country such as Zambia.

PART II

EMPIRICAL EVIDENCE ON CONSTRAINTS AFFECTING THE EFFICACY OF THE LEGAL FRAMEWORK IN ZAMBIA AND MAKING A CASE FOR A REGIONAL STOCK EXCHANGE

CHAPTER THREE

EMPIRICAL EVIDENCE ON CONSTRAINTS AFFECTING THE REGULATORY FRAMEWORK FOR PUBLIC DISTRIBUTION OF SECURITIES

This chapter examines empirical evidence on constraints facing the Zambian legal framework for public distribution of securities in its contribution towards the development of a competitive national stock exchange. The chapter shows that the efficacy of the legal framework is affected by various constraints. Underlying the views in this chapter is the theme that constraints such as inadequate liquidity on the Lusaka Stock Exchange can be overcome by promoting multiple listings and cross-border trade in securities. Indeed, the idea of establishing a regional stock exchange, as spelt out in Chapter Four, follows from evidence in this chapter.

Given that the Lusaka Stock Exchange is in its early stages of development and that the volumes of trade in securities on the exchange are reasonably small, to have a fuller grasp of the contribution of the legal framework to the development of a competitive stock exchange, it would be appropriate to look at what the market players and the regulatory authorities have said about the efficacy of the legal framework. In so doing, we will also look at the role played by market makers in promoting good conduct, investor confidence and fair trade on the market. Inevitably, there is an implied objective to highlight some empirical evidence on the market performance and market capitalisation of the Lusaka Stock Exchange. This analysis is important because what goes on in the market has a bearing on how the legal framework performs.

3.1. PERFORMANCE OF THE LUSAKA STOCK EXCHANGE AND MARKET CAPITALISATION OF THE EXCHANGE:

The first stock exchange to be set up in Zambia was the Lusaka Stock Exchange. This stock exchange was opened in 1994.[1] In this section, we look at how the Lusaka Stock Exchange has performed since 1994. The fluctuations in the performance and market capitalisation of a start up market, such as the Lusaka Stock Exchange, are well captured in the diagrams that follow below. The first diagram shows the number of trades on the Lusaka Stock Exchange between March 1994 and May 1996. The second illustration shows the volume of activity on the Lusaka Stock Exchange during

[1] It could be argued here that the official opening of the Lusaka Stock Exchange gave national publicity to the exchange as well as to the public offer on the sale of Government shares in Chilanga Cement Plc by the Zambia Privatisation Trust Fund (ZPTF). This move came after the privatisation of Chilanga Cement Plc by the Zambia Privatisation Agency (ZPA) and the acquisition of controlling and management interests in Chilanga Cement Plc by Commonwealth Development Corporation (CDC). Chilanga Cement Plc became the first company to be listed on the Lusaka Stock Exchange on 22nd May 1995. This was after a successful public offer for sale of 54,750,970 shares at K65 per share. The offer was fully subscribed. See Lusaka Stock Exchange, LuSe: Update and Overview, (Lusaka: Lusaka Stock Exchange, 1996), p. 2.

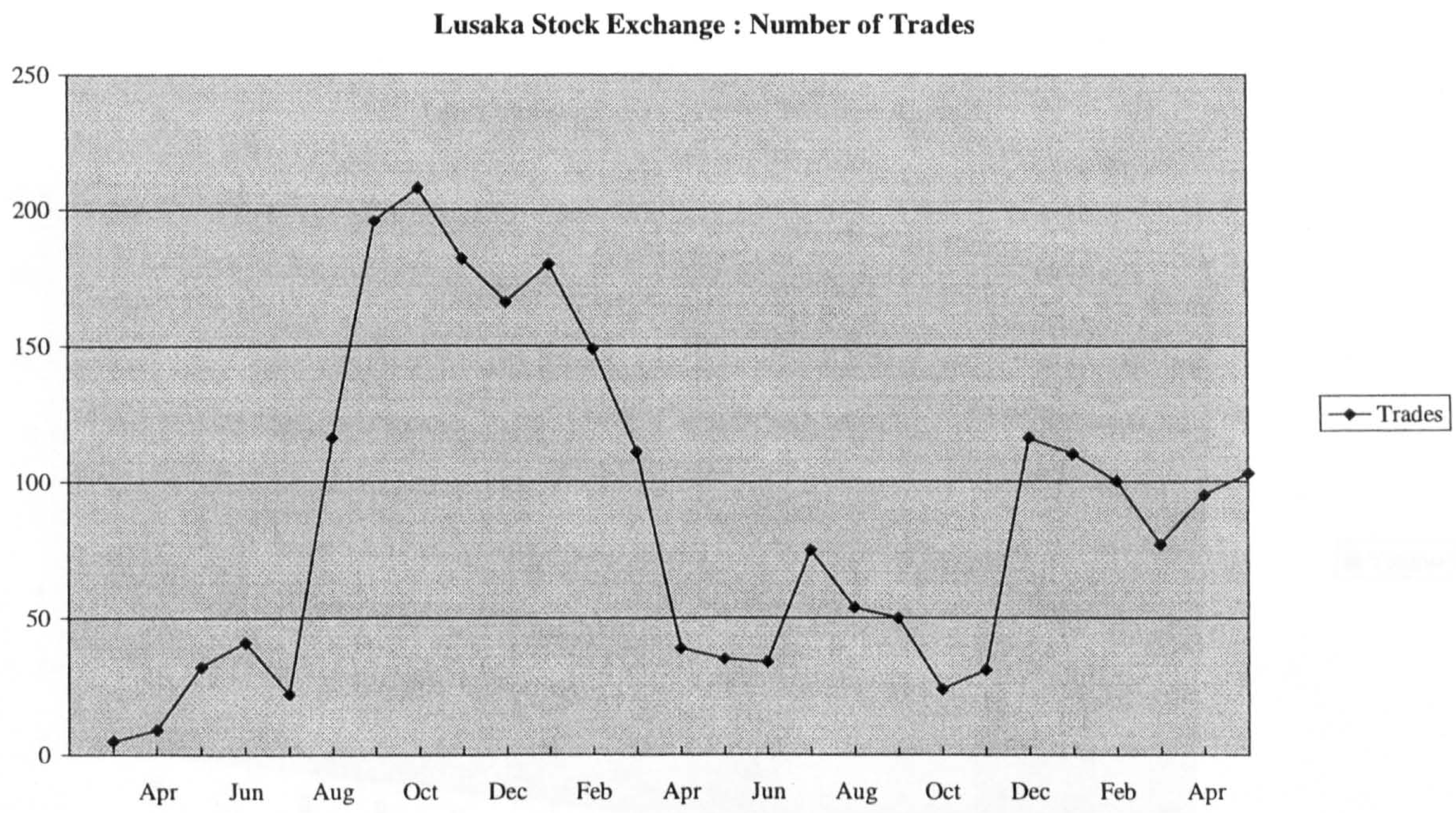
the same period. The third shows the turnover rate on the exchange. The fourth diagram illustrates the market capitalisation of the Lusaka Stock Exchange.

Fig. 3.1.1. Table of information on which Figs. 3.1.2 to 3.1.5 and Fig. 3.2.1 are based.

Month	No. of trades	Month	Volume	Month	Turnover (K)	Month	Market capitalis. Million Kwacha	Sector	Percentage
Mar. 1994	5	Mar. 1994	15,188	Mar. 1994	1,481,762				
Apr	9	Apr	42,086	Apr	1,675,583				
May	32	May	183,145	May	4,790,223				
Jun	41	Jun	281,02	Jun	3,851,045				
Jul	22	Jul	1,529,309	Jul	48,881,179				
Aug	116	Aug	312,395	Aug	10,057,388				
Sep	196	Sep	131,533	Sep	6,233,831				
Oct	208	Oct	259,672	Oct	52,747,775				
Nov	182	Nov	658,988	Nov	59,169,907				
Dec	166	Dec	520,684	Dec	66,769,459				
Total 1994	**977**		**3,934,020**		**255,658,152**		N/A		
Jan. 1995	180	Jan. 1995	290,509	Jan. 1995	83,637,042	Jan. 1995	679,884	Manufact	5.76
Feb	149	Feb	439,472	Feb	16,247,403	Feb	622,606	Agric	35.32
Mar	111	Mar	277,335	Mar	972,468	Mar	612,356	Banking	9.98
Apr	39	Apr	1,133,221	Apr	13,062,541	Apr	637,370	Property	0.92
May	35	May	189,047	May	3,511,457	May	628,109	Mining	48.01
Jun	34	Jun	272,974	Jun	15,042,081	Jun	578,654		
Jul	75	Jul	3,521,332	Jul	49,157,395	Jul	504,941		
Aug	54	Aug	460,047	Aug	9,045,530	Aug	501,841		
Sep	50	Sep	476,345	Sep	8,213,310	Sep	420,955		
Oct	24	Oct	183,777	Oct	2,521,652	Oct	365,064		
Nov	31	Nov	218,547	Nov	5,719,839	Nov	412,126		
Dec	116	Dec	454794	Dec	9,638,357	Dec	413,274		
Total 1995	**898**		**7,917,400**		**216,769,075**		N/A		
Jan	110	Jan	4,509,244	Jan	176,209,423	Jan	374,677		
Feb	100	Feb	12,955,421	Feb	521,817,110	Feb	364,449		
Mar	77	Mar	4,648,050	Mar	165,136,209	Mar	281,418		
Apr	95	Apr	214,034	Apr	5,439,971	Apr	282,418		
May	103	May	405,646	May	19,428,461	May	346,280		

Source: Adapted from Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), pp. 1, 3 and 4.

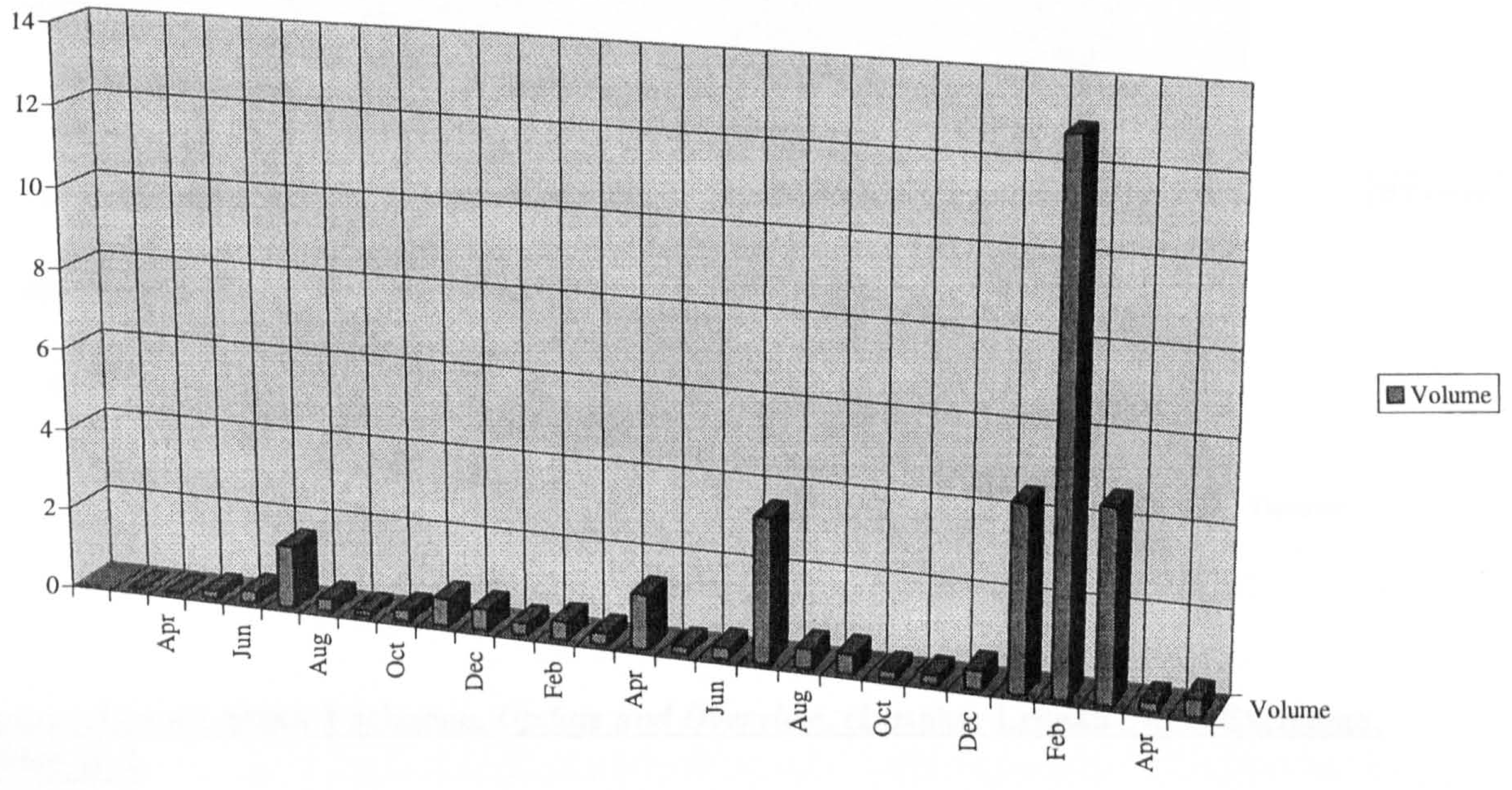
Fig. 3.1.2



Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 3

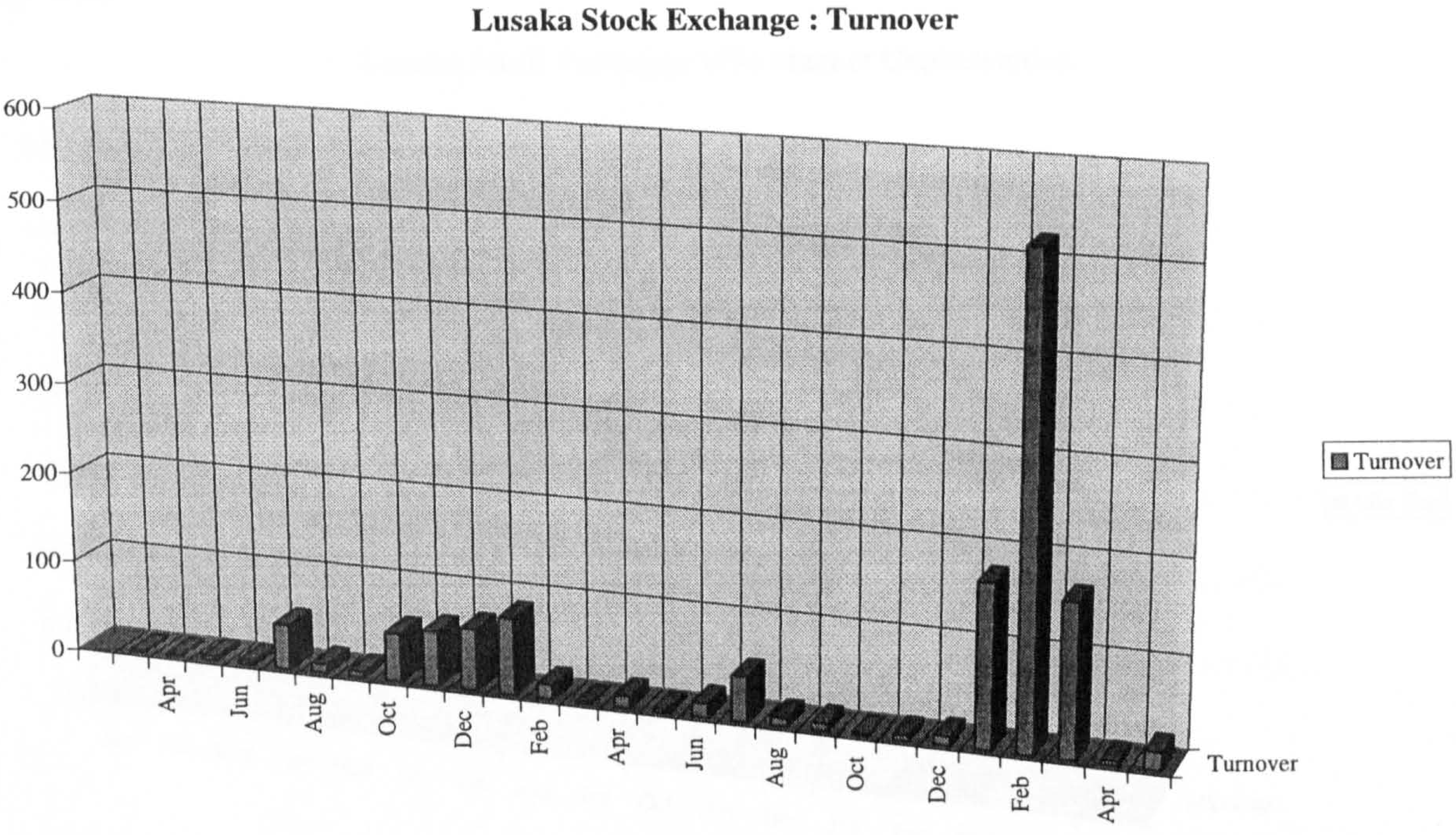
Fig. 3.1.3

Lusaka Stock Exchange: Volume Activity



<u>Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 3</u>

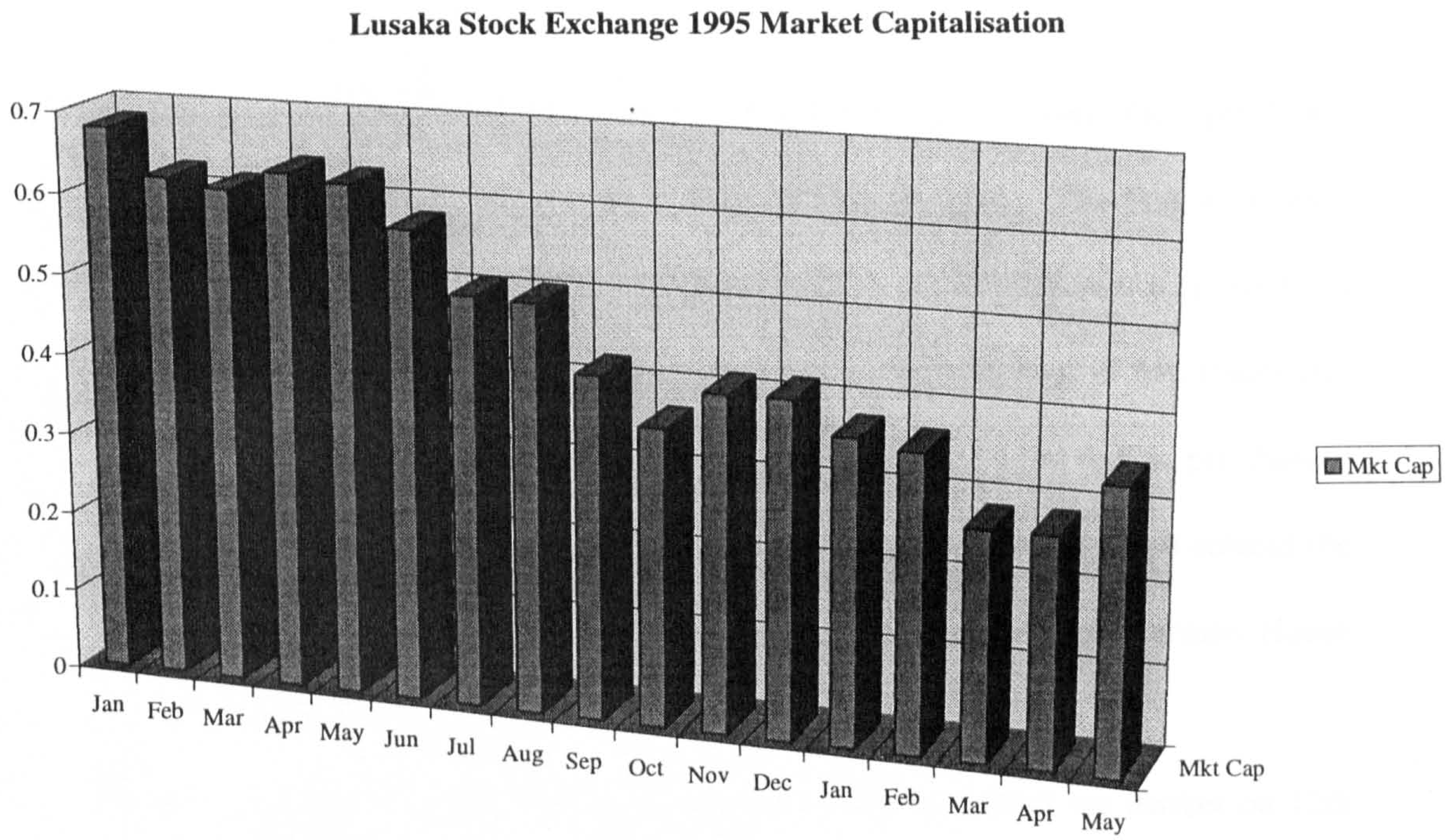
Fig. 3.1.4



Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 4

The chart showing the volume of activity on the Lusaka Stock Exchange identifies the *size* of the activity relating to replacement of securities whereas the chart on turnover shows the *rate* at which the securities are being replaced.

Fig. 3.1.5.



<u>**Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 4.**</u>

Despite the evidence showing that the market capitalisation of the Lusaka Stock Exchange has been declining, the decline has not been drastic. The decline has been steady. The fluctuations in the volume of activity and turnover indicate that business on the Lusaka Stock Exchange has not yet developed fully. Arguing that since the market performance of the Lusaka Stock Exchange is dogged by fluctuations, the legal framework governing public distribution of securities is ineffective would amount to pursuing a red herring. Although there does exist is a correlation between the efficacy of the legal framework and the performance of the Lusaka Stock Exchange, the degree to which this can be evaluated generally hinges on the empirical evidence available. Following below is an analysis of the information presented in the above charts.

> "The year 1994 was largely taken up with proving and testing the operational procedures of the exchange through trading of unlisted stocks. The first trade took place on 1st March 1994 and involved Standard Chattered Bank shares. Activity in Standard Chartered Bank shares picked up slowly recording a total of five trades and volume of 15, 185 shares in March and price movement from K100 to K84 per share.
> The second company to trade was Zambia Bata Shoe Company Ltd which entered the market at K350 per share on 3rd May (1994). The third company was Farmers House Plc on 7th June (1994) at K500 per share.
> Meridien Property Fund, a collective investment scheme, entered the market on 12th August (1994) trading at K2,737 a unit. Between August and September trading activity increased tremendously with the full introduction on the exchange of the three collective investment schemes run by Meridien Financial Services (Meridien Property Fund, Baby Bond and Family Bond). The number of trades increased to 116 in August and rose to 208 in October and 166 in December. Turnover correspondingly increased between September and December.
> On 27th September (1994) the first trade in ZCCM (Zambia Consolidated Copper Mines Ltd.) shares took place at K3,500 per share. The year 1994 ended with no listings but with a great sense of achievement and satisfaction that the securities market and exchange were now fully operational. A total of 3,934,020 shares were traded on a total turnover of K255.658 million and 977 trades."[2]

[2] See Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p. 2.

Although the year 1994 was largely taken up with proving and testing the operational procedures of the Lusaka Stock Exchange, 1995 saw a set back to the business on the Exchange. Weak investor confidence, caused by the financial problems of Meridien BIAO[3] and uncertainty regarding the three Meridien collective investment schemes, have been cited as factors that led to the collapse of trading activity on the Lusaka Stock Exchange.[4] Indeed, trading activity and turnover collapsed precipitously to levels experienced at the start of the stock market.[5]

> "Meridien Bank failed and was closed down by Bank of Zambia, the central bank. The Lusaka Stock Exchange suspended all trading in the Meridien units from 2nd June (1995) and this remained in force till their liquidation in December (1995) under the direct supervision of the Securities and Exchange Commission."[6]

However, in July 1995 a record three million shares were transacted on the Lusaka Stock Exchange in one single trade involving Standard Chartered Bank Plc shares.[7] These shares were sold at K8 per share and were purchased by a local investor. On 15th December 1995, Rothmans of Pall Mall (Zambia) Plc became the second

[3] Meridien BIAO, now liquidated, was a transnational banking institution under the group of companies related to Meridien International.

[4] See Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p. 2.

[5] See *Ibid*., p. 2. Here, as in many other instances, no explanation is given by the Lusaka Stock Exchange to explain the relationship between law and performance of the Lusaka Stock Exchange.

[6] Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p. 2.

[7] See *Ibid*., p. 2.

company after Standard Chartered Bank Plc to have its securities listed on the Lusaka Stock Exchange.[8] The listing of shares in Rothmans of Pall Mall (Zambia) Plc came after a ZPTF (Zambia Privatisation Trust Fund) public offer which attracted a subscription for sale of 30,238,8488 Zambian government shares at K40 per share. The offer was 46.5 percent subscribed for. In all these transactions, no major complaints were reported to the Lusaka Stock Exchange by market players over matters such as market abuses. The regulatory framework was thus seen to be in good working order.[9]

In terms of market capitalisation growth, whereas in January 1995 the Lusaka Stock Exchange opened on a market capitalisation of K679,884 million (US $971 million), largely due to contributions of ZCCM Plc (40.7 percent) trading at K3,100 per share and Zambia Sugar Plc (47.9 percent) trading at K50 per share,[10] the market capitalisation of the exchange declined as the year progressed. By the end of 1995, the market capitalisation of the Lusaka Stock Exchange had dropped by 39 percent to K413,274 million (US $435 million), mirroring the drop in stock prices across the board.[11] The drop in stock prices reflected the price discovery process in a new start up market.[12] In dollar terms, the market capitalisation had dropped by 55 percent

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[8] *Ibid.*, p. 2.

[9] See below.

[10] Lusaka Stock Exchange, Update and Overview, *supra.*, (n. 1), pp. 2-4.

[11] *Ibid.*, p. 2.

[12] R.M. Leuthold, P. Garcia and N. Charherli, "Information, Pricing And Efficiency In Cash And Futures Markets: The Case Of Hogs," in J.L. Stein and B.A. Goss (eds.), Futures Markets: Price Discovery And Price Determination, (Melbourne, Vic: The Economic Society of Australia, 1992), p. 27, observe that: "prices are discovered through a process of information evaluation. Buyers and sellers evaluate available information and arrive at transaction prices

reflecting both the drop in prices as well as the devaluation of the local currency (Kwacha) against the dollar. The total number of trades in 1995 was 898 transactions on a volume of 7,917,400 shares and a turnover of K216.7 million.[13] In 1996, the market capitalisation of the Lusaka Stock Exchange continued to decline in the first month of the year. It has been argued, however, that the decline was driven by price discovery.[14] The process of 'discovering prices' of securities relates mainly to how quickly the market learns what is the relevant demand. Various factors could explain the manner in which different players on the market obtain information on the relevant

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which clear the market. New information should be received and registered by both the cash and futures markets in establishing a market clearing price. How well this is done depends on the efficiency of the markets in sharing information relative to transactions costs. A key question is the speed with which each market receives and evaluates information in registering a market-clearing price. Thus, it is important to traders and participants to identify the market which is most informationally efficient - the market which registers new information most quickly." Similarly J.S. Stein and B.A. Goss, (eds.), Futures Markets: Price Discovery And Price Determination, (see above for full citation), p. 2, observe: "The price discovery process concerns how, and how quickly, the market learns what is the relevant demand curve...Price discovery is therefore important for welfare purposes: it determines how efficiently resources are allocated through time. The price discovery process is complete when... the market has discovered the objective expectation." See also generally LuSe, Stock Market Statistics for 1994 and 1995, (Lusaka: Lusaka Stock Exchange, 1995).

[13] Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p. 2.

[14] See *Ibid*., (n. 1), pp. 2-4; It could be argued further that price discovery is being driven by the formalisation of the market (namely, a central market), regulation requirements, disclosure of company information and the interplay of demand and supply. See generally Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1). Ideally, the net result should lead to market transparency. In turn, market transparency should lead to improved market efficiency and price formation.

demand at different times. It is not, however, the purpose of this work to delve into such arguments.

Suffice it to say, in January 1996 4.5 million shares were traded on the Lusaka Stock Exchange.[15] This high volume of trade in securities was triggered by foreign investor purchases in Rothmans of Pall Mall (Zambia) Plc. In March 1996, 4.6 million shares were traded on the Lusaka Stock Exchange following foreign investor purchases in Chilanga Cement Plc. April and May of that year saw subdued activity on the stock exchange due to inadequacy of liquidity on the market.[16] However, no reasons have

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[15] Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p. 2.

[16] Lusaka Stock Exchange, *Ibid*., p. 2; K. Boulding, Economic Analysis, 3rd ed., (New York: Harper and Brothers, 1955), p. 310, argues that "liquidity is a quality of assets which...is not a very clear or easily measurable concept." Although liquidity is a nebulous concept, as we saw above, its meaning is easily understood when the concept is narrowly defined as "the ability of individuals to trade quickly at prices that are reasonable in the light of underlying demand/supply conditions." See R.A. Schwartz, Reshaping The Equity Markets: A Guide for the 1990's, quoted in H.K. Baker, "Trading Location and Liquidity: An Analysis of U.S Dealer and Agency Markets for Common Stocks," Financial Markets, Institutions and Instruments, Vol. 5, No.4, (Oxford: Blackwells Publishers, March 1996), p. 127. M.N. Massimb and B.D. Phelps, "Electronic Trading, Market Structures and Liquidity," Financial Analysts Journal, Vol.50, No.1, (1994), 39-48 at p. 41, observe that liquidity refers to "a market's ability to provide immediate execution for an incoming market order (often called 'immediacy') and the ability to execute small market orders without large changes in the market price (often called 'market depth' or 'resiliency')." Indeed as H.K. Baker, "Trading Location and Liquidity: An Analysis of U.S Dealer and Agency Markets for Common Stocks," Financial Markets, Institutions and Instruments, (see above for full citation), p.2, observes: "these simple definitions of market liquidity reflect two dimensions of a desired transaction - namely, speed (transaction time) and price (transaction cost). The speed dimension involves the timeliness of liquidity. Based on this dimension, the liquidity of a stock issue means that transactions of its

been furnished by the Lusaka Stock Exchange to explain this development. Despite the constraint on liquidity, some 'bottoming out' was noticed in March and April of 1996. Indeed, in May 1996 there was an upward trend in the market capitalisation of the Lusaka Stock Exchange and this was expected to continue due to anticipated new listings in the remainder of 1996.[17]

3.2. SECTORAL ANALYSIS AND PORTFOLIO DIVERSIFICATION:

Generally, companies trading on the Lusaka Stock Exchange fall under five major sectors, namely, manufacturing, agriculture, banking, property and mining.[18] This sectoral representation indicates not only a broad spread in the Zambian economy, but also the diversity inherent in the economy. As the Lusaka Stock Exchange notes:

> "Currently (1996) there are only 8 companies trading on the Lusaka Stock Exchange. Three are listed and the other five are quoted. It is expected that other sectors such as telecommunications, electric power utilities, chemicals (fertilisers), tourism and agro processing will be represented as more companies are privatised... Based on the above brief sectoral analysis, it is evident that the Lusaka Stock Exchange, even in its infancy state offers enormous opportunities for risk diversification, particularly for institutional and foreign investors looking for good long-term investments in the base and primary

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shares are immediately available. Yet, demanders of immediacy can usually get rapid trade execution if they are willing to incur inferior trading terms. Therefore, the second dimension of a liquidity market is achieving immediacy at minimal cost." It must be observed, however, that liquidity, like market depth, ultimately affects the success or failure of a stock market.

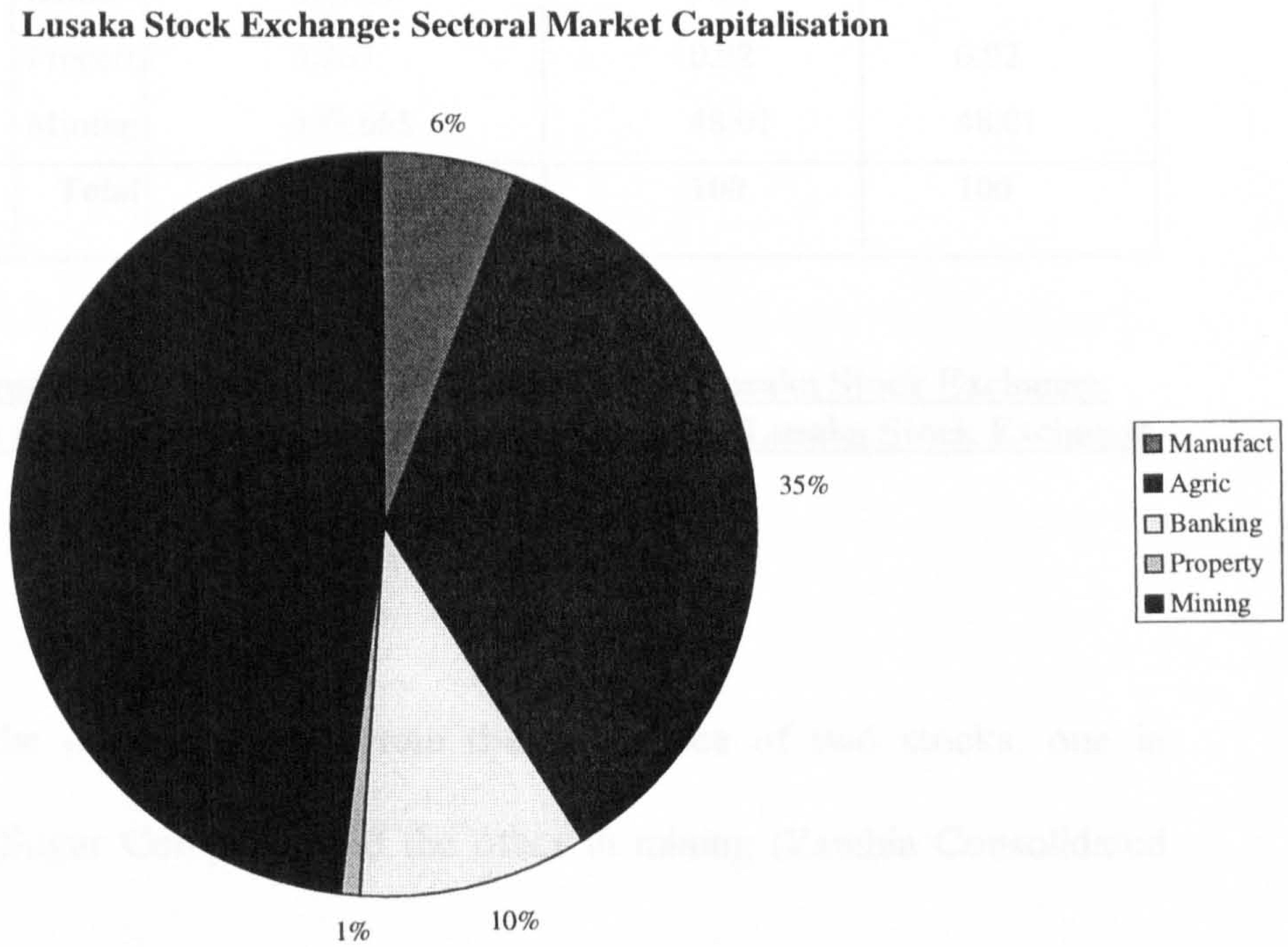
[17] Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p. 4.

[18] See *Ibid*., p. 6.

sectors of the economy where growth is expected to be highest. Further investment opportunities will soon arise with the listing of companies in agro processing industries, agriculture, beverage, telecommunications and mining"[19]

Appearing below is a pie chart on the spread of businesses of companies whose securities are quoted or listed on the Lusaka Stock Exchange.

Fig. 3.2.1



<u>Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 6</u>

[19] See <u>*Ibid*</u>., p. 6.

The weighting of each quoted or listed company and the weighting of each economic sector in terms of market capitalisation are presented below.[20]

No.	Company	Sector	Market Capitalisation' million Kwacha	% by Company	% by Sector
1	Chilanga	Manuf.	10,402	2.94	
2	Bata	Manuf.	3,507	0.99	5.76
3	Rothmans	Manuf.	6,451	1.83	
4	Zambia Sugar	Agric.	124,820	35.32	35.32
5	New Capital	Bank.	2,525	0.71	9.98
6	Stan. Chart.	Bank.	32,760	9.27	
7	Farmers House	Propert.	3,267	0.92	0.92
8	ZCCM	Mining	169,663	48.01	48.01
		Total	**353,395**	**100**	**100**

Fig. 3.2.2 Company and Sector Market Capitalisations on the Lusaka Stock Exchange. Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 6

The pie chart and the table above illustrate the dominance of two stocks, one in agriculture (Zambia Sugar Company) and the other in mining (Zambia Consolidated Copper Mines).

"At face value the chart is a quick and ready guide to the sectors in Zambia exhibiting huge potential for growth and investment, namely, agriculture and mining. However, as already mentioned, the Zambian stock market is only two years old and the current

[20] This is based on data as at 17th May 1996. The currency exchange rate at the time was that

statistics based on eight companies only do not capture other growth sectors such as transport, tourism, telecommunications, consumer retailing, beverages and agro processing which will soon be on the stock market. Clearly, the Lusaka Stock Exchange has enormous potential for growth and diversification. It is expected that privatisation and the fiscal incentives in place will increase very dramatically the number of companies trading on the Lusaka Stock Exchange in the next year or so. By the end of 1997 it is anticipated that the number of companies listed on the Lusaka Stock Exchange will have increased to ten... In another 2-3 years the Lusaka Stock Exchange expects to have a total base of 15-20 traded stocks. This reflects the rapid pace of privatisation as well as overall positive responses to the investment incentives."[21]

The above view, linking privatisations to performance of the Lusaka Stock Exchange, shows that the Lusaka Stock Exchange is of the view that there is a nexus between privatisations and performance of the Lusaka Stock Exchange. The Lusaka Stock Exchange concedes that:

K1,241.00 equalled US $1.00

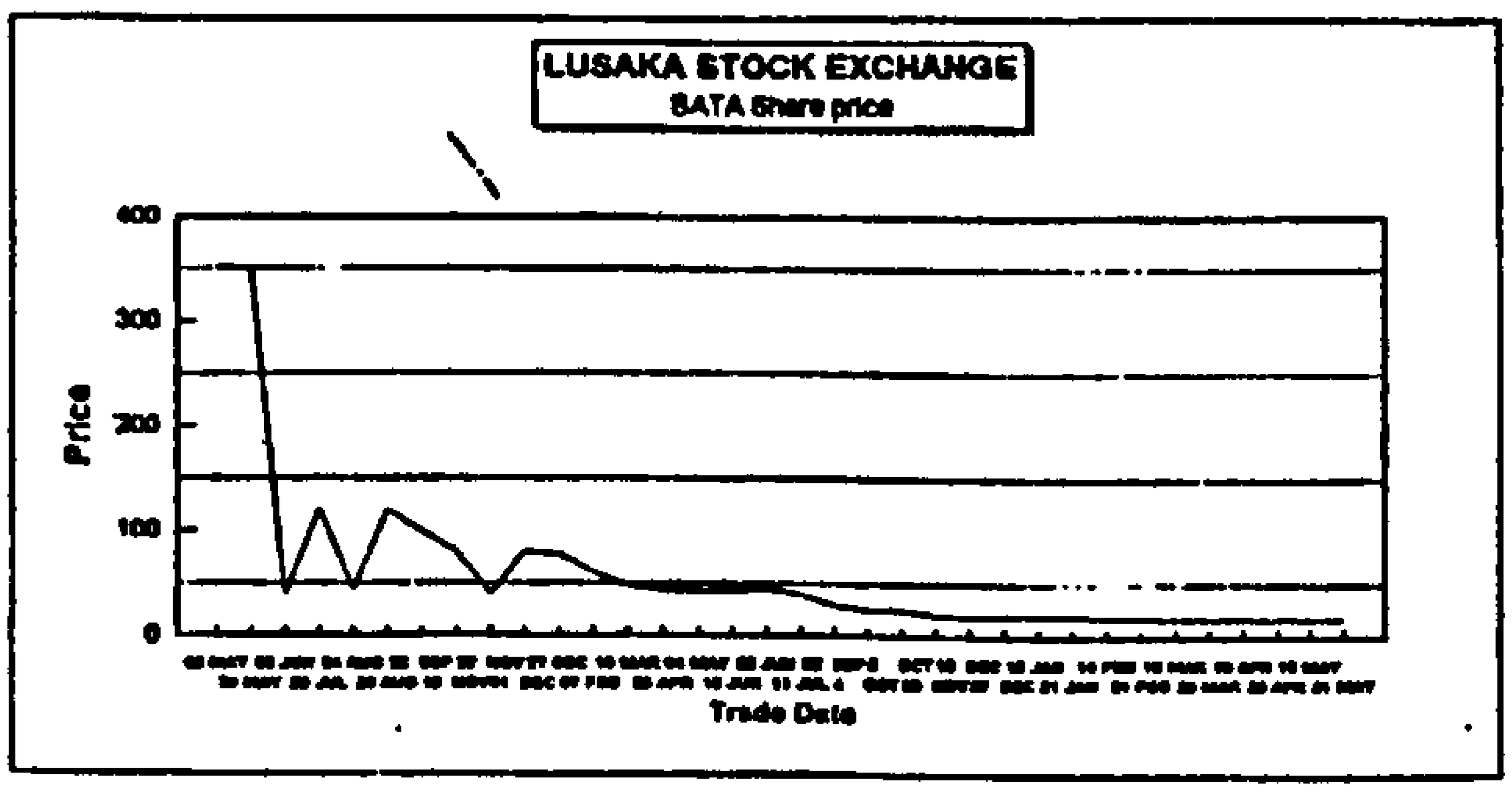
[21] Lusaka Stock Exchange, Update and Overview, *supra.*, (n. 1), p. 6. Some of the notable fiscal incentives listed down by the Lusaka Stock Exchange, *supra.*, (n. 1), p. 1, include: no exchange controls; no restrictions on shareholding levels; no restrictions on foreign ownership; no capital gains tax; no property transfer tax on listed securities (Companies Act 1994, sec. 85); and corporate income tax reduced to 30 percent for companies listed on the Lusaka Stock Exchange (effective 1st April 1996).

"The privatisation programme has been a major thrust to the development and public awareness of the Zambian stock market. The first listings on the Lusaka Stock Exchange, Chilanga and Rothmans, were by virtue of the privatisation programme."[22]

3.3. MARKET PERFORMANCE OF LISTED AND QUOTED COMPANY SECURITIES:

Fig. 3.3.1.

ZAMBIA BATA SHOE COMPANY



Shareholding:		%
Barfin - Canada	:	73.0
International Finance Corporate (IFC)	:	13.5
Public	:	13.5

	K Million		
	1995	1994	1993
Turnover	4,445	3,441	3,124
PBT	(289)	1,015	983
PAT	-	999	808
Dividends	-	19	70
Earnings per share	-	8	6
PE ratio	-	10	N/A

SECTOR: Industrial - Manufacture of retail shoes and industrial footwear.
Trading commenced on 3rd May 1994.

Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 8

The graph shown above, on the price of Bata Shoe Plc shares, shows how prior to achieving stability the price discovery process advances in a start up market. It has already been shown why the Lusaka Stock Exchange experienced a downward trend in its overall market capitalisation. It is now argued that the graph on Bata Shoe Plc

[22] LuSe, Investment Sense... 2, The Listing of ZCCM 'B' Ordinary Shares on the Lusaka Stock Exchange and Its Significance To the Zambian Stock Market, (Lusaka: Lusaka Stock Exchange, 1995), p. 4.

shares illustrates a further dimension to the problem. A big drop in the price of Bata Shoe Plc shares can be seen on the graph. The drop is attributed mainly to the price discovery process in a start up market. We saw earlier that the term 'price discovery process' relates to how quickly the market learns what is the relevant demand.[23] Indeed, what the above evidence suggests is that there are usually some lapses in the time in which 'price sensitive' information reaches players on a start up market such as the Lusaka Stock Exchange. These lapses determine how quickly the market responds to the relevant demand.[24] The lapses can be attributed to several factors which range

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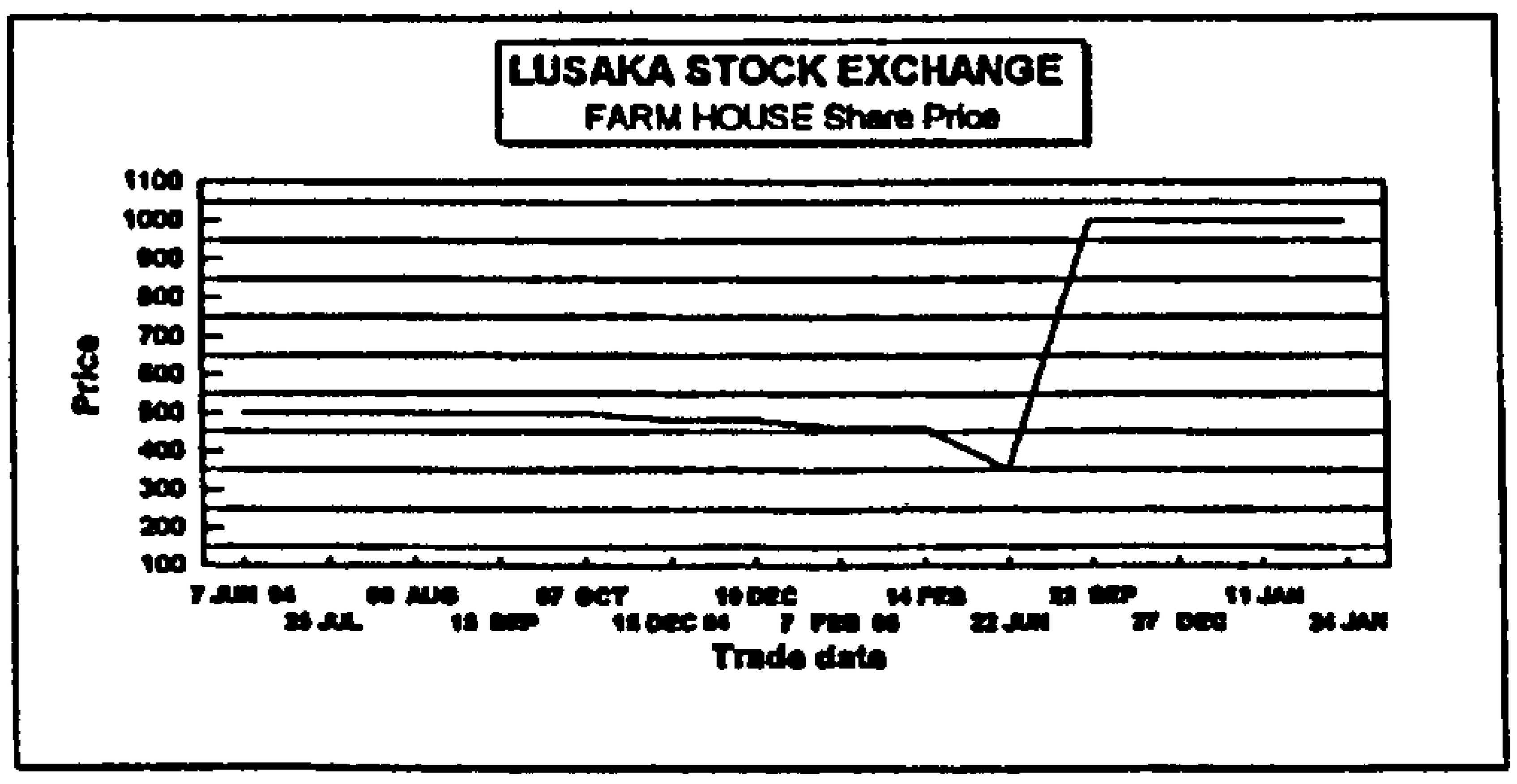
[23] See above.

[24] *Cf.* the position in the United Kingdom. Although delay by, say, withholding information can distort free market competition, in the United Kingdom a number of rules were introduced in 1989 (and revised in 1991 and 1993) to allow the publication of details of large trades in securities to be delayed; see generally A Report To The Chancellor Of The Exchequer By The Director General Of Fair Trading Under The Financial Services Act 1986, Rules Of The London Stock Exchange Relating To Market Makers, (London: Office Of Fair Trading, March 1995). In an earlier report by the Director General of Fair Trading, A Report To The Secretary Of State For Trade and Industry, Financial Services Act 1986: Trade Publication And Price Transparency On The International Stock Exchange, (London: Office of Fair Trading, April, 1990), pp. 3 and 27, it was observed that: "The delay in trade publication of large trades is designed to allow the large investor to obtain a better price than he would otherwise get. The market maker is prepared to give a better price because the information assymetry so created opens up trading opportunities during the delay period. The extension of reporting and publication requirements increases the transparency of business conducted on the Exchange." However, an empirical study of the London Stock Exchange shows that it is arguable that the rules introduced in 1989 confers an additional privilege on market makers, see Director General of Fair Trading, A Report To The Secretary Of State For Trade and Industry, Financial Services Act 1986: Trade Publication And Price Transparency On The International Stock Exchange, (see above for full citation) p. 26: "the delay in publication of large trades denies to the market two kinds of information relevant to the valuation of a security: details

from micro and macro-economic features of the stock market to constraints on the legal framework governing public distribution of securities. It is interesting to note, however, that the graph on Farmers House Plc, which is shown below, illustrates that, among other factors, the price discovery process in a start up market can also point to an upward trend in prices of securities.

Fig. 3.3.2.

FARMERS HOUSE PLC



Shareholding:			%
Institutional		:	0
Public		:	100

	K Million 1995	1994	1993
Turnover	433	180	49
PBT	224	49	1.2
PAT	147	32	0.43
Dividends	32	16	3.2
Earnings per share	45.28	-	-
PE ratio	22.08	-	-

SECTOR: Property Investment
Trading commenced on 7th June 1994

Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 8

The Lusaka Stock Exchange observes further that:

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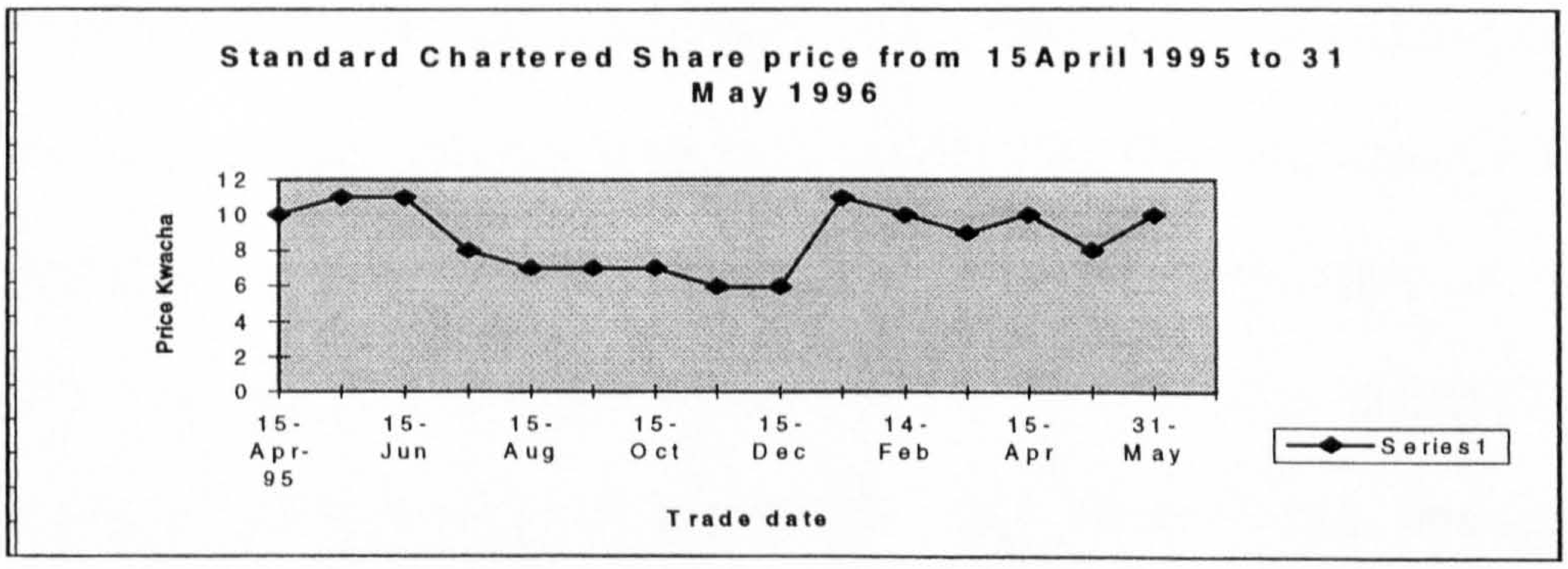
about the trades occurring and the information that may be implicit in the trade about the prospects of the particular economy. The extent to which the reduction in transparency brought about the delay in trade publication is important depends on two factors: 1) The proportion of large trades that are information based; 2) The amount of Exchange business affected by the change."

"The overall improvement in market pricing in the last two years of the Lusaka Stock Exchange can also be demonstrated by the price behaviour pattern in the last 12 months for Standard Chartered Bank, the most liquid stock... price movement and response in the Standard Bank stock is now reflective of investor expectations, market conditions and company performance. For some stocks such as Standard Chartered Bank the price discovery process is now essentially complete and *correct* market valuation levels are now established."[25]

In spite of the Lusaka Stock Exchange arguing that 'correct' market valuation levels have now been established for stocks such as Standard Chartered Bank Plc shares, it is not easy to determine what constitutes 'correct' market valuation levels. Perhaps, it would have been better to say 'steady' market valuation levels have now been established. The graph following below shows the price discovery process for shares in Standard Chartered Bank Plc on the Lusaka Stock Exchange.

Fig. 3.3.3.



Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 7

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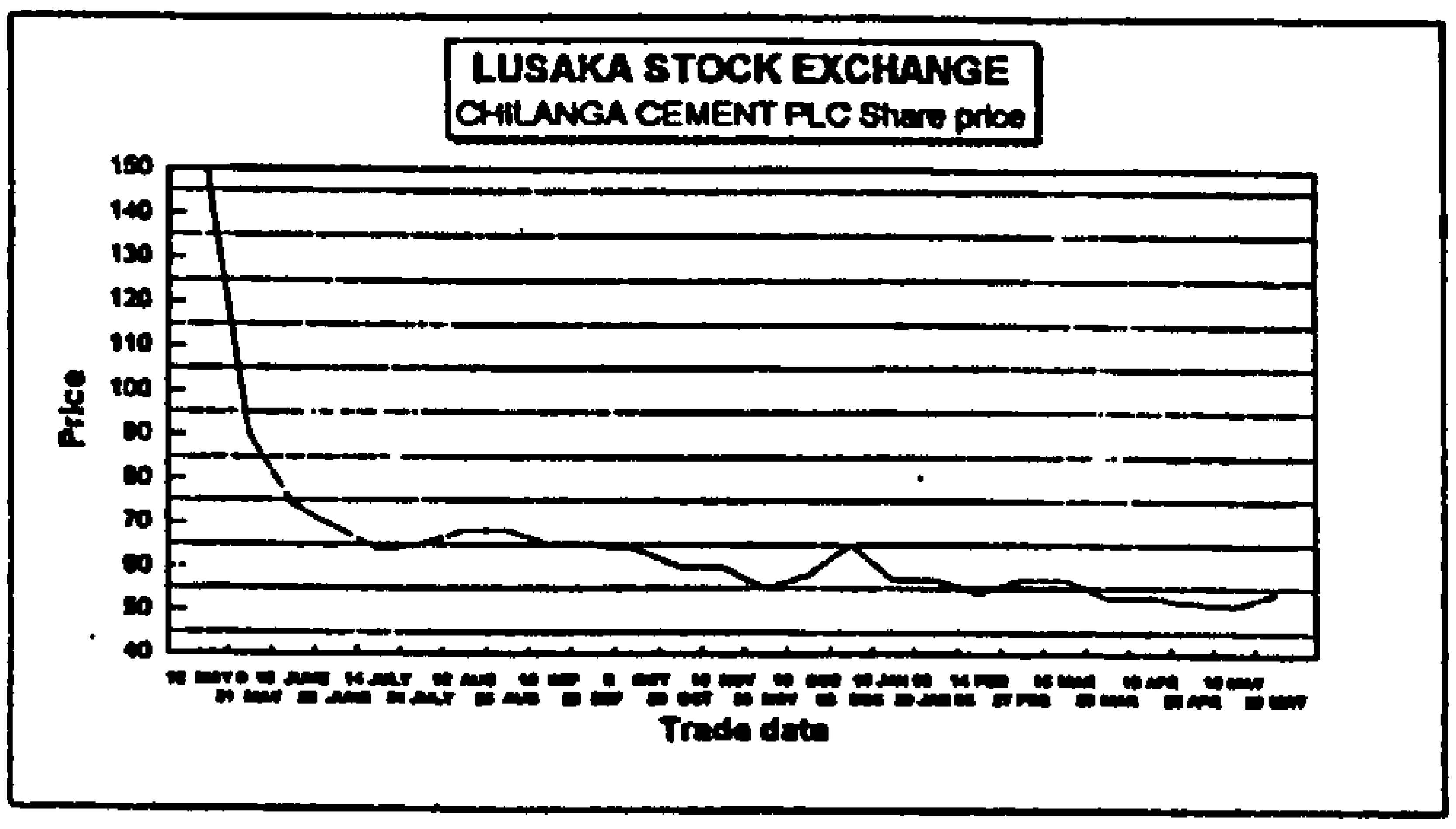
[25] Lusaka Stock Exchange, Update and Overview, *supra*., (n. 1), p.7.

The market performance of other company securities quoted or listed on the Lusaka Stock Exchange is set out in the graphs that follow below.

3.4. EVIDENCE ON PERFORMANCE OF OTHER LISTED AND QUOTED SECURITIES:

Fig. 3.4.1.

CHILANGA CEMENT PLC



SECTOR: Industrial - Producer of cement for construction and building.
Trading commenced on 12 May 1995.

Shareholding:		%
Commonwealth Development Corporation	:	50.1
Government	:	6.5
Zambia Civil Service Pension Fund	:	6.5
Anglo American Corporation	:	6.1
Zambia National Provident Fund	:	3.0
Portland Holdings Ltd - Zimbabwe	:	2.7
Public	:	25.1

Number of shares issued = 200,039,904

	K Million		
	1995	1994	1993
Turnover	20,027	12,363	5,351
PBT	2,319	2,657	1,241
PAT	874	1,805	831
Dividends	400	903	416
Earnings per share	4.37	9.02	4.16
PE ratio	12.35	-	-

Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 8.

We looked at the market capitalisation of the Lusaka Stock Exchange and noted that shortly after the exchange was established, the only company securities that were listed on its market were shares in Chilanga Cement Plc. When Chilanga Cement Plc was privatised in 1994, Commonwealth Development Corporation, a multinational corporation, exercised its pre-emption rights and purchased an additional 26 per cent shares in Chilanga Cement Plc for US $5.4 million.[26] This brought the total shareholding of Commonwealth Development Corporation in Chilanga Cement Plc to

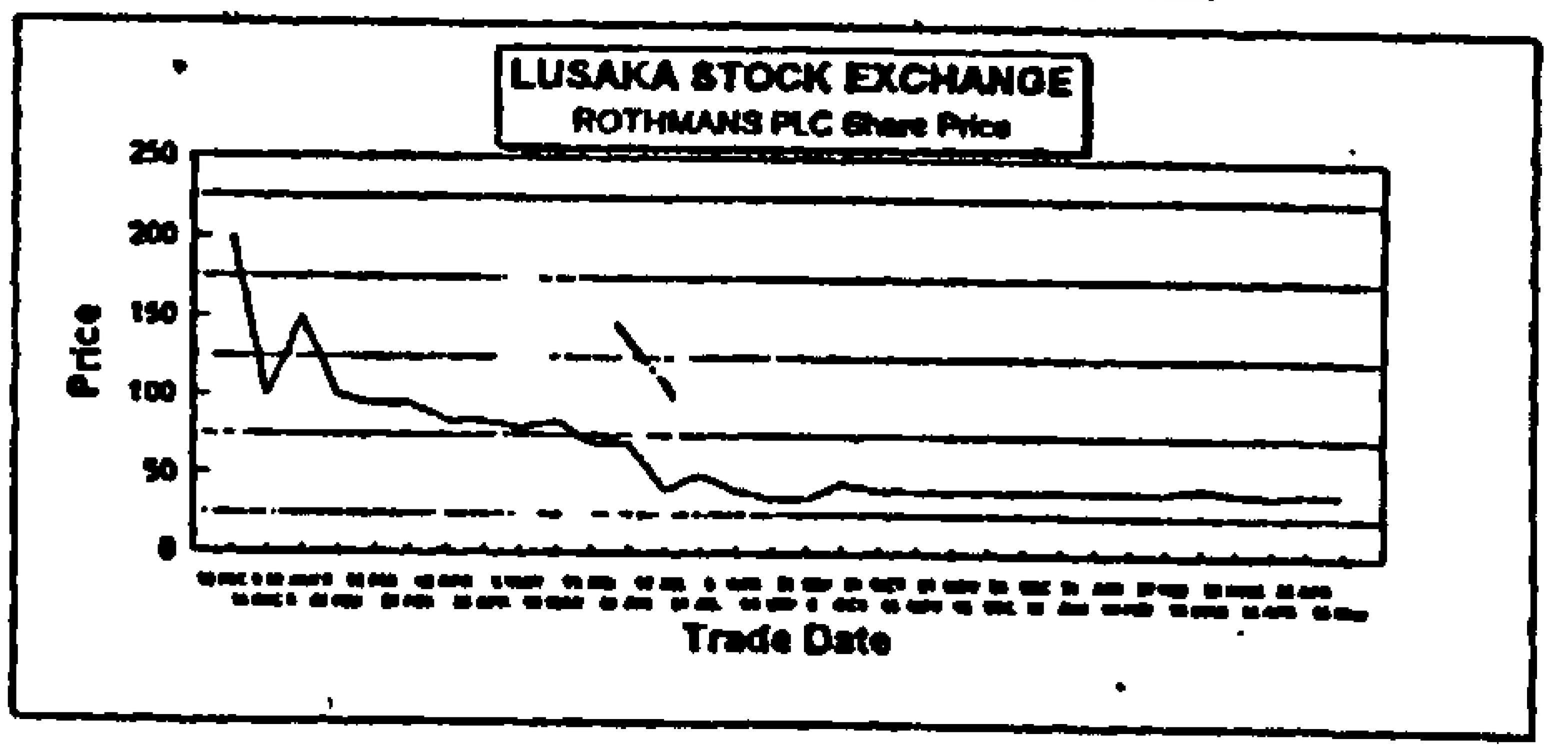
[26] See K.K. Mwenda, A Critical Review of Foreign Investment Policy in Zambia: Direct Investment, the Stock Exchange and Privatisation, unpublished MBA dissertation, (Hull: University of Hull, 1995), Appendix II.

50.1 per cent. A further 6.5 per cent of the remaining shares in Chilanga Cement Plc was taken up by Zamanglo Industrial Corporation Limited, a subsidiary of the Anglo American Corporation Group. The remaining 30 per cent of the Zambian government's shareholding in Chilanga Cement Plc (through Zambia Industrial and Mining Corporation Limited) was sold to the public by public flotation. The Zambia Privatisation Trust Fund was given the task to float the securities on the stock market. Thus by August 1995, more than 60 per cent of the shares in Chilanga Cement Plc were held by foreign investors. However, today, as shown in figure 3.4.1, Chilanga Cement Plc has more local investors largely due to the attractiveness of its shares not only to the public, but also to a few domestic institutional investors such as the Zambia National Provident Fund and the Zambia Civil Service Pension Fund.

Fig. 3.4.2.

STOCK PERFORMANCE (continued)

ROTHMANS OF PALL MALL (ZAMBIA) PLC



SECTOR: Industrial processing of tobacco and cigarette manufacture.
Trading commenced on 13th December 1994.

Shareholding:	%
Valtobac - Luxemburg	: 50.0
Zambia State Insurance Corporation	: 17.9
Zambia Privatisation Trust Fund	: 8.60
Public	: 23.5

K Million

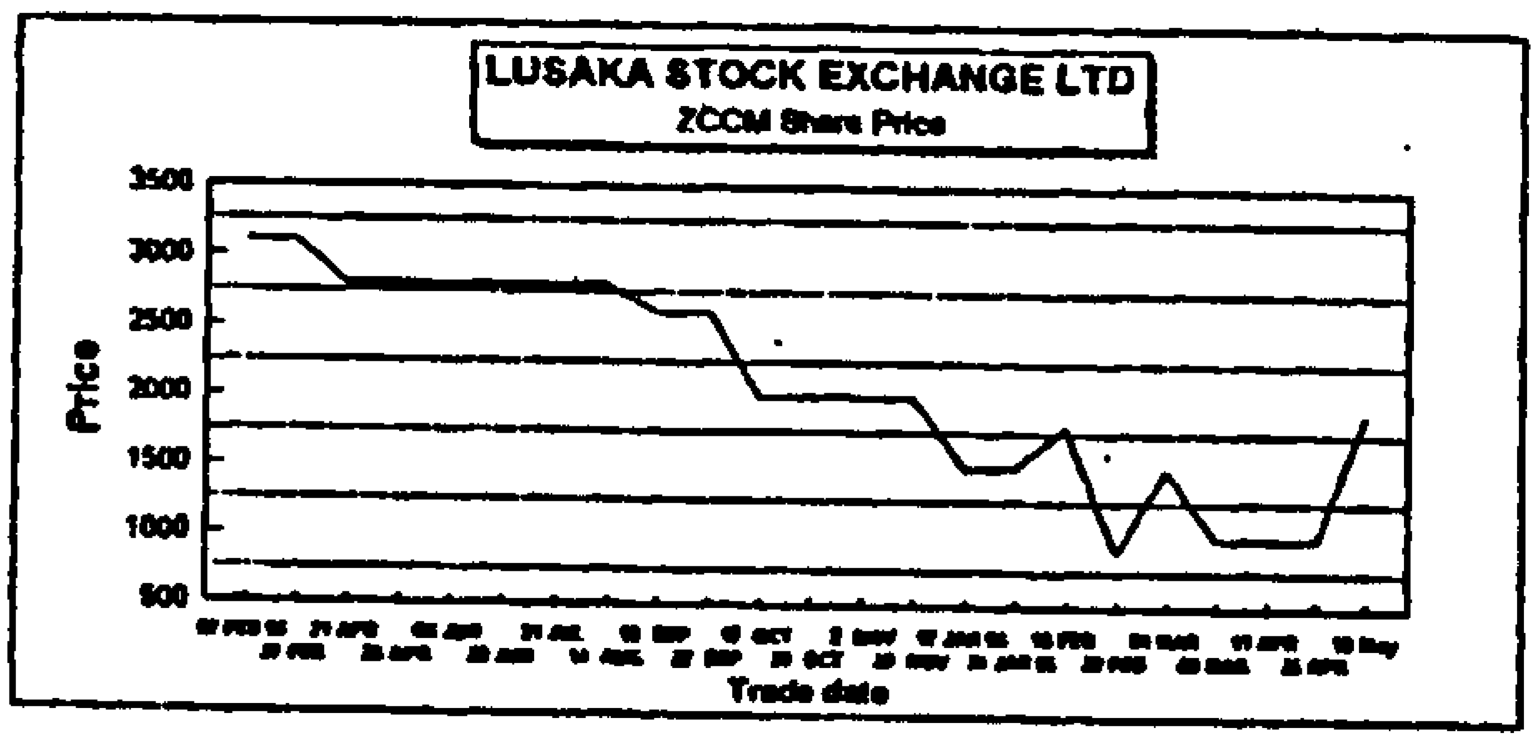
	1,995	1,994	1,993
Turnover	18,709	12,758	6,247
PBT	3,106	3,871	2,004
PAT	2,183	2,583	1,331
Dividends	164	80	40
EPS	10.50	11.73	6
PE ratio	3.80	8.52	N/A

Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 9

The graph shown above, on share price movements in Rothmans of Pall Mall (Zambia) Plc, like the graph on Bata Shoe Plc shares, shows how prior to achieving stability the price discovery process advances in a start up market. A big drop in the price of Rothmans of Pall Mall (Zambia) Plc shares can be noticed on the graph. Again, like in the case of Bata Plc, the drop in share prices is attributed mainly to the price discovery process in a start up market.

Fig. 3.4.3.

ZAMBIA CONSOLIDATED COPPER MINES LTD



SECTOR: Mining - Production of finished Copper and Cobalt for export.
Trading commenced on 27th September 1994.

Shareholding:	%
Government of The Republic of Zambia	: 60.3
Zambia Copper Investments [ZCI] Holdings	: 27.3
Public	: 12.4

	K Million		
	1,995	1,994	1,993
Turnover	1,121,301	574,957	359,086
PBT	34,823	(71,409)	66,293
PAT	3,461	(72,638)	41,557
Dividends	-	-	-
EPs	38.76	(813.45)	465.38
PE ratio	49.02	-	-

Source: Lusaka Stock Exchange, *Update and Overview*, (Lusaka: Lusaka Stock Exchange, 1996), p. 8

The share price movements in Zambia Consolidated Copper Mines (ZCCM) Plc indicate a gradual drop in share prices followed by a sudden rise in the prices. This random behaviour in share price movements could be attributed to several factors which include micro and macro-economic features of the Lusaka Stock Exchange. These features vary from market to market. As a result, on other stock markets where ZCCM Plc shares are cross-listed the price discovery process might be different. It is not, however, the aim of this work to examine the micro and macro-economic features of the price discovery process on the other markets where ZCCM Plc shares are cross-listed.

3.5. EMPIRICAL EVIDENCE ON CONSTRAINTS AFFECTING THE LEGAL FRAMEWORK AND THE DEVELOPMENT OF THE STOCK MARKET:

Constraints on the legal framework and failures of the stock market:

Our research findings indicate that when asked about how efficient Zambia's legal framework for regulating public distribution of securities is, almost all the interviewees observed that Zambia has in place an efficient legal framework.[27] These interviewees included market makers, financial intermediaries and the Chief Executives of the Lusaka Stock Exchange and the Securities and Exchange Commission.

When asked about the failures of the Lusaka Stock Exchange,[28] nine out of the twenty-three questionnaire respondents observed that the Lusaka Stock Exchange has not attracted enough local private investment. Here, nine responses represent the largest number of responses. The second largest number, seven, related to the view that the Lusaka Stock Exchange has liquidity constraints. Five, out of the twenty-three respondents, observed that the Lusaka Stock Exchange has not marketed its services very well. It was noted that although many people in the rural areas, who have potential to become market makers by investing in collective investment schemes, cannot communicate in English, the Lusaka Stock Exchange has not made efforts to market its activities to the rural communities in local languages.

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[27] See generally Appendices A to J (questions 1 and 2). See also results in research questionnaire, (Appendix K, question 11).

[28] See research questionnaire results, *Ibid.*, (questions 6 and 12).

Four respondents observed that stock trading on the Zambian stock market did not reflect accurate prices since trade did not operate on the market discipline of demand and supply. No explanation was given to clarify the meaning of 'the market discipline of demand and supply' in the context of trade on the Lusaka Stock Exchange. Other shortcomings of the Lusaka Stock Exchange, which attracted three or four responses each, included the views that there are sellers, but no buyers on the Lusaka Stock Exchange; trading is confined to the urban areas; people in Zambia have not responded favourably to long-term investment; there are few listed and unlisted company securities on the stock market; and that the Lusaka Stock Exchange has not been able to attract enough capital due to high inflation and interest rates in the national economy. Also, similar numbers of responses were obtained which indicated that the market share prices on the Lusaka Stock Exchange reacted slowly to information.[29] This evidence rationalises our submission on the price discovery process on a start up market such as the Lusaka Stock Exchange. Another set of three to four responses observed that there are low volumes of trade on the market and that there are other short-term investment choices (*e.g.* treasury bills at the Central Bank) which attract capital away from the Lusaka Stock Exchange. By contrast, the following matters attracted single responses each: the inability of the Lusaka Stock Exchange to create sufficient investor confidence due to the poor state of the economy; the lack of a centralised database to facilitate brokers' transactions; people have low savings; the absence of savings mobilisation schemes; forcing companies to list for tax purposes; expensive regulation; very low and unattractive dividend yields; and the Zambian

[29] This ties up with our argument earlier on the price discovery process in a start up market such as the Lusaka Stock Exchange.

government off-loading its parastatal company shares directly on the Lusaka Stock Exchange instead of going through the Zambia Privatisation Trust Fund.

The legal framework and evidence relating to market abuses:

Although constraints such as the inadequacy of liquidity and small volumes of trade in securities were noted as some of the constraints facing the Lusaka Stock Exchange, our research findings also show that even with weak statutory provisions on insider dealing law,[30] Zambia has not had a single case of insider dealing reported. The explanation here cannot be found in one succinct statement. We have noted above that almost all the interviewees observed that Zambia has in place an efficient legal framework for public distribution of securities.[31] On the other hand, it must be observed that since there are small volumes of trade on the Lusaka Stock Exchange that could mean that there is not enough activity on which we can base our evaluation of the law on insider dealing. Although, as we shall see in Chapter Six, the law on insider dealing in Zambia is conceptually weak due to poor drafting, the market players have not taken great advantage of the situation because the Zambian market is unsophisticated and few players are able to identify any abuses taking place on the market.[32] This view can be attributed partly to the fact that out of the players participating on the Lusaka Stock Exchange not many know about insider dealing.

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[30] See Chapter Six, infra.

[31] See generally Appendices A to J, (questions 1 and 2).

[32] See *Interview* with Mr. Mebeelo Mutukwa, Stockbroker and Managing Director, Pangea Securities Ltd. Lusaka, 11th December 1996 (Appendix F, question 5); *Interview* with Mr. Peter Yuyi, Manager Securities Brokerage, Emerging Markets Securities, Lusaka, 18th December 1996 (Appendix E, question 3(b)).

Our research findings also show that when asked if market abuses such as insider dealing were taking place on the Lusaka Stock Exchange,[33] nine out of the twenty-three questionnaire respondents *strongly disagreed.* Another nine *disagreed* while only two respondents thought that there was some form of insider dealing taking place on the Lusaka Stock Exchange. The remaining three respondents were not sure and thus *could not ascertain.* A further inquiry was made to find out if other abuses such as false, fraudulent and dishonest disclosures were taking place on the Lusaka Stock Exchange.[34] Twelve out of twenty-three respondents *disagreed* while eight *strongly disagreed.* The remaining three were not sure and thus *could not ascertain.* Overall, more than 80 per cent of the responses showed that there was no evidence of market abuses such as insider dealing or false, fraudulent and dishonest disclosures on the Lusaka Stock Exchange. Thus, although some minor market abuses could have taken place on the Lusaka Stock Exchange, no such abuses have been reported to the Securities and Exchange Commission.[35] Some of the reasons for this development include the view that since there are small volumes of trade in securities on the Lusaka Stock Exchange, the likelihood of there being fast and loose players on the market is minimal.[36] Also, as pointed out above, since most of the players on the market are not very sophisticated, they can hardly engage in or detect offences such as insider dealing.

[33] See research questionnaire results (Appendix K, question 15d).

[34] See Ibid., (question 15f).

[35] *Interview* with Mr. Mumba Kapumpa, Chief Executive, Securities and Exchange Commission, Lusaka, 18th December 1996 (Appendix C, question 8).

[36] See *Interview* with Mr. Peter Yuyi, op. cit., (question 3(b)). See also *Interview* with Mr Mumba Kapumpa, Ibid., (question 8).

Ultimately what obtains in Zambia is a form of market efficiency, unaffected by loopholes in the law on insider dealing, which thrives mainly because the law has not been put to strict test and the players and regulators are content with the system. If an economic analysis of the law were to be applied here, and the Coase theorem[37] adopted, the outcome would be that the regulatory system is efficient since all the interested parties are satisfied with the law.[38] However, as pointed out by a number of stockbrokers, the Zambian stock market is still unsophisticated.[39] Thus, in due course, as the volume of trade continues to grow, complaints of market abuses could arise if no pro-active measures are taken to amend the law on matters such as insider dealing.

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[37] See D. Harris, Remedies in Contract and Tort, (London: Weildenfeld and Nicholson, 1988), pp. 335-337 at p. 335. Harris observes that "according to Coase, in the hypothetical world in which there are no transaction costs to impede bargaining between the parties, where they have full information and are willing to co-operate to their mutual advantage, it would not matter what the court decided, or even if it found that D (defendant) was not liable at all. The reason is that the parties would proceed to negotiate an agreement whenever that would produce the efficient outcome."

[38] See D. Harris, Remedies in Contract and Tort, *Ibid*., p. 335, (For the moment, ignoring that 'imperfect' information or the different rate at which information relevant to demand is reaching the various players on the market is one of the factors driving the price discovery process). Rules which are implicitly agreed upon by interested parties must be treated in the same manner as rules which are negotiated and expressly agreed upon by such parties.

[39] See for example *Interview* with Mr. Mebeelo Mutukwa, op. cit., (question 5); *Interview* with Mr. Peter Yuyi, op. cit., (question 3(b)).

Off-the-market transactions and how they affect market transactions:

It was pointed out in Chapter One that with regard to off-the market transactions, this study examines only reasons why such transactions exist and how these transactions constrain the development of the Lusaka Stock Exchange.

One of the reasons why transactions in shares and other financial instruments off the Lusaka Stock Exchange have persisted is that securities regulation on the Zambian stock market is somewhat costly.[40] By staying away from the market, risk-averse players can avoid the costs of regulation.[41] Another reason why off-the-market activities have persisted in Zambia, and perhaps more important than the former, is that the availability of (and trade in) treasury bills and government bonds off the Lusaka Stock Exchange attracts capital to such short-term investment instruments.[42] In addition, one other reason that explains why off-the-market transactions have persisted in Zambia is that due to inflation in the economy many commercial banks offer high

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[40] Here, the word 'somewhat' is used to show the limitations to this view. Only one questionnaire respondent observed that Zambia had a costly regulatory structure. This one submission is in contrast to the views of almost all the interviewees. The latter respondents observed that Zambia has an efficient legal framework for regulating public distribution of securities.

[41] These could include compliance costs (*e.g.* on disclosure requirements, listing rules and rules on securities registration), transaction costs, costs relating to acquisition of information relevant to market demand and costs of entry and exist on the market.

[42] *Interview* with Dr. Abraham Mwenda, Director Financial Markets, Central Bank of Zambia, Lusaka, 30th December 1996 (Appendix I, question 6).

interest rates on clients' bank accounts.[43] Commenting on off-the-market transactions in the United Kingdom, the Director of Fair Trading observes:

> "If a securities exchange does not itself possess any market power, because there are plenty of alternative ways to trade the securities in question, then rules set by that particular exchange are unlikely to have any significant effects on competition in the market for dealing in the relevant securities. If trading on the exchange becomes too expensive investors will choose to trade elsewhere..."[44]

Indeed, a risk averse investor, who is eager to get quick returns on his investment, would prefer putting his money in a bank account to investing in shares on a stock market. Generally, shares are a long-term investment and returns on such instruments are conditional upon matters such as the availability of distributable profits from which dividends can be paid. However, there are now concerted efforts by the Central Bank of Zambia and the Lusaka Stock Exchange to introduce treasury bills and government bonds to the debt market of the Lusaka Stock Exchange. As pointed out by the Central Bank's Director of Financial Markets:

> "...like I said initially, ... when we started trading as a fiscal agent, the Government (of Zambia) charged us with the responsibility of primary issuing of the various

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[43] See *Interview* with Mr. S.M. Gupta, Director of Finance, Development Bank of Zambia Ltd., Lusaka, 14th December 1996 (Appendix D, question 7).

[44] A Report To The Chancellor Of The Exchequer By The Director General Of Fair Trading Under The Financial Services Act 1986, Rules Of The London Stock Exchange Relating To Market Makers, *supra*., (n. 24), pp. 25-26.

> government papers, that is, the treasury bills and bonds. At the time we started this, the stock exchange was not there. But once it was introduced, we had tried to... like I said earlier on, to promote secondary market dealing in debt securities by trying to have for instance bonds listed on the stock exchange. So far, that is the only tangible thing that has been tried. We are currently looking at the proposal which came from the Lusaka Stock Exchange to try and use the central depository system of the stock exchange as way of promoting secondary trading. But for primary trading we still deal with the...up until I think about two years ago, we used to issue through commercial banks as well as individuals. But, we have now eliminated what we call 'the retail issue', that is, the issuing to individuals and are only dealing with commercial banks in their individual capacity. We are not yet using the Lusaka Stock Exchange system for primary issues of government paper. But you see in the proposal there are certain issues which have to be worked out. Like, what are the legal implications? What needs to be revised in terms of the law regarding treasury activities? For instance, the current law requires right now that we issue paper as evidence of trade in treasury bills and the proposal by the Lusaka Stock Exchange is that they want to promote electronic... let me say, its a book entry system which has to do away with the requirement to have a physical paper. So, you need to change the law before you can move to the other system."[45]

Up until mid 1997, the debt market of the Lusaka Stock Exchange had been inactive compared to the equity market of the exchange. However, although the legal framework for public distribution of securities in Zambia has been seen by many as efficient,[46] its efficacy in relation to regulation of debt securities has not yet been fully

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[45] *Interview* with Dr. Abraham Mwenda, op. cit., (question 6).

[46] See generally, Appendices A to J, op. cit., (questions 1 and 2).

tested because the Central Bank of Zambia has, until recently, been distributing treasury bills and government bonds off the Lusaka Stock Exchange. We now turn to examine the role played by financial institutions in financing investors who intend to buy company securities in Zambia. We also examine below the issue of whether or not financial institutions in Zambia have played an active role in buying or holding shares in public companies.

3.6. LIMITED PARTICIPATION OF FINANCIAL INSTITUTIONS IN SECURITIES INVESTMENT AS A CONSTRAINT:

Commenting on the sources of corporate finance in many western countries, Alexander and Nobes observe:

> "In some countries, a major source of finance for two centuries has been share capital and loan capital provided by large numbers of private investors. This has been the predominant mode of raising finance in the United States and the United Kingdom. Although it is increasingly the case that shares in these countries are held by institutional investors rather than by individual shareholders, this still contrasts with state, bank or family holdings (see below) ...
>
> By contrast, in France and Italy, capital provided by the state or by banks is very significant, as are family businesses. In Germany, the banks, in particular, are important owners of companies as well as providers of debt finance. A majority of shares in some public companies are owned directly or controlled through proxies by banks, particularly by Deutsche, Dresdner and Commerz banks. In such countries the banks or the state will, in many cases, nominate directors and thus be able to obtain

private information and to affect decisions. If it is the case that many companies in continental countries are dominated by banks, governments or families, the need for published information is much smaller. This also applies to audit because this is designed to check up on managers in cases where the owners are 'outsiders'."[47]

In Zambia, the position of England and the United States has been quite influential in the area of corporate finance. There is need, however, to qualify this observation. The underdeveloped state of the Zambian economy has been a major drawback to the growth of the stock market in the country. We noted earlier on that the respondents to the research questionnaires indicated that liquidity constraints and the underdeveloped state of the economy were some of the drawbacks to the development of the Zambian stock market. Although the volumes of trade in equity securities could increase temporarily during the period of privatisation, it is doubtful that the increase will be sustained after the privatisations.[48] Privatisations in Zambia are too thin to stimulate a long term investment culture in the economy.

Empirical Evidence On The Concept Of A Stock Market In Zambia:

There is no doubt that the role of the Lusaka Stock Exchange, unlike that of the London and New York Stock Exchanges, is a peculiar one. Whereas the London and New York Stock Exchanges were not introduced as facilitators of privatisation programmes or as part of an IMF/World Bank sponsored economic recovery

[47] D. Alexander and C. Nobes, A European Introduction to Financial Accounting, (Hempstead: Prentice Hall, 1994), p. 68.

programme, the Lusaka Stock Exchange was introduced primarily to facilitate the privatisation of state owned enterprises in Zambia.[49] As our research findings indicate, when asked about how important the respondents considered the structural adjustment programme and privatisations as reasons for introducing the Lusaka Stock Exchange,[50] more than 80 percent of the respondents observed that the structural adjustment programme and privatisations were *very important* factors. The remaining 13 percent observed that the structural adjustment programme and privatisation were *fairly important* factors. No respondents mentioned any other factors.

Apart from facilitating the privatisation programme in Zambia, another reason why the Lusaka Stock Exchange was set up was that it was part of the IMF/World Bank sponsored economic recovery programme.[51] By contrast, economies of many western states have not undergone the type of socio-economic formations that were (and are) found in a number of African states. In Africa, these economic formations include colonialism and neo-colonialism, state capitalism, African socialism and the structural dependency of African states on metropole states.[52] Therefore, to try and transplant ideas such as those on stock markets in western countries and apply them to African economies without consciously evaluating the adaptability of such ideas to the local

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[48] *Interview* with D. Herman, Advisor, Publicity and Marketing, Zambia Privatisation Agency, Lusaka, 9th September, 1993.

[49] See Chapter One supra. See also below and research questionnaire results (Appendix K, question 4).

[50] See research questionnaire results, (Appendix K, question 4).

[51] See findings in Appendix K, question 4.

[52] See Chapter One, supra.

conditions in African countries would be playing down the role of stock markets in general. As Briston observes,[53] the increase in the issue of securities of a long-term or permanent nature and the expansion of industry are important factors that led to the development of markets such as the London Stock Exchange. It is clear that this was not the case in Zambia.

In Zambia, prior to privatisations being embarked on the state was the main provider of corporate finance to parastatal companies. Other business entities in the country were privately financed from sources such as primary issues of shares and commercial transactions relating to their trade. Banks in Zambia, although providing some form of debt finance, were not (and have not been) active in providing equity finance.[54] The State-led type of corporate financing that took place in Zambia was also seen in many other African countries that had state capitalist socio-economic formations. In most of these countries, the role of private investors as sources of equity and debt finance was seen as applying mainly to the private business sector. The public sector remained predominantly within the realm of state funding. From the time of state capitalism, a culture was built in Zambia that made private investors believe that it was only the state that was endowed with powers and responsibilities to invest in shares of parastatal companies. Generally, private investors, both individual and institutional investors, were denied the opportunity to invest in parastatal company shares. On a few occasions when such investors were able to invest in parastatal company shares

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[53] R.J. Briston, The Stock Exchange and Investment Analysis, (London: George Allen and Unwin Ltd., 1973), pp. 34-35.

[54] See above.

they did so at the invitation of the state.[55] Thus, organisations such as private banks remained rooted to the business of hosting bank accounts and seldom did they provide debt financing.[56] By contrast, one rare instance where banks have been seen as providers of equity finance in Zambia is the case of Development Bank of Zambia Limited.[57] Among other banks, Africa Development Bank owns equity interests in Development Bank of Zambia.[58]

The negligible role of banks in securities investment as a constraint:

Generally, banks in Zambia have not been active in providing finance to investors intending to purchase company securities.[59] Neither has the Zambian government been active in encouraging banks to provide finance to such investors. To this extent, the role of banks as providers of finance to investors has been played down. The effect that this has on public distribution of securities in Zambia is that it places a limit on the sources of finance available to prospective investors. In turn, these persons, although having some personal assets which they can use as collateral to secure loans, are not

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[55] See generally J.M Mulwila, Parastatal Companies and the Law in Zambia, unpublished PhD thesis, (London: University of London, 1980).

[56] For example, providing bank overdrafts that earn the bank money high interest rates.

[57] *Interview* with G. Ngulube, Director of Post Evaluation and Economic Research, Development Bank of Zambia, Lusaka, 2nd March 1992.

[58] See *Interview* with G. Ngulube in *Ibid*.

[59] Apart from the notion that many bank managers in Zambia have not yet appreciated the role of a stock market in raising corporate finance, there is also the argument that banks do not feel safe in lending money for the sole purpose of enabling the debtor to buy shares. The reason here is that shares are not seen by many banks as appropriate or adequate collateral for securing loans. See *Interview* with Mr. S.M. Gupta, *op. cit*., (question 11(b)).

able to participate fully on the Lusaka Stock Exchange due to their 'illiquid' financial positions. Finance and treasury managers of banks in Zambia must begin to appreciate the role of a stock exchange in facilitating capital formation.[60]

Before we turn to Part II of this chapter, we submit that it would not be easy to test the market efficiency of the Lusaka Stock Exchange given that the exchange is still in its early stages of development and it has few company securities listed on it. Furthermore, although, as we shall see in Chapter Six, the law in Zambia on insider dealing shows a number of weaknesses, that alone cannot be relied upon as a basis on which to test the market efficiency of the Lusaka Stock Exchange. We are mindful, however, that although liquidity constraints have been identified as some of the major constraints facing the Lusaka Stock Exchange,[61] we will only endeavour to pursue arguments relating to liquidity in so far as liquidity constraints affect the efficacy of the legal framework for public distribution of securities in Zambia. It is worth noting here that some studies have been undertaken by financial economists on the relationship between liquidity and the trading location of developed stock markets such as the Nasdaq, Amex and the New York Stock Exchange.[62] Since this study is not concerned

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[60] See for example *Interview* with Dr. Abraham Mwenda, op. cit., (question 3).

[61] See generally Appendices A to J.

[62] See generally H. K. Baker, "Trading Location and Liquidity: An Analysis of U.S Dealer and Agency Markets for Common Stocks," Financial Markets, Institutions and Instruments, op. cit. In that paper, H.K Baker observes (p.44): "...some differences in market microstructure appear to favour dealer markets while others favour agency markets. Microstructure analysis cannot assert *a piori* that a particular market structure will afford the most liquid for a given security... The problem of comparing the relative liquidity of alternative market structures starts with the definition of liquidity. Intuitively, the concept of liquidity is straightforward.

with the microstructures of the Lusaka Stock Exchange or with the impact of these structures on the liquidity of the exchange,[63] we will not pursue that line of thought.

Limited International Marketing Of Business On The Lusaka Stock Exchange As A Constraint:

One other constraint affecting the development of the Lusaka Stock Exchange has been that the Zambian government has not made as much effort to market the stock exchange internationally as it has done with the privatisation programme. Zambia's privatisation programme has been marketed to the international community through

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Liquidity refers to the ability to trade quickly at prices that are reasonable considering underlying demand/supply conditions. This definition stresses two dimensions of liquidity - speed and price (cost) - but it is neither perfect nor very rigorous. The concept becomes elusive when trying to measure liquidity. Unfortunately, there is no single, unambiguous, theoretically correct or universally accepted measure of liquidity." Later in this work, we shall examine other definitions of liquidity.

[63] It suffices to say that a number of financial economic studies on the topic show that due to differences in microstructures of stock markets, differences in liquidity are likely to occur among different markets. See generally H. K. Baker, "Trading Location and Liquidity: An Analysis of U.S Dealer and Agency Markets for Common Stocks," Financial Markets, Institutions and Instruments, *supra*., (n. 16). See also J.C. Groth and D.A. Dobosfsky, "The Liquidity Factor," in D.F. Parrillo, E.R. Hobbing, M.V. Porter and J.G Gutman, (eds.), The NASDAQ Handbook, (Chicago: Probus Publishing Co., 1992), pp. 327-345; Y. Amihud and H. Mendelson, "Liquidity and Stock Returns," Financial Analysis Journal, Vol. 42, No. 3, (1986), 43-48; Y. Amihud and H. Mendelson, "Liquidity and Asset Prices: Financial Management Implications," Financial Management, Vol. 17, No. 1, (1988), 1-115; P.L. Bernstein, "Liquidity, Stock Markets, and Market Makers," Financial Management, Vol. 16, No. 2, (1987), 54-62; and S.J. Grossman and M.H. Miller, "Liquidity and Market Structure," Journal of Finance, Vol. 43, No.3, (1988), 617-633.

adverts and articles in various media abroad.[64] If the Lusaka Stock Exchange has to develop into a competitive world market there is need to address this problem. Arguably, the lack of international publicity that the Lusaka Stock Exchange faces, as is the case with a number of other emerging markets in Africa, deprives prospective investors of information on matters such as the 'resiliency,' 'depth' and 'breadth' of a stock market.[65] In regulating and attracting investments to any stock market, information is an important factor to consider. Information can affect the efficiency of a stock market. Its transmission must therefore be regulated properly. Information can also affect investor confidence in the market. In addition, information can affect not only the prices of securities on the market, but also the fairness of trade on the market.

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[64] See for example Financial Times, (England), 20th July, 1995, p. 29, on the privatisation of Chambishi copper mines.

[65] According to R.A. Schwartz, Reshaping the Equity Markets: A Guide for the 1990's, quoted in H.K. Baker, "Trading Location and Liquidity: An Analysis of U.S Dealer and Agency Markets for Common Stocks," Financial Markets, Institutions and Instruments, *supra*., (n. 16), p. 6: A liquid market typically has three attributes - *depth, breadth*, and *resiliency*. A market has depth if there are orders both above and below the price at which a security now trades. Depth is lacking when price rounding is substantial and the bid-ask spread is large. On the other hand, a market is broad if the buy and sell orders are both numerous and large. Thus, price changes, in a liquid market, should be invariant to the size of the transaction. Breadth is lacking when the effective spread for large orders is large. By comparison, a market is resilient if new orders pour in promptly in response to price changes that result from temporary order imbalances. Resiliency is lacking when the order flow does not adjust quickly to errors in price discovery.

II. POTENTIAL MARKET PLAYERS ON THE LUSAKA STOCK EXCHANGE

3.7. LIMITED PARTICIPATION OF THE ZAMBIAN PUBLIC ON THE LUSAKA STOCK EXCHANGE AS A CONSTRAINT:

It has been shown above that by August 1995 Chilanga Cement Plc was the only company listed on the Lusaka Stock Exchange. Since the Zambian public had 37.3 per cent shareholdings in Chilanga Cement Plc at the time, 37.3 percent of the total market capitalisation represented the degree up to which the Zambian public participated on the Lusaka Stock Exchange. As more companies began to list shares on the Lusaka Stock Exchange, trade in these securities started to grow. We have provided above information on the market performance of some of the company securities listed on the Zambian stock exchange.

Limited participation of the rural population in securities investment as a constraint:

Given a dual economy that comprises a relatively underdeveloped rural sector and a semi-modern urban sector, Zambia today faces the problem of having a securities market that is predominantly confined to the urban sector. Generally, this is a common feature in many developed and less developed countries. By comparison, since developed countries often have highly capitalised urban areas from which capital can be drawn, developing countries need to adopt different innovative measures which would attract capital to their emerging markets from across the country. Such is our proposal for Zambia.

In Zambia, many people in the rural areas have no access to the stock exchange and do not know what a stock exchange is all about.[66] Indeed, there is no conscious effort on the part of financial institutions in Zambia to establish collective investment schemes in rural areas so that capital in these areas is mobilised and invested on the Lusaka Stock Exchange. Furthermore, it is evident that the economic infrastructure in Zambia's rural area is underdeveloped. People in the rural areas have inadequate credit facilities from which they can borrow money.[67] Most of the banking institutions in Zambia are located in the urban areas. This makes it difficult for the rural people to have access to banks. Apart from these factors, generally people in the rural areas have no assets to place as collateral to secure loans to buy shares on the Lusaka Stock Exchange.[68] In addition, as we have already established, banks in Zambia have not been known to loan money to investors for the purpose of enabling them to buy shares in companies. It could be argued, however, that even if banks in Zambia were to assist financially in acquisition of company shares many people in Zambia are still struggling to meet their basic physiological needs and would thus be inclined to seek first, their shelter, clothing and food before they can think about investing in company shares.[69] Generally, risk averse investors, who include a large part of the Zambian public, will not be inclined to

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[66] See for example *Interview* with Mr. P. Yuyi, op. cit., (question 5).

[67] See G.H. Miller and D. Levin, "Micro-enterprise development: An analysis of Kabwe and Lusaka enterprises in Zambia," Journal of Small Business Management, Vol. 31, No. 1, (1993), pp. 99-104.

[68] Apart from a few commercial and semi-commercial farmers who can place their stock or farming implements as security for a loan.

investing in shares since the pay-back period for investments in such instruments often stretches over a long period of time. Inflation in Zambia today makes it lucrative to invest in short-term instruments such as bank accounts, treasury bills and government bonds because these instruments have short pay-back periods and high yields.[70]

I have argued elsewhere that economic dualism in Zambia, like in many other developing countries, has led to a situation where a number of people in the rural areas are semi-literate.[71] By parity of reasoning, it could be argued that people in the rural areas may not appreciate the role of a stock exchange in fostering economic development. Thus, their position as potential market players would remain underplayed. Although there is presently no documented evidence on the percentage of Zambia's rural population that has sufficient education and resources to participate on the Lusaka Stock Exchange, the marketing of services in local languages and the use of collective investment schemes would help to galvanise resources in the rural areas for investment on the Lusaka Stock Exchange.

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[69] See *Interview* with Mr. P. Yuyi, *op. cit.*, (question 5). For an elaborate read on theories of motivation see generally C. Handy, Understanding Organisations, (London: Penguin, 1993).

[70] See above. See also Chapter Two, *supra.*

[71] See K.K. Mwenda, "Regulation of International Finance in Zambia," Public Law Journal, South Africa, Vol.11, No.2, (1996), p. 562; see also generally United Nations, Statistical Yearbook: Thirty-ninth issue (New York: United Nations, 1994).

The location of parastatal companies and the lack of collective investment schemes on the stock market as constraints:

Another problem facing the Lusaka Stock Exchange is that most of the parastatal companies that could be considered for listing are based in the urban areas. The Lusaka Stock Exchange itself, including the major collective investment schemes in Zambia, are also located in the urban areas. As we saw earlier, a number of respondents observed that this feature is a drawback to the development of the Lusaka Stock Exchange.[72] The locality of the stock exchange and that of institutions such as banks and collective investment schemes ostracises the rural community from investing in securities on the Lusaka Stock Exchange.[73]

Generally, the small volumes of trade and activity on the Lusaka Stock Exchange are indicators of anomalies such as lack of information on the part of the rural people and liquidity constraints in the national economy. The situation in Zambia can be arrested partly by the Zambian government considering the importance and need to disseminate information on privatisations and the Lusaka Stock Exchange to the rural people. Also, the setting up of collective investment schemes in Zambia must be encouraged, both in

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[72] See research questionnaire results, (Appendix K, question 6).

[73] In Zambia, like in many other developing countries where the state has had the monopoly in providing services such as postal deliveries and telecommunications, the infrastructure in these economic sectors is not well developed. One of the reason for this feature is that the absence of competition in the state-run systems stifled innovation and quality improvement. Thus, the use of technology such as postal services and telecommunications in Zambia's rural areas is quite poor. The residents in these parts of the country cannot therefore rely effectively on postal services and telecommunications as a medium through which to participate on the Lusaka Stock Exchange.

the urban and rural areas, so that individuals' savings can be mobilised and invested in securities on the Lusaka Stock Exchange. Zambian investment trusts must also be encouraged to invest in securities listed or quoted on foreign markets. This would not only help integrate emerging stock markets in Eastern and Southern Africa, but would also facilitate a much more efficient spread of investment risks since some overseas investment portfolio have higher returns than those in emerging capital markets. Our research findings indicate that almost all the interviewees observed that there is an urgent need to have collective investment schemes set up in Zambia.[74] The setting up of collective investment schemes such as unit trusts would be influenced by the expected returns from the investments on the Lusaka Stock Exchange. If, for example, the investment risks outweigh the expected returns, it is unlikely that there would be need to set up a unit trust to invest in risky portfolio.[75] The idea behind unit trusts, as we shall see in Chapter Seven, is to reduce the risk faced by individual investors.[76]

The absence of public utilities companies and football team companies on the stock exchange and its contribution to the liquidity crisis:

Public utilities companies in Zambia, such as parastatal companies supplying electricity and telephone services, must be encouraged to list their securities on the Lusaka Stock Exchange. Most of the parastatal companies that have securities listed or quoted on

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[74] See generally Appendices A to J.

[75] For detailed readings on corporate finance decisions and investment appraisal techniques see J.M. Samuels, F.M. Wilkes and R.E. Brayshaw, Management of Company Finance, (London: Chapman and Hall, 1994), pp. 67-84, 105-141, 177186,189-200.

[76] Linklaters and Paines, Unit Trusts: The Law and Practice, (London: Longman, 1992) Part C, Appendix 5429.

the Lusaka Stock Exchange have done so under the privatisation programme. It is, therefore, expected that when public utilities companies, such as the Zambia Electricity Supply Company, begin to undergo privatisation, they too will list their securities on the Lusaka Stock Exchange.[77]

Although the concept of a stock exchange in Zambia is new to many companies, the Lusaka Stock Exchange observes that football companies must be encouraged to list their securities on the stock market.[78] Football is a very popular sport in Zambia and it can draw individuals' savings when shares of football companies are distributed to the public on the Lusaka Stock Exchange. The listing of football companies on the Zambian stock market would promote professionalism not only in the sport itself, but also in the management of such companies. At the same time, this would increase the sources of finance available to football teams in Zambia. Our proposal here is based on the view that the Zambian public, like some publics in Europe, if faced with such diverse investment opportunities, could begin to invest in securities on the stock exchange. Indeed, for the most part these publics have some capital but choose to invest in other instruments. We have already shown how treasury bills and bank accounts in Zambia have attracted individuals' savings.

[77] Discussion with Mr. Charles Mate, Chief Executive, Lusaka Stock Exchange, Lusaka, 20th December 1996.

[78] See generally Discussion with Mr. Charles Mate, in *Ibid.*

Low levels of earnings and savings as a constraint:

The propensity of the Zambian public to build up personal savings is an important factor to address when looking at constraints facing the regulatory framework governing public distribution of securities in Zambia. In Zambia, like in many other developing countries, measures such as the wage ceiling under the structural adjustment programme do affect the general level of demand in the economy.[79] Indeed, wage ceiling does affect the level of savings of many Zambians.[80] It is submitted here that limited savings can adversely constrain demand in the economy. Also, since wage ceiling, imposed mainly to address inflation, can lead to limited purchasing power, that in turn could affect the extent to which people can secure finance to participate in public distribution of securities. Credit facilities from banks will generally not be available where prospective debtors cannot furnish sufficient security to secure loans. Indeed, limited credit facilities place a limit on the sources of finance available to enable investors to participate on the Lusaka Stock Exchange. Overall, it must be observed that when we consider personal savings of individuals in Zambia, and their buying power, there is need also to take into account the bid-ask prices on the market and the per capita income in Zambia. In 1987, GDP ('Gross Domestic Product', current prices) in Zambia was ZK18, 079.8 million whereas GDP per capita (current prices) was ZK2,486.9.[81] Following below is information showing a decline in the GDP of Zambia from 1980 to 1991:

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[79] On Zambia, see *Interview* with Mr. P. Yuyi, *op. cit.*, (questions 5 and 6).

[80] See *Ibid.*, (questions 5 and 6).

[81] H. Marden (ed.), Whitaker's Almanack, (London: J. Whitaker and Sons, 1995), p. 1064.

1980	**Z K3,656**	**US $808**
1985	Z K9,351	US $505
1991	Z K23,450	US $453

Fig. 3.7.1. Decline of the Gross Domestic Product in Zambia, 1980- 1991. Source: United Nations, *Statistical Yearbook: Thirty-ninth issue*, (New York: United Nations, 1994, p. 220

The information shown above takes into account the declining value of the Zambian Kwacha against the US dollar since the mid 1970's. Data on Zambia's inflation and exchange rate movements between 1986 and 1994 is presented below.

YEAR			*INFLATION (%)*	*EXCHANGE RATE (K:US$)*		
1986			54.6	7.37		
1987			47	8.88		
1988			54	8.35		
1989			128	13.98		
1990			107	31.71		
1991			118.4	65.92		
1992			187.3	173.93		
1993			191.1	401.17		
1994			38	681.90		

Fig. 3.7.2. Inflation and Exchange Rate Movements in Zambia, 1986-1994. Source: Central Bank of Zambia, Central Statistical Office, quoted in M.C. Mungule, *Structural Adjustment in Zambia: The Issue of Privatisation*, unpublished MA(Econ.) dissertation, (Lusaka: University of Zambia, 1995), p. 98.

Although inflation has now been reduced from over 100 per cent to single figures as a result of drastic economic restructuring measures such as wage ceiling and siphoning of the Kwacha out of circulation through use of treasury bills, the prices of commodities in the economy keep rising.[82] On that basis, it is argued that the likelihood of the Zambian public becoming a major market maker on the Lusaka Stock Exchange is relatively small. The majority of Zambians do not have enough capital to

[82] The Economist, July 1st-7th 1995, Vol. 336 No. 7921, pp. 54-55.

become market makers.[83] As pointed out earlier, they are busy struggling to meet their basic physiological needs. This explains why, for example, by August 1995 foreign investment constituted more than 60 per cent of the total market capitalisation of the Lusaka Stock Exchange.[84]

3.8. SOME EMPIRICAL EVIDENCE ON PRIVATISATIONS AND THE SUCCESS OF THE LUSAKA STOCK EXCHANGE:

By August 1995, there were proposals to float securities in Nanga Farms Limited on the Lusaka Stock Exchange once development projects at the farm were completed and it had been restored to profitability.[85] Also, in that year, the Zambian government (through Zambia Industrial and Mining Corporation Limited) had made proposals to transfer the remaining 10 per cent of its shareholding in Zambia Breweries Limited to the Zambia Privatisation Trust Fund.[86] The shares to be transferred were going to be floated on the Lusaka Stock Exchange for the public to buy. The privatisation of Zambia Breweries Limited was arranged in a way that required the splitting of the business in two parts. After the split, the divisions were then sold as separate entities. When Zambia Breweries was split into two divisions the minority shareholder in Zambia Breweries, Zamanglo Industrial Corporation Limited, exercised its pre-

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[83] This view has been expressed by a number of interviewees and questionnaire respondents. See for example *Interview* with Mr. Douglas Rolls and Mr. George Roberts, op. cit., (question 9); *Interview* with Mr. Peter Yuyi, op. cit., (question 5).

[84] See above.

[85] See K.K. Mwenda, A Critical Review of Foreign Investment Policy in Zambia: Direct Investment, The Stock Exchange and Privatisation, *supra*., (n. 26), p. 45.

[86] See *Ibid*., p. 46.

emption rights over the northern division. It purchased 90 per cent of the central division brewery at an agreed price of US $13, 815, 000.[87] Zamanglo Industrial Corporation also bought residential properties of the central division at an agreed price of US $1, 956, 004.[88] However, as the Zambia Privatisation Agency puts it:

> "Following the netting off of their 25 per cent ownership in the company, a total of US $7,501, 403 represents full payment for 90% of the central division."[89]

Successes Of The Lusaka Stock Exchange Weighted Against Constraints:

Under Zambia's privatisation programme some parastatal companies were not privatised. Instead, they were liquidated. Examples of such companies include Zambia Airways Ltd and United Bus Company of Zambia Ltd. Both companies were liquidated as it was believed that they were loss making and could therefore not pay their debts. Thus, there have been various privatisation strategies adopted by the Zambian government since the privatisation programme began.

Generally, the Lusaka Stock Exchange has had some success as a facilitator of privatisations in Zambia. Some of the reasons for this view are that despite the views of some respondents that the Lusaka Stock Exchange has shallow market depth,[90] and given the liquidity constraints facing the Lusaka Stock Exchange, it is still clear that most of the parastatal companies that have been privatised were off-loaded on the

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[87] See _Ibid_., p. 46.

[88] See _Ibid_., p. 46.

[89] See _Ibid_., Appendix II.

Lusaka Stock Exchange. Indeed, when asked about the successes of the Lusaka Stock Exchange,[91] ten out of twenty-three questionnaire respondents observed that a number of companies in Zambia have now been listed on the exchange. Nine others observed that the local media has covered well statistics on the trading activities of the exchange. Four respondents observed that some big investors have been attracted to the Lusaka Stock Exchange and an open and orderly market for transacting in equity securities is now in place. Three respondents observed that the Lusaka Stock Exchange has succeeded in creating a secondary market in government bonds and treasury bills. Two others said the listing of some company securities on the stock exchange has given true value to the securities. Other views attracted single responses in the questionnaires. These included views that the legal framework for public distribution of securities in Zambia is good; trading procedures of the Lusaka Stock Exchange are an amalgamation of many systems; there has been legislative intervention in Zambia to reduce company income tax and other taxes so as to promote the development of the Zambian capital market; the Lusaka Stock Exchange has conformed to the G thirty requirements; and that the Lusaka Stock Exchange has a central depository system which is highly efficient compared to other systems in Africa's emerging markets. One respondent observed, however, that the Lusaka Stock Exchange has not made any success.

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[90] See *Interview* with Mr. Douglas Rolls and Mr. George Roberts, op. cit., (question 11).

[91] See research questionnaire results (Appendix K, question 5).

Other constraints affecting the market and the regulatory framework:

Limitations to successes of the Lusaka Stock Exchange rest on a number of factors. We have already identified a number of these factors. They included views on the persistence of off-the-market transactions, the inadequacy of liquidity, the manner in which prices of securities are discovered, the limited role played by financial institutions in participating on the Lusaka Stock Exchange, the presence of only a few collective investment schemes in Zambia, a shallow market depth of the Lusaka Stock Exchange and low incomes and savings of the Zambian people.

It is also clear that one other reason why the Lusaka Stock Exchange is still underdeveloped is because manufacturing industry in Zambia is growing at a slow pace compared to the steady growth of the domestic trade industry. Merchant traders in Zambia comprise the larger faction of foreign investors that the MMD Government has succeeded in attracting to Zambia. A good example here is the South African Shoprite chain of supermarket stores. In Zambia, it is a notorious fact that merchant traders often run their businesses as family entities. The Asian community is a classic example here. The concept of 'going public' is unknown to them or it is simply not attractive. On the other hand, very few foreign investors in Zambia have set up new manufacturing industries. We have already seen how Chilanga Cement Plc has absorbed most of the foreign investment in the manufacturing sector.

Another reason why the volume of trade in securities on the Lusaka Stock Exchange is low is that privatisation of a number of parastatal companies in Zambia has taken the form of restoring them back to their previous owners.[92] Also, in other cases privatisations have taken the form of allowing holders of pre-emption rights to exercise these rights. We saw this when we looked at the privatisation of Chilanga Cement Plc. There is an indication here that, in theory, the prerequisite of a perfect market that there should be large numbers of independent buyers and sellers has not been met.[93]

Constraints On Free Market Entry and Free Exist:

Briston observes:

> "Other characteristics of a perfect market are free entry and perfect knowledge."[94]

Although free entry is generally available on the Lusaka Stock Exchange, the exit mechanism on the exchange raises a problem.[95] It is argued that Zambia needs to promote the institution of collective investment schemes to facilitate free entry and free exit on the Lusaka Stock Exchange.[96] This is particularly important when we consider

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[92] See generally M.C. Musambachime, "Privatisation of State-Owned Enterprises In Zambia: 1992-1996. A Model For Africa?" unpublished seminar paper (presented to the Department of History at the University of Namibia, Namibia on June 2, 1997).

[93] See R.J. Briston, op cit., p. 35.

[94] Ibid., p. 35.

[95] See below.

[96] See *Interview* with Mr. Nduba Namoonde, op. cit, (question 13), where he observes: "Ken, I yearn for collective investment schemes in this country. I am privileged to have managed the Meridien Property, Baby and Family Bonds. I was the fund manager in 1991 and 1992. That was the best investment to have happened to Zambia. It was affordable... Right now the only collective investment scheme worth talking about is the Cavmont Guarantee and Trust Company which I was privileged to have formed actually."

the position of small investors. As the Chief Executive of the Lusaka Stock Exchange, observes:

> "The empirical evidence gives a very interesting scenario. If you look at what happened between August 1994 and January 1995 you will see that trading activity went up by a factor of 10, and turn-over increased a little bit, volumes did not go up significantly. That increase in trading activity was driven by the introduction of the Meridian Collective Investment Schemes; the Meridian Property Scheme, the Baby Bond, and the Family Bond. These were collective investment schemes which had been developed much earlier; three to four years earlier than the stock market. And as soon as they came on the market they pushed up our activity by, as I said, a factor of 10. And what that shows is the effectiveness or the power of a collective investment scheme in galvanising broad participation across the spectrum. When the Meridian problem surfaced in early 1995 and the market lost confidence you see a collapse of the market. Trading activity just went down to almost zero and the statistics show that very well. But, in that short period of time we learned a lesson, as I said, the empirical evidence shows clearly that for a start-up market what you need at the early stage is a collective investment scheme or a Unit trust. I believe that if Meridien Bank had not collapsed and therefore the schemes had continued our market would have developed at a much faster pace. What are we doing about it today? The stock exchange is now talking very closely with ZPA (Zambia Privatisation Agency) with a view to developing a Unit trust. If you look at what has happened, say in Swaziland, Swaziland has a very successful unit trust, "The Swaziland Unit trust" which was developed by the private sector entity with the corporation of the Ministry of Finance there and it is doing extremely well. If you look at what happened in Zambian Sugar

you needed to have K110,000.00 and that threshold was a barrier to many small investor. There are many people out there who would have been willing to buy shares at K5,000.00 or K10,000 but they couldn't get in. Now with a Unit trust - and I am glad that we working with ZPA on this now- with unit trust you actually facilitate the participation of small investors."[97]

Mate further observes:

"Another point about a Unit trust, and this goes to our experiences again in the last year, if you look at Chilanga Cement, Chilanga Cement was our first listing in May 1995, the offer price was K65.00. Chilanga Cement was enthusiastically received. To put it mildly it was over sold. Today, Chilanga Cement has something like 4,700 new share holders as a result of that flotation. But, many of those 4,700 were people who got into the market purely out of excitement and the novelty factor. They are small investors. A month after the flotation many of them found themselves in need of money liquidity and many of them had been coming here wanting to sell their shares because they had to pay their electricity bill, buy school uniforms (for their children) and so on...Now if the money was in a bank account they could go back and withdraw it, simple! Now that it is invested in a stock market the format of the market mechanism is quite different. They come in and they want to recover their 65,000 so they put in an offer of 65,000 and there is no buyer at that instance in time. So the tendency then is to reduce the price from 65,000 to say 60,000 and a day later there is still no buyer and so they reduce the price further to 55,000. In short the share price in Chilanga has been

[97] *Interview* with Mr. Charles Mate, op. cit., (question 11).

coming down because of the pressure from the small investors who are desperately in need of liquidity. Chilanga, the company itself, is now performing extremely well. The plants are now running at close to full capacity something that has not happened in the last ten years, I believe. So whereas the underlying asset is a lot better, the company is performing a lot better, the share price is now depressed because of the small investors and their need for liquidity. So liquidity is a critical factor for a small investor and so a Unit trust would actually have helped us balance out that problem and that these small investors would not have gone into Chilanga. They would have gone into a Unit trust; and so Chilanga, therefore, would not suffer the negative image it has in the market today because of its price being low - because its only those investors who are a lot more sound who would actually be invested in Chilanga directly. But, the small investors would be in their Unit trust; an open-ended Unit trust would enable them to go in on a monthly basis buy a few units or sell a few units and that would give them the entry-exist mechanism. Not on the stock exchange where clearly the impact is more likely to depress prices negatively, and to basically send a negative signal all around when the underlying companies themselves are performing extremely well."[98]

3.9. THE LIMITED ROLE PLAYED BY OTHER FINANCIAL INSTITUTIONS IN PROMOTING SECURITIES INVESTMENT AS A CONSTRAINT:

By participating on the Lusaka Stock Exchange, financial institutions can help to promote competition on the stock market and thus contribute towards the development of the stock exchange. We have already seen that banks in Zambia have

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[98] *Ibid.*, (question 11).

not been very active in participating in securities investment. Here, we note further that there are not many insurance companies, building societies and pension funds that are participating on the Lusaka Stock Exchange.[99] Although when asked if financial institutions in Zambia are playing a major role as market makers on the Lusaka Stock Exchange,[100] eight out of twenty-three questionnaire respondents observed that these institutions are playing a *very big* role, this view relates only to the few financial institutions that are already participating on the market.[101] Two respondents observed that the role that financial institutions are playing is *reasonably big*. Another two observed that the role is *average*. Four others observed that the role is *marginal* while seven others responded that financial institutions in Zambia are not playing a major

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[99] See research questionnaire results (Appendix K, question 27).

[100] See *Ibid.*, (question 27).

[101] To illustrate this point, in a discussion with Ms. Annie C. Mwale, Finance Director, Zambia National Building Society, (Lusaka, 13th December 1996) the discussant pointed out that Zambia National Building Society, the leading building society in the country, has not been participating on the Lusaka Stock Exchange. The discussant did not give any reasons for this. However, section 89 of the Building Societies Act 1970 of Zambia provides that: "(1) A building society shall not invest any part of the surplus funds of the society except in investments authorised by an order made by the Minister... (2) The Minister may from time to time vary or revoke an order... provided that a society which, at the time when an order comes into operation, has funds invested in what, by virtue of such order, has ceased to be an authorised investment, may, with the written approval of the Registrar, retain such investment and the Registrar shall give his approval to such retention for so long as he is satisfied that the realisation of the investment would be detrimental to the interests of the society." Although no such order has been made by the Minister since the establishment of the Lusaka Stock Exchange, our submission that the Zambia National Building Society has not participated in securities investments lies not in the lack of legal pedigree on which the building society can rely, but on the fact that the building society does not know much about what is going on in the stock market.

role as market makers on the Lusaka Stock Exchange.[102] Indeed, financial institutions such as insurance companies, building societies and pension funds can form part of the body of market makers on the Lusaka Stock Exchange. Reasons explaining why insurance companies and other financial institutions have not been actively involved in equity investments will now be addressed.

Factors Constraining The Participation Of Insurance Companies, Pension Funds and Building Societies In Securities Investment:

Under state capitalism in Zambia, the state owned and controlled the major financial institutions in the country. Zambia State Insurance Corporation, a statutory body then, was the only organisation permitted by law to conduct insurance business in the country.[103] Zambia National Provident Fund, another statutory body, was one of the few organisations in Zambia running a pension fund scheme.[104] Later, the reintroduction of the accommodation development strategy saw a shift in government policy and legislation towards a liberalised economy. This shift resulted in the abandonment of state capitalism and the introduction of policies for a free market economy in Zambia. Today, a number of insurance companies, building societies and

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[102] Several reasons were given for this view. See research questionnaire results (Appendix K, question 27). The reasons include arguments such as the legal framework does not provide for participation of some financial institutions, there are better and more secure alternative investments choices to which limited resources can be applied (e.g. treasury bills) and that banks are greedy.

[103] See generally K.K. Mwenda, The Politics of Company Law in Zambia: A Critical Analysis of the Parastatal Sector, unpublished FCI dissertation, (London: Institute of Commerce, 1992).

[104] See generally *Ibid*.

pension funds have now been set up.[105] Even so, it is clear that the parastatal companies that had monopoly in the respective business fields have continued to enjoy that monopoly. For example, in the insurance sector Zambia State Insurance Corporation appears to be taking the lead.

Turning to pension fund schemes, Zambia National Provident Fund faces minimal threats from new entrants. The only financial institutions which seem to be increasing in numbers are banks. We have already observed that most of the rural people are deprived of major banking institutions. However, as more new banks are being set up,[106] other banks are collapsing.[107] There are various reasons that explain the collapse of banks such as Meridien Bank Ltd in Zambia. It is not our purpose here to pursue that line of thought. Suffice it to say that given the decline in the GDP of Zambia, as noted above, the propensity of the indigenous people to build up savings from their earnings is low. Also, given the introduction of a stock market in Zambia, whether banks will depend heavily on making profits from their clients' accounts or they will diversify into other forms of corporate finance, such as participating on the Lusaka Stock Exchange, is an issue to be addressed by the financial strategies of these institutions. What is clear, however, is that there is need to examine the importance of having institutions such as collective investment schemes to take up roles of market makers on the Lusaka Stock Exchange. As argued above, such institutions could

[105] For example Madison Insurance Limited and Professional Insurance Corporation Zambia Ltd.

[106] For example Finance Bank Limited, Cavmont Bank Limited etc.

become market makers on the Lusaka Stock Exchange and thereby help to reduce the liquidity constraints on the market. Banks could set up and administer unit trusts to pull together resources of individuals so that these moneys are invested in securities on the Lusaka Stock Exchange. Indeed, as the Chief Executive of the Lusaka Stock Exchange observes,[108] there is a dire need to have collective investment schemes participate on the Lusaka Stock Exchange.

3.10. EVIDENCE ON COMPETENCE AND DILIGENCE OF DEALERS, STOCKBROKERS AND ADVISERS:

In Zambia, the development of a competitive stock market is also tied to the question of how competent and diligent financial intermediaries are when transacting on the Lusaka Stock Exchange. Given that the Lusaka Stock Exchange is a new institution there is need to provide financial intermediaries with good training of how to conduct business on a stock market. Intermediaries' good conduct on the market could contribute towards the development of a competitive stock market. Although the training of intermediaries could be costly, we shall see in Chapter Seven how fiduciary duties of financial intermediaries can be used to promote investor protection on the Zambian stock market.

Our research findings indicate that when asked about how professional the questionnaire respondents considered financial intermediaries operating on the Lusaka

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[107] For example Capital Bank Limited, Commerce Bank Limited, Africa Commercial Bank Limited and Meridien Bank (Z) Limited.

[108] See above.

Stock Exchange,[109] a number of responses indicated that the intermediaries needed specialist training. On a scale of four sets of competencies; highly professional, reasonable professional, competent and not very professional, 9 percent of the respondents said financial intermediaries in Zambia were *not very competent.* Another 9 percent said financial intermediaries were *highly professional* while 45 percent, the majority, thought that financial intermediaries in Zambia were *competent.* On the other hand, 21 percent of the respondents said the intermediaries were *reasonably professional* while 16 percent could not ascertain.

3.11. CONCLUSION:

This chapter has examined the empirical evidence on some of the constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. It was argued, among other things, that a number of constraints on the legal framework can be overcome by measures such as promoting the role of collective investment schemes and other financial institutions in securities investment. Also, encouraging public utilities companies and football team companies to list their securities on the stock market was seen as an important factor. The development of a regional stock exchange in Eastern and Southern Africa and the promotion of multiple listing and cross-border trade in securities were identified as important solutions to problems such as the liquidity constraints on the Lusaka Stock Exchange.

[109] See Research questionnaire results (Appendix K, question 21).

In explaining some of the important reasons why the Lusaka Stock Exchange is underdeveloped, a link between the market capitalisation of the Lusaka Stock Exchange and privatisations in Zambia was identified. The question of whether or not to invest in developing a stock exchange was tied to the prospect that privatisations will stimulate increased liquidity. It has been shown in this chapter that the Zambian privatisations are too thin to stimulate a long term investment culture in Zambia. Indeed, the role of the stock exchange must not be understood as one confined to facilitating privatisation only. The perception of the Zambian government that privatisation is a process confined to converting state owned enterprises into private owned enterprises offers a narrow view of the problem. It would be better if the government could seriously consider supporting private initiatives that are geared towards the setting up of new privately owned enterprises. Such initiatives could, under a favourable economic climate, stimulate competition at the macro-economic level once the new enterprises get into competition with existing state owned and privately owned enterprises. In making this submission, we are mindful, too, that not all state owned enterprises have been loss-making. Indeed, some of these state enterprises could be retained and allowed to compete with newly developed and privately owned enterprises. Here, competition is expected to stimulate increased liquidity on the Lusaka Stock Exchange.

CHAPTER FOUR

TOWARDS A REGIONAL STOCK EXCHANGE AS A POSSIBLE SOLUTION

Given the thesis that faced with various constraints, the regulatory framework for public distribution of securities in Zambia, among other factors, is likely to have limited success in facilitating the development of a competitive stock exchange, this chapter argues that the introduction of a regional stock exchange in Eastern and Southern Africa and the promotion of multiple listing and cross-border trade in securities would facilitate the development of more efficient and competitive capital markets in the region. This would help to ease the liquidity problem on the Lusaka Stock Exchange and on other stock exchanges in the region.

4.1. DEFINING A REGIONAL STOCK EXCHANGE:

The term 'regional stock exchange' refers to a stock exchange which would promote not only cross-border trading in securities of companies within the region, but also attract securities investment from abroad. In terms of functions, a regional stock exchange would have functions similar to those of any stock exchange, except for the fact that a regional stock exchange, unlike a national stock exchange, would not belong to one country. Thus, although a regional stock exchange would belong to the region, such an exchange would be located in one of the countries in the region. Indeed, the regional stock exchange could draw upon resources of the various countries in the region. Being regionally and internationally focused, the regional stock exchange could be established under a multilateral treaty or under regulations of a regional integration body. Finance for the setting up of such a stock exchange could be obtained from sources which include funds from the responsible regional integration body, long-term finance from the Africa Development Bank, loans from the World Bank and the International Monetary Fund, and financial aid from other members of the international donor community. The setting up of the Preferential Trade Area (PTA) Clearing House, for example, under the PTA Treaty, provides an illustration of how this can be done.

In contrast to national stock exchanges, which are governed mainly by municipal laws, a regional stock exchange would be regulated mainly by aspects of both conventional and customary international law. Indeed, since South Africa already has the Johannesburg Stock Exchange, a relatively highly developed capital market,[1] the Johannesburg market could act as

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[1] On the financial clout of the South African Johannesburg Stock Exchange, see "*Statisques*, Federation Internationale des Valeurs, Paris, 1990" in D. Alexander and C. Nobes, A European Introduction to Financial Accounting, (Hempstead: Prentice Hall, 1994), p. 69. The Johannesburg Stock Exchange, Africa's leading stock market, is much more capitalised than markets such as the Ghanaian, the Kenyan and the Zimbabwean Stock Exchanges respectively. For example, The Economist, (July 1st - 7th 1995), Vol. 336, No. 7921, p. 55, reports that by 1990 there were more than 200 domestic companies listed on the Johannesburg Stock Exchange. Also, the Johannesburg Stock Exchange has several non-domestic companies listed on it. By contrast, in August 1995, Ghana had only seventeen companies listed on its stock market [see The Economist, (July 1st - 7th 1995), Vol. 336, No. 7921, p. 55)]. Even by this number, Ghana was above Kenya and Zimbabwe whose stock exchanges had market capitalisation of under US $2 billion respectively by August 1995. Indeed, by the end of May 1994,

a competitor to the regional stock exchange. Ultimately, competition would be expected to stimulate increased market liquidity and efficiency in the allocation of resources within the Eastern and Southern African region.

On the other hand, instead of setting up a *formal* regional stock exchange in Eastern and Southern Africa, an *informal* market in trade of securities at the regional level could be created through multiple listing and cross-border trade in securities on national stock exchanges within the region. This version of a regional stock market, though, lacking in formal structure could prove less costly to set up. There would, however, be a need to harmonise national laws (of various states in the region) and national stock exchange rules on matters such as listing requirements and regulation of financial intermediaries. This objective might not be too easy to achieve due to the 'self-interest' agenda of many states in the region.[2] Also, the policing mechanism required to pursue persons such as insider dealers might not be effective under an *informal* market since there would be no supra-national authority to address such matters. However, empirical evidence suggests that of the two companies that are cross-listed on the Lusaka Stock Exchange and on other stock exchanges, Zambia Consolidated Copper Mines Plc and Trans-Zambezi Plc, the creation of an international market in shares of these companies has not led to any major problems.[3] Generally, problems that are associated with multiple listing and cross-border trade in securities relate mainly to costs of entering foreign

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Ghana's Stock Exchange market capitalisation had improved from US $30 million in 1990 when the stock exchange was established to US $2.1 billion.

[2] For a discussion on the 'self-interest' agenda, see below.

[3] *Interview* with Dr. Tukiya-Kankasa Mabula, Director of Licensing, Securities and Exchange Commission, Lusaka, 5th August 1998. See also *Interview* with Mr. Lewis Mosho, Company Secretary and Legal Advisor, Lusaka Stock Exchange, Lusaka, 21st August, 1998.

markets and costs of regulating financial intermediaries.[4] Costs of entering foreign markets include transaction costs, taxation costs,[5] listing costs, costs of information disclosure and costs of various national regulatory bodies to monitor information disclosure.

The Political And Socio-Economic Context Dictating The Need To Set Up A Formal Stock Market:

The Eastern and Southern African region, as a whole, is politically and economically weak. Civil wars have been going on in Rwanda, Burundi and the Democratic Republic of Congo. Various states in the region are now divided on how to resolve this problem. The fragmentation in the collective will of states in Eastern and Southern Africa now entails that the setting up of a *formal* stock exchange is a much more attractive idea than that of having an informal regional stock exchange. Indeed, we are faced with a context in which the social and economic interests of several states are widely divided and the momentum to galvanise a collective will is almost non-existent. Therefore, to promote efficient and effective securities regulation in this region a regulatory system that does not lead to a 'lawless' situation must be put in place. The context dictates that a more centralised approach to regional financial integration be adopted.

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[4] For a good analogy of problems associated with regulating financial intermediaries in the international business environment, see S. Picciotto, International Business Taxation, (London: Weidenfeld and Nicholson, 1992), pp. 135-141.

Advantages Of Having A Regional Stock Exchange:

Generally, to stimulate increased liquidity on the Lusaka Stock Exchange measures such as multiple listing and cross-border trade in securities must be encouraged. The introduction of a regional stock exchange that co-exists with national stock exchanges would be a step forward towards stimulating increased liquidity on the Lusaka Stock Exchange. Indeed, cross-listings are likely to take place both on the regional stock exchange and the national stock exchanges. There is need, however, to place caution here that in moving towards a regional stock exchange, Eastern and Southern African states must consider the prospects of harmonising their monetary and fiscal policies.[6] Also, there is need to develop and improve the information technology obtaining in the region.[7] Ideally, economies of scale and competitive capital markets could result from the establishment of a regional stock exchange. It is hoped that increased market liquidity under an effective regulatory framework can then bring about market transparency on the regional stock exchange.

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[5] See for example A. H. Qureshi, The Public International law Of Taxation: Text, Cases And Materials, (London: Graham and Trotman/Martinus Nijhoff, 1994), pp. 56-57.

[6] See *Interview* with Mr. Mumba Kapumpa, Chief Executive, Securities and Exchange Commission, Lusaka, 18th December 1996, (Appendix C, question 15): "...the francs CFA countries in West Africa, the French speaking countries, they are setting up a regional stock exchange which will be based in Abidjan most likely, of all the French speaking West African countries. Now they are perhaps in a different position than we are in this region (Southern and Eastern Africa) in the sense that all of them belong to the francs CFA monetary system which is the currency that they all use so that... and they were connected to France such that although they are different independent countries they have always operated from a monetary point of view as one country. Therefore, it would be very easy for them to consider that particular regional stock market."

[7] See for example *Interview* with Mr. D.B. Luswili, Management Accountant and Acting Finance Director, Stanbic Bank (Z) Ltd, Lusaka, 12th December 1996 (Appendix H, question 11).

Our proposal to have a regional stock exchange established in Eastern and Southern Africa is an important and original contribution of this work to the field of knowledge under investigation. We are not advocating for the setting up of a regional stock exchange that must replace the existing national stock exchanges in the region. By contrast, we are arguing that both the regional stock exchange and the national stock exchanges must co-exist so that the national stock exchanges can accommodate listing of company and government securities that cannot meet listing costs on the regional stock exchange.[8] Ideally, it is submitted that securities that must be admitted to listing on a regional stock exchange are those in highly capitalised companies or in companies that attract a lot of investment. Given this view, we submit further that for smaller companies that have a low capitalisation such a listing requirement would prove costly. Indeed, since smaller companies are often not highly capitalised and their market share, in terms of attracting investment, is usually small, these companies would be better off if they traded on listed or unlisted securities markets of national stock exchanges. Alternatively, smaller companies could trade their securities off securities markets by using such methods of distribution as pre-emption rights issues and bonus issues.

The establishment of a regional stock exchange in Eastern and Southern Africa would be a step forward towards the integration of Africa's emerging capital markets. In general, the

[8] Similar views are expressed in *Interview* with Mr. Mebeelo Mutukwa, Stockbroker and Managing Director, Pangea Securities Ltd., Lusaka, 11th December 1996 (Appendix F, question 20), where Mr. Mutukwa observes that: "there are some companies which are very specific to a country which may not be very attractive on the regional stock exchange and those that would continue to sit on the local one, but there should be provision to create SADC (Southern African Development Community) companies and let them graduate after meeting very strict selection criteria onto the regional stock exchange."

integration of Africa's markets could be achieved not only through cross-listings,[9] but also through improved communications between the regional stock exchange and the national stock exchanges, and improved communication between the respective national stock exchanges. The position of the United Kingdom provides a helpful example:

> "... the Stock Exchange (UK) does not have a monopoly of trading in securities. Section 37 and Schedule 4 to the Financial Services Act 1986 gives the Secretary of Sate a general power to recognise 'investment exchanges' which meet the criteria of the Act and so permit them to operate in this country... In addition, securities of large companies may be quoted on exchanges in other countries as well as in London, so that those other exchanges may provide competition for the Stock Exchange. Indeed, within the European Community it is sometimes feasible for a British company to list only on an exchange in another Community country."[10]

We are, however, mindful of the impediments that could hinder progress on regional economic integration in Southern and Eastern Africa. We will look at a number of these constraints later. The same constraints impinge upon prospects of establishing a regional stock exchange. The idea behind setting up a regional stock exchange must be understood as an integral part of the

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[9] On the need to promote cross-listings so as to integrate the markets in the region, see *Interview* with Mr. Charles Mate, Chief Executive, Lusaka Stock Exchange, Lusaka, 20th December 1996 (Appendix A, question 16); *Cf. Interview* with Mr. Douglas Rolls (Securities Services Manager) and Mr. George Roberts (Manager Merchant Banking), Barclays Bank (Z) Ltd., Lusaka, 12th December 1996, (questions 18(b), 19 and 22); *Interview* with Mr. D.B. Luswili, op. cit., (questions 20, 21 and 23); *Interview* with Mr. Peter Yuyi, Manager Securities Brokerage, Emerging Markets Securities, Lusaka, 18th December 1996 (Appendix E, question 11); and *Interview* with Mr. Mebeelo Mutukwa, supra., (n. 8), (questions 16, 17 and 18).

political and economic integration of Eastern and Southern African states. Separating the idea of a regional stock exchange from that of regional integration in general would not only make it difficult to set up a regional stock exchange, but it would also slow down the pace and degree of regional integration in Eastern and Southern Africa. Indeed, the financial, banking and monetary sectors of various states in Eastern and Southern Africa must integrate if the region must have economy power and independence. All in all, the setting up of a regional stock exchange must be preceded by thoughtful consideration of the various levels of regional integration reached by the regional integration schemes in Eastern and Southern Africa.[11]

4.2. REGIONAL INTEGRATION SCHEMES IN EASTERN AND SOUTHERN AFRICA:

For purposes of this study, there are two major regional integration schemes under which a regional stock exchange could be set up in Eastern and Southern Africa. These regional schemes are the Common Market For Eastern And Southern Africa (COMESA) and the Southern Africa Development Community (SADC). The other regional integration scheme in Southern Africa, the Southern African Customs Union (SACU),[12] which has been held by some commentators as not only having the longest unbroken period of customs union integration in Africa, if not in the world, but also as being the most effectively functioning

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[10] See P. Davis, Gower's Principles of Modern Company Law, (London: Sweet and Maxwell, 1997), p. 395.

[11] For a discussion on the regional integration schemes in Eastern and Southern Africa, see below.

[12] All SACU Member States are parties to the SADC Treaty. The five SACU Member States are Namibia, Botswana, Lesotho, Swaziland and South Africa. SADC Member States include Tanzania, Zambia, Angola, Malawi, Mozambique, Zimbabwe and the SACU Member States.

regional arrangement in Africa,[13] has a small number of Member States and deals mainly with relaxation of tariff barriers. Thus, in this chapter we focus mainly at the COMESA and SADC regional integration schemes while making limited reference to the SACU scheme.

4.3. THE COMMON MARKET FOR EASTERN AND SOUTHERN AFRICA:

The Common Market For Eastern And Southern Africa (COMESA) was established on November 5, 1993 by a treaty entered into at Kampala, Uganda.[14] The treaty provides that States that can be member parties to the COMESA integration scheme include the Democratic Republic of the Congo (formerly known as Zaire), Eritrea, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Sudan, Swaziland, Tanzania, Uganda, Zambia, Djibouti, Angola, Burundi, Comoros, Seychelles, Somalia and Zimbabwe.[15] It is further provided in the preamble to the COMESA Treaty that:

> "The following States of Eastern and Southern Africa may become Member States of the Common Market upon fulfilling such conditions as may be determined by the Authority:
>
> The Republic of Botswana; and
>
> The Republic of South Africa (Post-Apartheid)."[16]

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[13] See for example R. Gibb, "Regional Integration in Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union," Journal of Southern African Studies, Vol. 23, No. 1, (March 1997). p. 68.

[14] See International Legal Materials, Vol. XXXIII, No. 5, September 1994, p. 1067.

[15] Preamble of the treaty establishing COMESA in *Ibid.*, p.1073.

[16] Section 3 of the preamble of the COMESA Treaty.

4.3.1. BACKGROUND TO THE ESTABLISHMENT OF COMESA AND OBJECTIVES OF COMESA:

COMESA was set up to replace the Preferential Trade Area of Eastern and Southern Africa (PTA), a regional integration scheme which had among its objectives, the following agenda:[17]

i) to create trade within the Eastern and Southern African region (*i.e.* between Member States) and;

ii) to divert trade away from the then apartheid South Africa.

Thus, it is clear that COMESA is a follow up to PTA. What has happened is that PTA has now been transformed into COMESA. The process of economic integration under this regional integration scheme has now progressed from a preferential trade area to a common market. Here, the integration scheme is designed to have three phases. The first phase relates to the establishment of a preferential trade area. This is followed by the conversion of this trade area into a common market. Finally, it is expected that the common market will be converted into an economic community. Although the COMESA Treaty provides that the regional integration scheme under that treaty is divided in three phases, the treaty does not distinguish a 'preferential trade area' from a 'common market' or from an 'economic community'.[18] Neither does the treaty distinguish a 'common market' from an 'economic

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[17] See generally Heads of State and Government of the PTA, PTA Trade And Development Strategy, (Lusaka: PTA Publication, 30-31 January, 1992).

[18] A helpful, but limited, view is provided in COMESA, Common Market For Eastern And Southern Africa: In Brief, (Lusaka: COMESA Publication 1996), p. 4: "... the Member States have agreed to create and maintain: (a) a *full free trade area* guaranteeing the free movement of goods and services produced within COMESA and the removal of all tariffs and non-tariff barriers; (b) a *customs union*

community'. Article 2 of the COMESA Treaty merely provides that 'Preferential Trade Area' means the Preferential Trade Area for Eastern and Southern Africa established by Article 1 of the PTA Treaty. Article 2 of the COMESA Treaty goes on to provide that a Common Market means the Common Market for Eastern and Southern Africa established by Article 1 of the COMESA Treaty itself. Even so, the provisions referred to in Article 2 of the COMESA Treaty do not provide definitions of what constitutes a preferential trade area, a common market or an economic community. A helpful view on what could constitute an arrangement such as a preferential trade area is provided by Swann:

> "Economic integration can take various forms and these can be ranged in a spectrum in which the degree of involvement of participating economies, one with another, becomes greater and greater. The *free trade area* is the least onerous in terms of involvement. It consists in an arrangement between states in which they agree to remove all custom duties (and quotas) on trade passing between them. Each party is free, however, to determine unilaterally the level of custom duty on imports coming from outside the area."[19]

By contrast, it is clear that the COMESA Treaty does not draw a clear distinction on the three phases of its regional integration scheme. What is, however, established is that, on paper, the

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under which goods and services imported from non-COMESA countries will attract an agreed single tariff in all COMESA States; (c) *free movement of capital and investment* supported by the adoption of common investment practices so as to create a more favourable investment climate for the entire COMESA region; (d) a *gradual establishment of a payments union* based on the COMESA Clearing House and the eventual establishment of a common monetary union with a common currency; and (e) the *adoption of a common visa arrangement*, including the right of establishment leading eventually to free movement of *bona fide* persons."

[19] D. Swann, The Economics of the Common Market, (London: Penguin, 1993), pp. 11-12.

COMESA scheme is now moving from its first phase into its second phase since PTA has been abolished and replaced by COMESA.[20] There is, none the less, considerable doubt as to whether there have been any feasible institutional changes that have resulted from the change of names.

4.3.2. ORGANS OF COMESA:

Article 7 of the COMESA Treaty provides for the establishment of the following organs:

> "(a) the Authority
>
> (b) the Council
>
> (c) the Court of Justice
>
> (d) the Committee of Governors of Central Banks
>
> (e) the Intergovernmental Committees
>
> (f) the Technical Committees
>
> (g) the Secretariat
>
> (h) the Consultative Committee."

We begin by looking at organs of COMESA concerned with policy matters before looking at other organs. The Authority and the Council are vested with powers to formulate and recommend policies respectively. The Authority, consisting of the Heads of State or Government of the Member States, is the supreme policy organ of the Common Market and is responsible for the general policy and direction and control of the performance of the

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[20] See above. See also K.K. Mwenda, "The Law On Regional Integration In Southern And Eastern Africa: Threats and Prospects," SA Public Law Journal, Vol. 12, No. 2, (1997), pp. 453-468.

executive functions of the Common Market.[21] Furthermore, the Authority is responsible for the achievement of COMESA's aims and objectives.[22] The decisions of the Authority are binding on all Member States and on all other organs of the Common Market other than the Court in exercise of its jurisdiction.[23] These decisions are taken by consensus[24] and the Authority has powers to determine its own rules of procedure.[25]

The Council of Ministers, on the other hand, consists of such Ministers as may be designated by each Member State.[26] The Council is responsible for monitoring and keeping under constant review functions of COMESA.[27] The Council also ensures that the proper functioning and development of the Common Market is realised. This COMESA organ makes recommendations to the COMESA Authority on matters of policy aimed at the efficient and harmonious functioning and development of the Common Market.[28] The Council also gives directions to all other subordinate organs of the Common Market other than the Court in the exercise of its jurisdiction.[29] With regard to powers of the Court, the Council may request the Court to give advisory opinions on matters affecting the Council.[30] Apart from the functions outlined above, other important responsibilities of the Council include making

[21] COMESA Treaty, Article 8(1).

[22] Article 8(1).

[23] Article 8(3).

[24] Article 8(7).

[25] Article 8(6).

[26] Article 9(1).

[27] Article 9(2)(a).

[28] Article 9(2)(b).

[29] Article 9(2)(c).

[30] Article 9(2)(e).

recommendations to the Authority on the designation of Least Developed Countries[31] and on the designation of economically depressed areas of the Common Market.[32] Like decisions of the Authority, decisions of the Council are binding on all Member States and on all subordinate organs of COMESA other than the Court in the exercise of its jurisdiction.[33] Similarly, decisions of the Council are taken by consensus.[34] On the other hand, subject to any directions that the Authority may give, the Council has power to determine its own Rules of Procedure.[35]

Under the COMESA Treaty, the Committee of Governors of Central Banks is responsible for the development of programmes and action plans in the field of finance and monetary co-operation,[36] whereas the Intergovernmental Committee is responsible for the development of programmes and action plans in all sectors of co-operation except in the finance and monetary sector.[37] COMESA also has a Secretariat headed by a Secretary-General.[38] The Secretary-General is appointed by the Authority and is the chief executive officer of the Common Market.[39]

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[31] Article 9(2)(i).

[32] Article 9(2)(j).

[33] Article 9(3).

[34] Article 9(6).

[35] Article 9(5).

[36] Article 13(2).

[37] Article 14(1)(2).

[38] Article 17.

[39] Article 17(2).

Chapter Five of the COMESA Treaty establishes the Court of Justice. This organ plays the traditional role of a judiciary and adjudicates over claims by Common Market employees and third-parties against the Common Market.[40] Decisions of the Court of Justice on the interpretation of provisions of the treaty take precedence over decisions of national courts.[41]

4.3.3. OBJECTIVES OF COMESA:

Article 3 of the COMESA Treaty provides that the following are the objectives of COMESA:

> " The aims and objectives of the Common Market shall be:
>
> (a) to attain sustainable growth and development of the Member States by promoting a more balanced and harmonious development of its production and marketing structure;
>
> (b) to promote joint development in all fields of economic activity and the joint adoption of macro-economic policies and programmes to raise the standard of living of its peoples and to foster closer relations among its Member States;
>
> (c) to co-operate in the creation of an enabling environment for foreign, cross border and domestic investment including the joint promotion of research and adaptation of science and technology for development;
>
> (d) to co-operate in the promotion of peace, security and stability among Member States in order to enhance economic development in the region;
>
> (e) to co-operate in strengthening the relations between the Common Market and the rest of the World and the adoption of common positions in international fora; and

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[40] Article 27.

[41] Article 29(2).

(f) to contribute towards the establishment, progress, and the realisation of the objectives of the African Economic Community[42]."

Given the above objectives, it is argued that paragraph (c) of Article 3 of the COMESA Treaty, dealing with the need for COMESA Member States to cooperate in the creation of an enabling environment for foreign, cross border and domestic investment, supports our proposal to promote cross-listings and have a regional stock exchange set up. Indeed, Article 80 of the COMESA Treaty, dealing with banking and capital market development, provides as follows:

"The Member States undertake to implement a regional-wide capital market development programme to be determined by the Council and shall create a conducive environment for the movement of capital. To this end, Member States shall:

(a) take steps to achieve wider monetisation of the region's economies under a liberalised market economy;

(b) establish national stock exchanges and an association of national stock exchanges to enable objectives to be pursued in a concerted and co-ordinated manner including promotional activities, training, standardisation and harmonisation of operational rules and regulations;

(c) establish a Common Market rating system of listed companies and an index of trading performance to facilitate the negotiation and sale of shares within the Common Market and also external to the Common Market;

[42] In Article 2 of the COMESA Treaty it is provided, *inter alia*, that the COMESA Treaty was inspired by the treaty for the establishment of the African Economic Community: "*Inspired* by the objectives of the Treaty for the Establishment of the African Economic Community and in compliance with the provisions of Article 28(1) of the said Treaty."

(d) develop a region-wide network of national capital markets, with the purpose of facilitating the flow of information on national stock exchanges and their functioning, listed companies, availability of stocks, bonds, securities, treasury bills, notes, and other monetary instruments for the cross-border marketing of such instruments; and

(e) ensure adherence by their appropriate national authorities to harmonise stock trading systems, promotion of monetary instruments, and permission for residents of the Member States to acquire and negotiate monetary instruments."

Although Article 80 of the COMESA Treaty is silent on the need for COMESA Member States to work towards the creation of a regional stock exchange, evidence from deliberations of the PTA (now COMESA) Heads of State and Government indicates that PTA had been working towards creating a regional stock exchange.[43] Besides, Article 80 of the COMESA Treaty provides an implicit view that the objective of PTA to set up a regional stock exchange has now been carried over into COMESA. In 1992, the Heads of State and Government of the PTA (now COMESA) at the tenth summit held in Lusaka, Zambia, reaffirmed that:

"One of the strategies of the PTA in mobilising domestic PTA savings is the establishment of a sub-regional stock exchange. This will allow and promote cross-border investment as well as the free movement of capital within the sub-region. Such free movement of capital will only be made possible if the financial structures of the Member States are integrated. The objective is to promote the establishment of national stock exchanges which will be linked to a sub-regional PTA stock exchange to facilitate flow on the demand for and sale of shares in the various

[43] See below.

Member States. A regional Stock Exchange will assist Member States in their privatisation of industry and in debt equity-swap exercises."[44]

In addition to the above objective, Article 75 of the COMESA Treaty deals with the need for COMESA Member States to harmonise their monetary and fiscal policies so that a much more efficient allocation of resources within the Common Market could be realised. We have already highlighted the importance of COMESA Member States fulfilling this objective if financial, banking and monetary integration is to be achieved. In addition, Article 77(1) of the COMESA Treaty spells out the need for COMESA Member States to establish currency convertibility so that their currencies are convertible into one another. The accomplishment of this objectives by COMESA Member States would greatly facilitate the setting up of a regional stock exchange. However, although it is not the aim of this work to spell out the technical details of how to set up a regional stock exchange, we submit that a viable regulatory framework to govern trade in securities on a regional market could be structured along the following lines.

4.4. PROPOSALS ON THE STRUCTURE OF A REGULATORY FRAMEWORK TO GOVERN PUBLIC DISTRIBUTION OF SECURITIES ON THE PROPOSED COMESA STOCK MARKET:

It is the view of COMESA that cross-border investments would be facilitated by the creation of a common investment code to encourage the movement of capital and dividends.[45] This

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[44] Heads of State and Government of the PTA, PTA Trade And Development Strategy, *supra*., (n.16), p. 29.

[45] See *Ibid*., p. 30.

common investment code, together with the municipal laws of COMESA Member States, can provide legal rules on securities regulation at the regional level. Provisions of this code must take precedence over municipal laws of COMESA Member States. Indeed, matters such as cross-border insider dealing can be dealt with in a much easier way if laws such as the common investment code were adopted.[46]

Controlling Market Abuses On The Regional Stock Exchange:

If, for example, a party resident in country X, a COMESA Member State, commits the wrong of insider dealing (assuming that insider dealing is a civil wrong here) on a national stock exchange of country Y, another COMESA Member State, judgement must be sought in the courts of country Y and then enforced in country X. In situations such as these, the execution of a multilateral regional treaty would facilitate the enforcement of foreign judgements.[47] The same analogy applies to judgements or decisions relating to civil wrongs committed on the regional stock exchange. However, a major problem arises where insider dealing is treated as a criminal offence. Can the concept of enforcement of foreign judgements apply to criminal law too? The concept of enforcement of foreign judgements would not be easy to apply to criminal

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[46] See below.

[47] See for example The European Convention On Jurisdiction And The Enforcement Of Judgements 1968. For detailed readings on enforcement of foreign judgements see A. Lowenfeld, International Litigation And Arbitration, (St. Paul, Minnesota: West Publishing Co., 1992), pp. 368-450; Henry v. Geoprosco International Ltd. [1976] Q.B. 726 (C.A.); Somportex Limited v. Philadelphia Chewing Gum Corporation [1968] 3 All E.R. 26; Somportex Limited v. Philadelphia Chewing Gum Corporation 92 S.Ct 1294, 31 L.Ed.2d 479 (1972); Elefanten Schuh GmbH v. Jacqmain [1981] E.C.R. 1671, [1982] 3 C.M.L.R 1; Etablissement Rohr S.A. v. Ossberger [1981] E.C.R. 2431, [1982] 3 C.M.L.R. 29; Hilton v. Guyot 159 U.S. 113, 16th S.Ct. 139, 40 L.Ed. 95 (1895); Johnston v. Compagnie Generale Transatlantique 242 N.Y. 381, 152 N.E. 121 (1926).

law mainly due to differences in the criminal legislation of COMESA Member States and also due to the high standard of proof required in criminal cases generally. To overcome this problem, we propose that the common investment code must provide that if a criminal offence is committed on the Eastern and Southern Africa regional stock exchange or on a foreign national stock exchange within the region, the courts of the home state of the offender must try the offender where:

(a) the offence is one which cannot lead to extradition;[48]

(b) the conduct of the offender also constitutes a crime under the laws of the offender's home state; or

(c) the home state of the offender refuses to extradite the offender on grounds of preservation of state security or public interest.

We suggest further that the common investment code must include measures to address situations where the home state of the offender, acting in breach of the common investment code, decides not to extradite the offender to a state which has the jurisdiction to try the offender. Provisions of the Vienna Convention On The Law Of Treaties 1969 must apply to the common investment code. Under Article 60 of the Vienna Convention, a *material breach*, such as a violation of a provision essential to the accomplishment of the object and purpose of

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[48] In Factor v. Laubenheimer, 290 U.S 276, 287, 54 S.Ct. 191, 78 L.Ed 315 (1933), it was held that "[t]he principles of international law recognise no right to extradition apart from treaty. While a government may, if agreeable to its own constitution and laws, voluntarily exercise the power to surrender a fugitive from justice to the country from which he has fled ... the legal right to demand his extradition and the correlative duty to surrender him to the demanding country exist only when created by treaty."

a particular treaty, can enable all parties to the treaty, by unanimous action, to terminate the treaty altogether or to terminate it for the defaulting state only. Also, under Article 60 a single state which is specifically affected by a material breach may suspend the multilateral treaty between itself and the defaulting state, or any single state (not including the defaulting state) may suspend the treaty for itself entirely if the treaty is such that a material breach by one state radically alters the obligations under the treaty for all states.[49]

An alternative system would be to provide in the common investment code that a docket can be opened in the state where a criminal offence has been committed. The docket is thereafter sent to the courts of the home state (or country of residence) of the accused so that the accused can face trial there. Again, if this system were to be adopted, we propose that provisions of the Vienna Convention On The Law Of Treaties 1969 must be made applicable to the common investment code.

Authorisation And Regulation Of Financial Intermediaries:

The Eastern and Southern African regional investment code must also specify that for parties intending to trade on any stock or securities exchange in the region, they will not only be required to comply with rules and regulations of the regional stock exchange, but that they will also be required to be authorised to conduct securities business in their home countries. This rule must be extended to parties who are from non-Member States of COMESA and who intend to deal in securities on the regional stock exchange and/or in securities on any national stock exchange within Eastern and Southern Africa. The onus must be placed on the regional

[49] See M. Dixon, Textbook On International Law, (London Blackstones, 1990), p. 70.

competent authority (for regulating securities trade on the Eastern and Southern African regional stock exchange) to maintain liaison with other competent authorities so that players from non-Member States of COMESA do not break the law. If parties from non-Member States, who are resident abroad, break the law, the competent authority in their home country must be contacted so that the culpable parties face disciplinary action. The competent authority in Eastern and Southern Africa must be satisfied that the measures meted out to culpable parties by competent authorities in other countries is satisfactory. If not, the Eastern and Southern African competent authority must exercise reasonable discretion, under the code, to bar the culpable parties from dealing in any securities on a particular stock exchange or in securities on all stock exchanges within the region. Also, persons residing within the region who cooperate with such law offenders must face disciplinary action by having their securities removed from the securities market of the regional stock exchange. Powers and duties of the regional competent authority must supersède and have precedence over those of the national competent authorities.

Information Disclosure Requirements:

Turning to information disclosure provisions on matters such as listing particulars and company prospectuses, we submit that the common investment code must be drafted in such a way that it endeavours, as far as possible, to strike a balance between the various securities laws of COMESA Member States. The common investment code of COMESA must be viewed as a 'compromise' document. Areas of common interest must be identified and codified into provisions of the common investment code. Indeed, where a company is listing for the first time on the regional stock exchange and that company's securities are not listed on any other stock exchange (*i.e.* where there is no cross-listing), the listing requirements that must be met by such a company must be more stringent than where a company is entering into cross-listing on a regional stock exchange. The reasons for this submission are mainly twofold. First, preparing information is costly and the process of preparing information need not be repeated *in toto* where an investor has already made detailed disclosures on another market. Prospective investors trading on the regional stock exchange can have access to the earlier information on the company by requesting for such information from the company. The common code must place legal obligations on the company to disclose information released on another market where such information is being requested by an investor. Also, the common code must provide for continuing disclosure obligations on all companies whose securities are listed on the regional stock exchange. Continuing disclosure obligations would protect investors where, for example, information disclosed on another stock market is no longer up to date. As in the case of many national stock exchanges, the regional stock must be permitted to have listed and unlisted securities markets. Similar considerations that underlie the establishment of these market structures at national level, underlie our proposal for such structures on the regional stock exchange. A number of these considerations are examined in Chapters Five and Six.

Dispute Settlement And Promoting Securities Trade:

Overall, the common investment code must be binding on all COMESA Member States and it must be adopted in the legislation of the Member States. Such an approach would enable the courts of law in the COMESA Member States to apply regional law with less difficulties. Disputes on public distribution of securities on the regional stock market could be settled by an administrative body established pursuant to provisions of the regional investment code, with a right of appeal being allowed to the COMESA Court of Justice.[50] National courts must be obligated to enforce awards made by the COMESA Court of Justice. Besides, a regional securities regulatory body, which would be the competent authority, must be set up to regulate cross-listings and trade in securities on the regional stock exchange.

Nationals of one COMESA Member State could be encouraged to buy and hold stocks and shares in other COMESA countries. This would contribute to effective resource mobilisation and investment within the sub-region while at the same time economising on the use of foreign exchange. In addition, the establishment of a regional stock exchange would prevent the massive outflow of capital from the sub-region and reduce external borrowing. COMESA does acknowledge that in the foreseeable future the sub-region will continue to require large foreign capital for the growth and development of the private sector.[51] To improve the levels of capital in the region, COMESA admits that mechanisms must be created through the establishment of a COMESA Investment Fund, COMESA Unit Trusts and other financial schemes to enable direct private equity investments to take place in the sub-region.[52]

The Importance Of Having A Competitive Regional Financial Sector To Support The Development Of A Regional Stock Exchange:

We submit that COMESA must go beyond enhancing liquidity levels on national stock exchanges in the region (including the COMESA stock exchange) and introducing a well

[50] On the COMESA Court of Justice, see below.

[51] Heads of State and Government of the PTA, PTA Trade And Development Strategy, *supra*., (n.16), p. 30.

[52] See *Ibid*., p. 30.

designed regulatory framework for public distribution of securities on the regional stock market to addressing the importance of having a competitive regional financial sector. The creation of a competitive and efficient regional stock exchange will require COMESA to pay attention to various matters which include the following: to create appropriate financial institutions in the COMESA Member states; to develop better systems of prudent regulation and supervision; to improve the flow of financial information; and to develop appropriate skills for managing complex financial operations. In addition, this will require the improvement of legal and accounting systems to support modern financial processes; increasing the supply of long-term loans and other types of financing; supervision of financial markets and institutions regarding the quality of their loans and the adequacy of their capital rather than compliance with directives on credit allocation, as has been the tendency in the past; the development of financial institutions whose services will compete with and complement those of commercial and development banks, insurance companies, and pension funds which are potentially important sources of long-term finance in this regard; and the creation of money and capital markets for effective mobilisation of domestic savings.[53] A number of these features have already been identified in Chapter Three as lacking in the Zambian context. Thus our proposals here, though meant mainly to address the issue of setting up a regional stock exchange and that of promoting cross-listings, follow from the findings in Chapter Three.

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[53] See *Ibid.*, p. 29.

Facing The Challenges Of An Underdeveloped Economic Infrastructure:

Ndulo argues that the economic infrastructure in Africa is inadequate to support economic integration.[54] He observes that one of the major constraints on the growth and development of inter-African trade has been the inadequacy of payment and financial systems.

> "Increased African trade will need finance and financial instruments such as banking networks providing letters of credit, export credits and other financial services."[55]

If the recommendations that have been spelt out above are given thoughtful consideration and implemented properly, that could discount fears such as those expressed by Ndulo. The successful performance of SACU is a precedent upon which COMESA could exploit its own strengths and potentialities. Indeed, the political will amongst COMESA Member States must be right before the organisation can begin to think of achieving its goals.

4.5. COMMON INTERESTS OF COMESA MEMBER STATES AND THE POLITICAL WILL OF THESE STATES AS PREREQUISITES TO REGIONAL INTEGRATION:

Throughout this work we have maintained that faced with various constraints, the legal framework for regulating public distribution of securities in Zambia, among other factors, has had limited success in facilitating the development of a competitive stock exchange in Zambia. In Chapter One, for example, we saw how the development of foreign investment law and

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[54] M. Ndulo, "Harmonisation of Trade Laws in the African Economic Community," International and Comparative Law Quarterly, Vol. 42, (1993), p. 105,

[55] *Ibid.*, p. 105.

policy in Zambia is influenced by trends in the international political economy. To this end, it is important to consider the role played by the international political economy in influencing Zambia's policies towards regional economic integration under schemes such as COMESA.

The 'Self-interest' Agenda Of States In The Eastern And Southern African Region As A Constraint On Regional Integration:

In many parts of the world, different states have different ideologies and they often pursue different economic policies at different times. In Eastern and Southern Africa, for example, whilst Zambia has recently reverted[56] to the accommodation development strategy, other Member States of COMESA such as Malawi have always retained the accommodation development strategy so as to provide better terms of attracting foreign investment to these countries.[57] Kenya, like Zambia, has shifted its national policy stance from the re-organisation development strategy to the accommodation development strategy.[58] In both these countries there has been a deliberate effort to enact legislation offering generous fiscal incentives.[59] These incentives are targeted at attracting foreign investment to the countries offering the incentives. Here, the pursuit of different national goals militates against the idea of regional integration. This is one of the major shortcomings of many regional integration schemes.

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[56] Since the mid 1980's.

[57] See Chapter One, *supra*.

[58] See for example Nedcor Securities, The Stock Markets of Africa, (London: Nedcor Securities, 1996), p. 20, showing that Kenya has removed restrictions on foreign investment. In addition, there are no restrictions on capital gains in Kenya. The Kenyan Exchange Control Act was recently repealed by parliament to allow free flow of foreign exchange. Also, foreign participation in local companies is allowed up to an aggregate of 40%, with individual interests up to 5%.

[59] See Chapter One, *supra*.

Indeed, the idea of having a regional stock exchange set up in Eastern and Southern Africa is not free from the 'self-interest' agenda.

This 'self-interest' problem manifested by many COMESA Member States has increasingly become acute in the light of the IMF and World Bank structural adjustment programmes. The 'self-interest' agenda defeats the customary international law notion of 'equality and interdependence' of States codified in Article 6 of the COMESA Treaty. Privatisations are now being embarked upon at a competitively hurried pace in many COMESA Member States. Foreign investment is being sought ambitiously. Small national stock exchanges have been set up in almost every country in the region. Pieces of investment legislation providing generous fiscal incentives and anti-expropriation guarantees have been enacted. What this evidence shows is that the harmonisation of, say, national fiscal policies in the region will not be easy to achieve because of the unwillingness of many COMESA Member States to forgo some of their so-called 'national priorities'. National priorities must be seen as complementary to regional interests if regional integration is to succeed in Eastern and Southern Africa.

Zambia's Privatisation Programme As An Example Of The 'Self-interest' Agenda:

If we look at Zambia as a sovereign state that is trying to pursue its national goals of privatisation, it is clear that Zambia's ambitious privatisation programme did not arise out of any need to complement regional integration efforts. It is our submission that privatisations in Zambia have been targeted mainly at fulfilling the country's interests in her relationship with international financiers. Although it could be argued that in pursuing its policies on privatisations, Zambia, as sovereign state, has a right in international law to undertake privatisations,[60] there is considerable difficulty in seeing how state sovereignty could be achieved when a state is acting under conditions set by its international financiers. By the very nature of conditions being attached to Zambia's economic policies, the doctrine of state sovereignty withers away.

Lack Of A Supra-national State Policing Institution As A Constraint On Regional Integration:

One other problem facing the COMESA regional integration scheme is the absence of a supra-national State policing system. It is well established that international law has limited mechanisms for policing States.[61] The lack of a supranational institution to enforce treaty obligations and police Member States is a major shortcoming of many regional integration schemes. The COMESA integration scheme is not free from this problem. However, we have spelt out above some important proposals to redress this problem in as far as securities trading on the regional stock exchange is concerned.

4.6. OTHER FACTORS AFFECTING THE HARMONISATION OF NATIONAL POLICIES OF COMESA MEMBER STATES:

In the preceding section, we identified 'self-interest' goals and the lack of a supra-national State policing institution as some of the important factors affecting the efficacy of the

[60] See K.K. Mwenda, "The Law On Regional Integration In Southern And Eastern Africa: Threats And Prospects," SA Public Law Journal, Vol. 12, No. 2, (1997), p. 462.

[61] See J.G. Starke, Introduction to International Law, (London: Butterworths, 1989), pp. 3-18; A. Cassese, International Law In A Divided World, (Oxford: Clarendon Press, 1994),pp. 11-14, 215-246; D.J. Harris, Cases And Materials On International Law, (London: Sweet and Maxwell, 1991), pp. 1-17.

COMESA regional integration scheme. We observed earlier that problems facing the COMESA regional integration scheme are likely to be similar to those that would arise if a regional stock exchange were to be set up. The setting up of a regional stock exchange must be seen as an important aspect of integrating the Eastern and Southern African region. It could be argued further that due to constraints such as the 'self-interest' agenda of COMESA Member States, a number of these states have not benefited much from the COMESA regional integration scheme. We examine below some of the political, economic, socio-cultural and technological obstacles to the COMESA regional integration scheme.

Political Factors Threatening The Success Of The COMESA Regional Integration Scheme:

Political factors affecting the efficacy of the COMESA integration scheme include a number of issues already discussed above, that is, the pursuit of 'self interest' goals by COMESA Member States and the lack of a supra-national State policing institution. Also, the presence of some dictatorial One-party States in the region, such as the then Zaire, ran contrary to the notion of democratic government imbedded in the COMESA Treaty.[62] Democracy is one of the underlying features imbedded in the principles of the COMESA Treaty.[63] On the other hand, ideological differences between Member States could lead to political problems as well. However, now that the cold war is over there are minor differences in ideology among developing countries.

[62] See Article 2 of the COMESA Treaty stressing the importance of observing principles of liberty, fundamental freedoms and the rule of law.

[63] See explanation in supra. (n. 62).

Economic, Socio-cultural And Technological Factors Threatening The COMESA Regional Integration Scheme:

Economic factors that affect the efficacy of the COMESA integration scheme include differences in the balance of payment positions, differences in economic policies, the issue of convertibility of currencies and the differences in the currency exchange rates of Member States. We have already identified a number of these factors as being central to the introduction of a regional stock exchange.[64]

Socio-cultural factors include problems over the choice and use of language (*e.g.* the use of Afrikaans in South Africa), differences in national culture, differences in the literacy levels and differences in the social stratification of various Member States. Technological factors that affect the efficacy of the COMESA integration scheme include differences in the advancement of each Member State's productive forces (this can also be an economic factor), problems of adaptability of technology to industry in the Member States (*e.g* the issue of literacy levels and user-comprehension in management information systems), and differences in the choice between capital intensive or labour intensive technology for the Member States.

4.7. THE SADC OPTION AS ANOTHER THREAT TO THE COMESA REGIONAL INTEGRATION SCHEME:

In this section, we look at the Southern African Development Community[65] as a regional integration scheme that poses a threat to the success of the COMESA integration scheme. On

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[64] See above.

[65] Established by the Treaty of the Southern African Development Community done at Windhoek, Namibia on 17 August 1992, reproduced in 32 International Legal Materials, 116, (1993).

August 17th 1992, Member States of the Southern African Development Co-ordination Conference (SADCC)[66] signed a Treaty[67] establishing the Southern African Development Community (SADC). SADC replaced SADCC.[68] The background to the SADC regional integration scheme is contained in the following note:[69]

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[66] Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe.

[67] As well as a Protocol to the Treaty Establishing the Southern Africa Development Community on Immunities and Privileges. This Protocol confers the privileges and immunities on SADC institutions that are necessary for the proper performance of their functions, and are to be comparable to those accorded to similar international organisations. The formalities for entry into force of this Protocol are essentially the same as for the Treaty.

[68] See Article 44. B. Tsie, "States and Markets in the Southern African Development Community (SADC): Beyond the Neo-Liberal Paradigm," Journal of Southern African Studies, Vol.22, No.1, (March 1996), p. 84, observes that: "The old SADC was simply a Conference; a compromise to be more precise, of independent Southern African states whose primary objective was to reduce dependence on, but not only on, South Africa through the coordination of interstate projects in a decentralised manner."

[69] See also B. Tsie, "States and Markets in the Southern African Development Community (SADC): Beyond the Neo-Liberal Paradigm," in *supra*., (n. 68), p. 84, where that author argues that the direction which SADC has taken is unmistakable, at least in comparison to its predecessor - SADCC. The latter had 'no treaty, no central authority' not even any mechanism to ensure that its decisions were implemented. Unlike SADCC, the 'new' SADC has provisions for imposing sanctions on any of its Member State which persistently fails, without good reason, to fulfil obligations assumed under its Treaty or purses policies which undermine the principles and objectives of SADC (see Article 33). The shortcoming of Tsie's view, however, is that it advances a false notion that Treaty provisions are an end in themselves. Tsie's view does not give thoughtful consideration to the aspect of how sanctions can be enforced under a multi-lateral treaty.

"As an international economic organisation, it will have legal personality in each of the member State's territory (Art. 3) and its headquarters will be in Gaborone, Botswana - seat of the current SADCC secretariat (Art. 2) ...

SADCC was instituted twelve years ago on April 1 1980 when the Heads of State or Government of nine Southern African countries[70] met in Lusaka, Zambia to adopt a declaration - 'Southern Africa: Towards Economic Liberation', which formed the basis for the creation of the institution. Comprised of loose association of states with a quasi-legal personality, its aim amongst others, was to pursue policies to facilitate the economic development and independence of these countries from South Africa, and to achieve the integrated development of the region.

The dramatic changes that have taken place regionally[71] and internationally,[72] together with the developments in South Africa with the dismantling of statutory apartheid, and the unbanning of organisations such as the African National Congress (ANC) and Pan African Congress (PAC), led SADCC to reconsider its position and its lack of progress in achieving its objectives. This became particularly pressing with the prospect of an economically strong democratic South Africa joining the group. Listing several critical reasons[73] for integrating Southern African

[70] Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe.

[71] Thus the rapprochement reached in Angola between UNITA and the MPLA, the peace talks being brokered between Renamo and Frelimo in Mozambique, and movements in the rest of Southern Africa towards more democratic government, have contributed towards a positive view of the economic gains to be achieved by integration.

[72] The end of the Cold War and the collapse of the centrally-planned economies of Eastern Europe and the former Soviet Union.

[73] Including the argument that political change in South Africa is likely to lead to new patterns of investment in the region, with marked preference for South Africa because of its more attractive

economies, the (SADCC) report argued that there was an absolute necessity for these governments (SADCC Member States) to transform and restructure their economies to make them more productive and competitive ... no single country in the region could make the necessary change on their own.

> 'In these circumstances, closer economic co-operation and integration have become no longer merely desirable, but imperative for growth, development and indeed survival.'

The treaty is seen as an important step towards the attainment of the goals. By formalising what was previously a loose-knit group of states, the treaty gives SADC the teeth it lacked as SADCC, thereby remedying what many considered to be a major flaw in what was otherwise seen as a pragmatic approach to development. In other words, it provides the Community (SADC) with the capacity to enforce decisions taken by its supreme organ, the Summit of Heads of State or Government.[74] ."[75]

Following below are the organs of SADC:[76]

(a) the Summit of Heads of State or Government;

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investment climate, infrastructural development, and its managerial, technical and technological capacities. A further argument looks to developments in the advanced industrialist countries, as well as in the Pacific Rim and Latin America where these countries are entering into protectionist trading blocs constructed of free trade zones. This has made integration even more crucial to enable the countries of the region to strengthen their bargaining power with these trading blocs.

[74] A function that the SADCC Secretariat lacked. This weakened SADCC's ability to follow through on policies and strategies adopted by the Member States.

[75] R.H. Thomas, "Introductory Note", in 32 International Legal Materials, 116-117, (1993).

[76] See B. Tsie, *op. cit.*, p. 84.

(b) the Council of Ministers;

(c) the Commissions;

(d) the Standing Committee of Officials;

(e) the Secretariat;

(f) Sectoral Coordination Units (SCU's); and

(g) the Tribunal.

However, we shall not examine details relating to the functions of SADC organs since such discussion falls outside the scope of this study. We now turn to look at the differences between COMESA and SADC.

4.8. DRAWING COMPARISONS AND MAKING DISTINCTIONS:

There are several areas of common interest between SADC and COMESA. It is such areas that we propose to examine here. The SADC Treaty emphasises the need to harmonise political and socio-economic policies of SADC Member States.[77] It is clear from our discussion on the objectives of COMESA that this SADC objective also obtains under the COMESA Treaty. That said, it must be observed that the SADC Treaty goes on further to provide that the SADC integration scheme should achieve complementarity between national and regional strategies and programmes.[78] By contrast, there is no emphasis on complementarity in the COMESA Treaty. The latter treaty does, however, provide that Member States should not take measures which frustrate objectives of the treaty.[79] On the

[77] SADC Treaty, Article 5(2).

[78] Article 5(1).

[79] See above.

other hand, whereas the legal structure of SADC does not compel Member States to enact the necessary legislation at a national level to enable SADC to implement interstate projects, the COMESA Treaty requires COMESA Member States to take steps to secure the enactment and continuation of such legislation which gives effect to the COMESA Treaty.[80]

A Regional Stock Exchange Under An Integration Scheme Focusing On Market-Driven Development?

On paper, it is clear that whereas the SADC Treaty is concerned mainly with the issue of development in its multi-dimensional sense,[81] the COMESA Treaty is much more focused at market-oriented economic growth.[82] This distinction can be seen by looking at Article 5(1) of the SADC Treaty which provides that some of the objectives of the SADC regional integration scheme are to achieve development and economic growth, alleviate poverty and enhance the standard and quality of life of peoples of Southern Africa. There is no such provision in the COMESA Treaty. In practice, however, SADC like COMESA and SACU, has a market driven approach to development. As Gibb observes:

> "In 1995, SADC set itself some ambitious targets: the elimination of trade barriers within two years; the creation of a common market with the free movement of the factors of production; and the creation of a common currency by the turn of the century. SADC's policies represent

[80] COMESA Treaty, Article 5(2).

[81] See above.

[82] COMESA, Common Market For Eastern And Southern Africa: In Brief, *supra*., (n. 18), pp. 9-10, provides that COMESA recognises the concepts of production-led and market-led integration as being two sides of the same coin. For the purposes of investment in production, the entire COMESA region is now considered as a 'domestic market.'

> an ambitious, perhaps over-ambitious, attempt to achieve wider and deeper integration in areas such as monetary and fiscal policies, and exchange and trade regimes. In marked contrast to its predecessor (the Southern African Development Coordination Conference), SADC has adopted trade liberalisation and the free market approach to integration. There is in theory, therefore, a marked similarity in the integration strategies being pursued by SACU and SADC."[83]

In comparison with objectives of SADC, one other shortcoming of the COMESA regional integration scheme lies in the fact that trade creation in a region, such as Eastern and Southern Africa, which is mainly constituted by primary goods exporters, would not be easy to achieve. For example, how does Zambia export her copper (raw materials) to Tanzania when Tanzania has no secondary industry to process this copper into finished goods? Similarly, Zambia may not have enough secondary industries to process sisal from Tanzania. In the light of such shortcomings, it is important to have trade creation in company and government securities encouraged at the regional level so that the financial sectors of COMESA Member States can integrate. On trade in goods and services, some countries in the region are beginning to move towards capital intensity. Zimbabwe, for example, has a steel industry which gives it the potential for growth as an industrialised country. Even so, countries which are Member States of both COMESA and SADC are faced with the problem of choosing which regional laws to apply in their international contracts with other states. Should the rules of COMESA prevail over those of SADC or are the two of equal weight? Which rules must a State follow in the event that COMESA rules contradict SADC rules? Similarly, which rules must a State follow

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[83] See R. Gibb, "Regional Integration in Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union," _supra._, (n. 13), pp. 83-84.

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Summit meeting held in Johannesburg, member states (SADC) decided that dual membership of SADC and COMESA was incompatible and that SADC states must resign their membership of COMESA."[86]

New Developments And Prospects For The Future:

SADC, COMESA and SACU have been, or are in the process of reformulating and renegotiating their constitutions.[87] As Gibb observes, whilst both the World Bank and the Africa Development Bank, advising on regional integration in southern Africa, prioritise and promote multilateralism, the Africa Development Bank argues for a 'delayed free market option', with regional cooperation taking place behind a common external tariff providing 'breathing room for productive enterprises in southern Africa to become internationally competitive by first becoming regionally competitive'.[88]

"From a neo-liberal perspective, although such a discriminatory trading relationship is clearly a 'second-best' option compared to multilateralism, the Africa Development Bank sees it as the most practical way to promote free trade in the long-term. The World Bank, on the other hand, places a far greater emphasis on 'unilateral liberalisation' and free market policies, both regionally and internationally. As Keet observes, the World Bank initiative:

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[86] R. Gibb, "Regional Integration in Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union," *supra*., (n. 13), pp. 83-84.

[87] See generally R. Gibb, "To Ignore Regional Cooperation Could Be Economic Suicide," Business Day, 25th August 1995.

[88] See R. Gibb, "Regional Integration in Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union," *supra*, (n. 13), p. 70.

' is designed to ensure that regional organisations in southern Africa do not become what the Bank considers 'inward looking and discriminatory against third parties'."[89]

However, since 1990 there has been considerable conflict between SADC, on the one hand, and COMESA and its predecessor the Preferential Trade Area (PTA), on the other.[90] As we have noted above, COMESA has objectives which are almost identical to those now being pursued by SADC: complete trade liberalisation and monetary union.[91] It is clear that the establishment of the European Union was a catalyst in the creation of regional integration schemes such as COMESA.[92] The African states had as one of their objectives the idea that establishing regional institutions such as COMESA would lead to the creation of economies of scale which could protect the sub-region from the imbalance in the international economic order.[93] However, as Ndulo observes,[94] although the idea of a regional integration scheme may sound romantic, the dynamics of implementing such a scheme are not easy to come by. We have already shown some of the constraints facing the COMESA regional integration scheme. The problem of pursuing 'self-interest' goals by COMESA Member States, a problem which arose under the Maastricht Treaty when Britain hesitated to sign that treat, is one notable

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[89] *Ibid.*, pp. 69-70. See also D. Keet, "International Players and Programmes For - and Against - Economic Integration in Southern Africa: Working Paper," (Cape Town: University of Western Cape, Centre for Southern African Studies, 1994).

[90] See R. Gibb, "Regional Integration in Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union," *supra*, (n. 13), pp. 83-84.

[91] *Ibid.*, pp. 83-84

[92] See for example His Majesty King Mswati III of the Kingdom of Swaziland, then Chairman of the PTA Authority, in Heads of Sate and Government of the Preferential Trade Area, *op. cit.*, p. viii: "We have no choice but to develop a collective response to the impacts of the European Common Market..."

[93] See COMESA, Common Market For Eastern And Southern Africa: In Brief, *supra.*, (n. 18), p. 10.

constraint. Moreover, it is not easy to talk of synergy in a situation where there is a divergence of power and authority. By this we mean COMESA has its own interests and SADC has its own interests to serve as well. At the same time both bodies retain a relatively identical group of Member States. Instead of having one strong regional integration body in Southern and Eastern Africa, there is a duplication of effort. This could result in conflict of interests between the two bodies as they have similar objectives. The commitment of the Member States towards each of these regional integration schemes varies from country to country. We have already shown above how SADC Member States have resolved that those SADC States that are also members of COMESA must withdraw from membership of the latter group. Despite these shortcomings, the prospects of setting up a regional stock exchange in Eastern and Southern Africa appear bright.[95]

4.9. SOME EMPIRICAL EVIDENCE SUPPORTING THE CASE FOR A REGIONAL STOCK EXCHANGE:

Out of the ten interviewees that were asked about the prospects of setting up a regional stock exchange in Eastern and Southern Africa, 70 per cent observed that there was need to have a regional stock exchange set up.[96] The respondents noted that the regional stock exchange must co-exist with the national stock exchanges so that cross-listings are facilitated.[97] On the other hand, a notable dissenting minority view was that of the Chief Executive of the Lusaka

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[94] See above.

[95] See below.

[96] See generally Appendices A to J.

[97] See *Ibid.*

Stock Exchange. Although the Lusaka Stock Exchange Chief Executive does not explain why he is against the idea of setting up a regional stock exchange, he none the less points out that:

> "I am not a proponent of a regional stock market at this stage. I know that if you look at what's happening... every country in the region is now having a stock exchange. Malawi has just opened theirs. Tanzania are going to do the same before the end of the year. Uganda is doing the same. So there is a criticism which you will hear these days that it is becoming like a fashion to have a stock exchange and it is being used as a symbol of national pride and if you don't have a stock exchange its something you are missing. So that criticism I think is a bit unfair. If you look at the fundamental role of the stock exchange - this where we seem to get the argument wrong - it is to actually promote growth in the economy and to move money from holders of money...savers, to users of money."[98]

The shortcoming of this dissenting view, in the light of the empirical evidence submitted in Chapter Three, is that that evidence shows that there is inadequate liquidity in the Zambian economy. Where will the money savers come from when the cost of living in Zambia is high and there are inadequate collective investment schemes to galvanise resources of the risk averse individual investors? Moreover, many financial institutions in Zambia have already been seen as not playing an active role in promoting and participating in equity investments. In addition, it appears that the fears being expressed by the Lusaka Stock Exchange Chief Executive are unfounded.[99] A regional stock exchange does not necessarily have to replace

[98] *Interview* with Mr. Charles Mate, op. cit., (Appendix A, question 15).

[99] See Ibid., (Appendix A, question 15). Mr. C. Mate argues: "If you go for the regional idea...it will only be the biggest company in Malawi, the biggest company in Zambia and so on. The question then is what do you do with the rest of the economy? What do you do with small, medium enterprises which

national stock exchanges. A regional stock exchange and national stock exchanges can co-exist as we have shown above. We have also argued that small companies and those companies that have features which are particularly attractive to domestic markets could begin by listing on national stock exchanges, with a possibility of moving into cross-listings. On the other hand, highly capitalised companies and other companies capable of meeting regional stock exchange costs of listing can trade directly on the regional stock market, with possibilities of engaging in cross-listings too. It is our humble submission that the basic idea in our proposal is to have capital markets in the region integrate so that efficient and competitive capital markets can be created, together with the promotion of an efficient securities regulatory framework. As our study shows, there is need to have efficient capital markets and efficient securities regulation in the Eastern and Southern African region.

In Which Country Must The Regional Stock Exchange Be Based?

During our fieldwork, interviewees were also asked about the possible location of a regional stock exchange in Eastern and Southern Africa. When asked about a suitable country in which such a regional stock exchange could be located, about 70 per cent of the interviewees observed that South Africa was the ideal place as it had the necessary infrastructure and a good economy.[100] However, some dissenting views, though in the minority, observed that placing a regional stock exchange in South Africa would bring about uneven development in

really form the foundation of your economy in terms of employment, in terms of domestic growth... What do you do with all that? Its like you are pushing them aside and making them irrelevant to the economy of the country."

[100] See generally Appendices A to J.

the region since most of the financial resources would be concentrated in South Africa.[101] Other places that were pointed out as suitable countries in which a regional stock exchange could be located included Zimbabwe, Zambia, Malawi and Botswana.[102] Out of this list, Zimbabwe was the favourite due to its centrality, political stability and the fact that it has the oldest stock exchange in the region.[103]

4.10. CONCLUSION:

This chapter has argued that the promotion of multiple listing and cross-border trade in securities and the introduction of a regional stock exchange in Eastern and Southern Africa would help to develop competitive capital markets in the region. Indeed, the adoption of such measures would also help to alleviate the liquidity crisis on a number of African stock markets.

In this chapter, a number of obstacles to regional integration and the setting up of a regional stock exchange were spelt out. Proposals to redress these obstacles were made. Although it was observed by a number of interviewees that advantages of establishing a regional stock exchange included the promotion of cross-listings, the integration of financial systems in the region and the creation of economies of scale,[104] it was not pointed out under which regional integration scheme this stock exchange could be set up. Should a regional stock exchange be

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[101] See *Ibid*.

[102] See *Ibid*.

[103] See Interview with Mr. Nduba Namoonde, *op. cit*., (question 16).

[104] See for example *Interview* with Dr. A. Mwenda, *op. cit*., (Appendix I, question 11); see also *Interview* with Mr. Mebeelo Mutukwa, *op. cit*., (Appendix F, question 17); *Interview* with Mr. Douglas Rolls and Mr. George Roberts, *op. cit*., (Appendix G, question 22); and *Interview* with Mr. Mumba Kapumpa, *op. cit*., (Appendix C, question 18).

set up as a COMESA stock exchange or as a SADC stock exchange? Or, should a regional stock market be set up under a different treaty altogether? Since COMESA has a larger group of Member States,[105] and it has already undertaken some preliminary studies on the prospects of setting up a regional stock exchange, COMESA must be allowed to continue work on the regional stock exchange. Indeed, while we acknowledge that Article 21 of the SADC Treaty does address generally aspects of investment and finance, as possible areas of cooperation, it is clear that the SADC Treaty does not deal specifically with the issue of setting up a regional stock exchange.

It is our submission here that the modalities of setting up a regional stock exchange are likely to be influenced by a number of macro-economic and micro-economic factors. For example, if a regional stock exchange were to be set up in South Africa that could involve, perhaps, the conversion of the Johannesburg Stock Exchange into a regional market. But, then, the question arises: since South Africa is not a Member State of COMESA, how can South Africa host the COMESA stock exchange? On the other hand, if a regional stock exchange were to be introduced under the auspices of SADC, it would appear perfectly acceptable to a number of SADC Member States that South Africa hosts the stock exchange. It is also possible that an entirely new institution could be set up as a regional stock exchange without converting one of the existing national stock exchanges in Eastern and Southern Africa into a regional stock exchange. As noted above, the setting up of a regional stock exchange could be influenced by a number of macro-economic and micro-economic factors. These factors would depend on the host country's factor endowments. It is our submission finally that the merging of SADC and

[105] As long as SADC Member States with dual membership do not break away.

COMESA into one institution should now be seen as an important prerequisite to attaining sustainable development in the Eastern and Southern African region. Such a development would not only be a great stride towards efficient regional integration, but also an important contribution towards the creation of efficient capital markets and efficient securities regulation in Eastern and Southern Africa.

PART III

THE LEGAL FRAMEWORK IN ZAMBIA AND CONSTRAINTS POINTING TO THE NEED TO INTRODUCE CROSS-LISTINGS AND A REGIONAL STOCK EXCHANGE

CHAPTER FIVE

PUBLIC DISTRIBUTION OF SECURITIES: THE OLD LAW

This chapter examines the efficacy of the legal framework for public distribution of securities in Zambia prior to 1993. The chapter focuses on the 1970 and 1990 Stock Exchange Acts. Although these statutes have now been repealed,[1] the discussion in this chapter not only provides important insights into the legal framework under the present 1993 Securities Act, but it also places the legal framework under the 1993 legislation into an historical context. Arguments in this chapter are underscored by the view that to overcome the various constraints on the legal framework for public distribution of securities in Zambia there is need to develop a regional stock exchange and to promote multiple listing and cross-border trade in securities. This development must be supported by efficient regulatory rules both on the Lusaka Stock Exchange and the regional stock exchange.

In Zambia, the first piece of legislation to be enacted on the regulation of public distribution of securities on stock markets was the Stock Exchange Act 1970. In spite of the enactment, no stock

[1] See below.

exchange was ever established until 1993.[2] By late 1971 the Stock Exchange Act 1970 had been amended.[3] The Stock Exchange Act 1970 was finally repealed a year later.[4] On the other hand, the Stock Exchange Act 1990 only lasted three years. It was repealed and replaced by the Securities Act 1993.[5] Up until 1993, the main form of public distribution of securities in Zambia were off-the-market distributions such as over-the counter trade in securities, exercise of pre-emption rights, distributions through bonus issues to existing shareholders, share transmissions and private share transfers.

As a corollary to the 1970 and 1990 laws, the repealed Zambian Companies Act 1921 had provisions on certain aspects of public distribution of securities in Zambia. We will look at some of the relevant provisions of the Companies Act 1921. Provisions of the Securities Act 1993 and those of the Companies Act 1994 will be examined in the subsequent chapters when we look at the efficacy of the present legal framework for public distribution of securities in Zambia. We now turn to look at some of the important reasons why no stock exchange was ever set up in Zambia prior to the enactment of the Securities Act 1993.

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[2] See *Interview* with Mr. Mumba Kapumpa, Chief Executive, Securities and Exchange Commission, Lusaka, 18th December 1996 (Appendix C, questions 3, 4 and 5).

[3] See Stock Exchange (Amendment) Act, No. 5 of 1971.

[4] See Stock Exchange (Repeal) Act, No. 15 of 1972.

[5] See The Securities Act (Commencement) Order, 1993 [Statutory Instrument No. 172 of 1993]. The Securities Act No. 38 of 1993 was given presidential assent on 8th August 1993. The Act came into force on 17th December 1993. This paved the way for the Lusaka Stock Exchange to begin operations on 21st February 1994. The official opening of the Lusaka Stock Exchange took place on 27th April 1995 when Mr. F.T.J. Chiluba, the President of the Republic of Zambia, officially opened the stock exchange.

5.1. FACTORS INHIBITING THE SETTING UP OF A STOCK EXCHANGE BEFORE 1993:

We have already seen in Chapter One that Zambia underwent three successive development strategies from the time of attaining political independence to the time of introducing the structural adjustment programme. In the early 1970's, the enactment of the Stock Exchange Act 1970 was a reflection of how the law was being used to codify the prevailing development strategy in Zambia. Generally, state capitalism suppressed the growth of competition in the economy. The state had monopoly over major economic interests, controlling and owning businesses in Zambia. Shares in state owned enterprises (parastatal companies) could not be sold to the public. The state held on to the shares in these companies. Ultimately, state capitalism led to a situation where there were virtually no securities that could be traded on a stock market. The enactment of legislation on public distribution of securities was therefore a mere symbolic gesture to imitate what was going on in countries such as Ghana that had attained independence before Zambia. This symbolic gesture shows why Zambia's Stock Exchange Act 1990, passed eighteen years after the repeal of the Stock Exchange Act 1970, was simply a replica of the repealed Stock Exchange Act 1970.[6] As the Chief Executive of the Securities and Exchange Commission observes:

> "The 1990 Stock Exchange Act was really a re-hash of the 1970 Zambia Stock Exchange Act, and I was personally responsible for doing that... which I usually say: '*I am even ashamed as a*

[6] See *Interview* with Mr. Mumba Kapumpa, op. cit., (Appendix C, question 4).

lawyer to have done that...' The late Gibson Chigaga wanted the law to start a stock exchange like yesterday and my advice that we do research work first were met by objections from the minister. So the only thing I had within the twenty-four hours or so I was given I had to look and search and I found the 1970 Act and all I did was to change where it said '1970' and I put '1990' and that is how the Act (1990) was produced."[7]

This evidence on the poor preparation of the Stock Exchange Act 1990 supports the view that faced with various constraints, the legal framework for public distribution of securities in Zambia is likely to have had limited success in facilitating the development of a competitive stock exchange. Indeed, in enacting the Stock Exchange Act 1990, the Zambian government did not make efforts to revise and improve the 1970 law and neither did the government give thoughtful consideration to the prospects of having in place a regulatory framework that would provide for an optimally efficient and competitive stock market in Zambia.[8] One of the reasons for this development is that the government - through parliament - enacted the Stock Exchange Act 1990 as a hasty response to the structural adjustment programme without paying much attention to weaknesses of the Stock Exchange Act 1970.[9]

After the repeal of the Stock Exchange Act 1990 by the Securities Act 1993, a number of innovations in the law were introduced. In outline, under the Companies Act 1921 of Zambia

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[7] Ibid., (Appendix C, question 4).

[8] See *Interview* with Mr. Mumba Kapumpa Ibid, (Appendix C, question 4). See also *Interview* with Mr. Charles Mate, Chief Executive, Lusaka Stock Exchange, Lusaka, 20th December 1996 (Appendix A, question 4).

and under the Stock Exchange Act 1990 there were no statutory provisions requiring public companies engaging in secondary trading of securities to prepare and issue prospectuses. This problem has now been resolved by the Securities Act 1993 which requires issuers of securities to prepare prospectuses whenever they are distributing securities to the public. Under the Companies Act 1921, the only statutory provisions that required a company to prepare and issue a prospectus were provisions on primary trading of securities.[10]

Other constraints on the 1970 and 1990 legal framework(s), which have now been superseded by provisions of the Securities 1993 include the views that the Stock Exchange Acts 1970 and 1990 had no provisions to regulate collective investment schemes; to provide for the law against insider dealing; to prohibit issuing and use of false and misleading information; to state the contents requirements for listing particulars; and to provide for any statutory duties of financial intermediaries.

5.2. ADVANTAGES OF RAISING CAPITAL ON THE STOCK MARKET:

At the outset, it is stressed that an analysis of the attractiveness of emerging markets has already been made.[11] In this section, we concentrate not on the attractiveness of emerging markets as such, but on other advantages that could influence an investor to distribute its securities on a stock exchange instead of borrowing money from a bank or selling off some of its assets.

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[9] *Interview* with Mr. Mumba Kapumpa, Ibid., (Appendix C, question 4).

[10] See Companies Act 1921, sections 69(11), 70 and 72.

[11] See Chapter Two, *supra*.

Generally, the issue of shares on a stock market, such as the Lusaka Stock Exchange or the proposed COMESA regional stock exchange, is one of the most ideal methods of converting individuals' savings into capital investment for industry. By pooling risks and rewards among a number of investors, stock markets allow companies to raise capital on better terms than would be available from single investors.[12] Thus, the main advantages of going public include the following:

(a) ***Raising Capital***

New equity capital can be raised by a company both at the time of flotation and subsequent to the flotation by issuing shares for cash or as consideration in the acquisitions.[13] A company can decide to 'go public' for reasons which might not necessarily point to a strategic decision to expand. For example, political-economic considerations such as privatisation of state owned enterprises in a particular country might underlie a company's decision to 'go public'.

(b) ***Reduction of Reliance on Debt Financing***

Long-term financial stability of a company can be achieved from the use of equity capital while reducing reliance on debt financing.[14] This technique would particularly be attractive to state owned enterprises in Zambia that are undergoing privatisation. Indeed, the technique would help to broaden the share ownership base of most of these state owned enterprises. Also, equity capital in

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[12] London Stock Exchange, Going Public, (London: International Stock Exchange, 1992), p.1.

[13] London Stock Exchange, Going Public, *supra.*, (n. 12), p.3; See also Companies Act 1985 of the United Kingdom, sec. 103.

[14] See *supra.*, (n. 12), p.3.

the companies could provide the best alternative when other financing avenues such as debentures are no longer accessible.[15]

(c) *Marketability*

Generally, stock markets provide a mechanism for the valuation and trade of securities. This mechanism is advantageous to companies and their shareholders as it permits shareholders such as the Zambian government (having equity interests in state owned enterprises) to unlock some of their cash in the companies.[16] The cash is unlocked by selling off a part of the shareholders' investment in the business. Indeed, the advantages of this arrangement are twofold. First, the existing shareholders are able to value any residual shareholdings in the company. Secondly, shares which can be easily traded and for which a market valuation can be obtained are often more acceptable as security for loans.[17] The latter point explains how marketable a company would be to a venture capitalist or a debt financing house if the company had shares which could be easily traded and for which a market valuation could be obtained.

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[15] London Stock Exchange, Going Public, *supra*., (n. 12), p.3.

[16] *Ibid*., p. 3.

[17] *Ibid*., p. 4.

(d) ***Prestige***

Generally, 'going public' on a market such as a regional stock exchange could enhance a company's profile and, as noted above, the company's shareholding base could be broadened.[18] Also, where there is a statutory framework for regulating public distribution of securities this generates some investor confidence by making investors feel that they are protected from market abuses such as insider dealing and price manipulation. Indeed, this form of investor protection could operate as an incentive to attracting more debt financing to companies whose securities are listed on the market. We now turn to look at the competent authority for authorising stock exchanges in Zambia.

5.3. THE COMPETENT AUTHORITY:

Under the 1970 and 1990 Stock Exchange Acts, no regulations or rules were ever passed to facilitate securities regulation in Zambia as there was no stock exchange in existence at the time. In practice, however, what happened was that the statutes were enacted, but the law in these documents remained on paper and was never put into practice. Thus, the analysis of both the 1970 and 1990 Stock Exchange Acts will not focus on any subsidiary rules or regulations, but simply on the salient features of the principal legislation and the common law. As established above, there was basically no difference between the 1970 and the 1990 Stock Exchange Acts.

[18] Ibid., pp. 3-4.

Part II of the 1970 and 1990 Stock Exchange Acts established the Zambia Stock Exchange Council and provided that this council was a body corporate.[19] Both the 1970 and 1990 statutes provided that the Council was the sole authority for the licensing of stock exchanges, stockbrokers and dealers in stocks.[20]

Section 10 Of the Stock Exchange Acts 1970 and 1990 As A Major Constraint On the Legal Framework:

Section 10(h) of the Stock Exchange Acts 1970 and 1990 contained the key administrative powers of the Zambia Council of Stock Exchanges. This statutory provision also conferred wide discretionary powers on the Council to acquire rights or interests in any securities that were listed on any stock market in Zambia. These discretionary powers were designed to achieve three purposes. First, the Council could make its acquisitions where it was necessary and convenient for the exercise of its functions.[21] Secondly, the Council could make acquisitions for the purpose of exercising control over the marketing and dealings in any securities on a stock market in Zambia. Thirdly, acquisitions could be for any purpose deemed necessary by the Council.[22] The shortcoming here was that although this provision gave vast discretionary powers to the Council, both the 1970 and 1990 statutes were silent on the compensation of parties whose securities would be acquired by

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[19] Stock Exchange Act 1970, sec. 4; Stock Exchange Act 1990, sec. 4.

[20] Stock Exchange Acts 1970 and 1990, (*Ibid*), sec. 10(a)

[21] *Ibid*., sec. 10(g).

[22] *Ibid*., sec. 10(h).

the Council. Also, the 1970 and 1990 statutes fell short of providing expressly for measures to control the Council's exercise of the discretionary power. Such constraints must be avoided when drafting the common investment code for the regional stock exchange. As there were no provisions in the 1970 and 1990 Zambian Stock Exchange Acts, on the compensation of parties that lost out on securities acquired by the Council, other sources of the law had to be sought to protect investors. Indeed, the only remedy that was available, though outside the Stock Exchange Act(s), was an application for judicial review of administrative action.

Although, ideally, section 10 was designed to promote investor protection, what section 10 did was to mirror the values imbedded in the ideology of state capitalism. Generally, the Stock Exchange Acts 1970 and 1990 set out various levels at which the state could intervene. In a way, state intervention could have brought fears to investors who thought that the state could have abused its discretion by acquiring securities of these investors.

Political Appointments (and political accountability of appointees) As A Constraint:

The Zambia Council of Stock Exchanges was to be constituted by political appointees appointed by the Cabinet Minister.[23] Under the 1970 and 1990 Stock Exchange Acts, the Minister was given power to appoint the chairman of the Council, a member of the Council nominated by the Bank of Zambia, and two other members belonging to a stock exchange and nominated by that exchange.[24]

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[23] See Stock Exchange Acts 1970 and 1990, (*Ibid*), sec. 5(1)(2).

[24] See Stock Exchange Acts 1970 and 1990, (*Ibid*), sec. 5(1)(2).

To carry out its functions, the Council had to appoint a Secretary as the chief executive and agent.[25] The Secretary of the Council was accountable to the Minister.[26] There is no doubt here that this begs a question. The political accountability of the chief executive of the Council to the Minister reinforces our earlier submission that the regulatory system under the 1970 and 1990 Stock Exchange Acts was primarily designed to introduce various levels of regulation at which the state could intervene. Political intervention was further strengthened by parliamentary funding of the Council.[27] Here, it would have been better to provide that the Council would raise its own funds from activities such as the licensing of financial intermediaries and the authorisation of stock exchanges. Similar reasoning could be extended to the idea of setting up a regional stock exchange.

Generally, under Zambia's 1970 and 1990 statutes the Council's primary function as the principal authorising and regulatory body in the securities industry was not free from political influence. The Council's role was also jeopardised by factors such as the expectation that the Council had to operate or manage its own stock exchange.[28] The Council was expected to establish Council stock exchanges which would then compete with other stock exchanges falling under the supervisory role of the Council. The extent to which the Council was expected to be impartial and independent in

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[25] See *Ibid.*, sec. 7.

[26] *Ibid.*, sec. 7(5).

[27] *Ibid.*, sec. 11(1)(a).

[28] *Ibid.*, sec. 12.

exercising its role as the competent authority was not addressed by the Stock Exchange Acts 1970 and 1990.

By comparison, the position of England offers an interesting model. For purposes of implementing the three European Union Directives on the securities industries in the European Union States,[29] the International Stock Exchange has been designated as the competent authority responsible for authorising the conduct of financial services in the United Kingdom.[30] Unlike the position in Zambia, in the United Kingdom European Union laws have an important role to play in the development of English securities law. Also, in England, the Secretary of State can delegate powers assigned to the International Stock Exchange to another body without prejudice to earlier decisions of the Exchange.[31] By contrast, in Zambia, under the 1970 and 1990 Stock Exchange Acts, no such powers existed.

[29] Council Directive No. 82/121/EEC of February 15, 1985 relating to interim reports; Council Directive No. 80/390/EEC of March 17, 1980 relating to listing particulars; Council Directive 79/279/EEC of March 5, 1979 relating to admissions to listing.

[30] Financial Services Act 1986, sec. 142.

[31] *Ibid.*, sec. 157.

5.4. TYPES OF STOCK EXCHANGES THAT COULD BE SET UP:

Under the 1970 and 1990 Stock Exchanges Acts, a company intending to go public in Zambia could apply for listing of its securities on a Council stock exchange list,[32]or on a licensed stock exchange list.[33] Both markets dealt with the listing of securities.

Lack Of Statutory Provisions On The Setting Up Of An Unlisted Securities Market As A Constraint:

Due to poor drafting of the Stock Exchange Acts 1970 and 1990 and lack of corporate finance law experts among the legislators,[34] these statutes did not provide for the marketing of unlisted securities.[35] Although it is very clear that Zambia's financial sector is still in a developing phase and that there is need to promote the growth of small entrepreneurial firms, at the time of enacting the 1970 and 1990 Stock Exchange Acts, the Zambian government did not give thoughtful consideration to the importance of having laws that made provision for the participation of small investors on the stock market. In developing countries, such as Zambia, legislation to protect small investors is important since small investors comprise the larger base of domestic capital in the

[32] Stock Exchange Act 1970, sec. 12; Stock Exchange Act 1990, sec. 12.

[33] See Ibid., sec. 15.

[34] As revealed by the field work conducted by the author in Zambia between July 1993 and October 1993 and in December 1996. See also *Interview* with Mr. Mumba Kapumpa, op. cit., (Appendix C, question 4).

[35] As pointed out below, the Stock Exchange Acts 1970 and 1990 did not provide a market for trading unlisted securities in Zambia. This meant that securities issued by small companies and securities issued by highly capitalised companies were all to be traded on one market.

economy. Indeed small investors could be afforded the opportunity to raise finance by trading their securities on a less capitalised securities market such as an unlisted securities market. The bigger companies could then have their securities traded on a listed securities market. Furthermore, to avoid the problem of marketing securities which appear more attractive than others on the same market as that on which the less attractive securities are being marketed, the argument for an unlisted securities market is given more weight. In England, the International Stock Exchange which is the sole stock exchange in that country hosts two types of securities markets.[36] There is the Alternative Investments Market, established in mid 1995 as a market where small and growing companies can trade their securities, and there is the Official List Market which mainly caters for much more capitalised companies. Recently, however, the other market that was in existence, the Unlisted Securities Market, was abolished.[37] As Davis observes:

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[36] See J.L. Powell, Issues and Offers of Company Securities: The New Regime, (London: Sweet and Maxwell, 1988), p. 22; See also Company Law News, 142, (Oxfordshire: Tax, Business and Law Publishers, 26 January, 1993), pp. 4-5, on recommendations to close the Unlisted Securities Market in the United Kingdom at the end of 1995. The USM was closed at the end of 1996 and a new market, the Alternative Investments Market, was set up in mid 1995. See generally London Stock Exchange, *AIM:* A Guide For Investors, (London: London Stock Exchange, 1996); London Stock Exchange, *AIM:* A Guide For Advisers and Brokers, (London: London Stock Exchange, 1996); London Stock Exchange, *AIM:* A Guide for Companies, (London: London Stock Exchange, 1996). Unlike the Official List Market of the London Stock Exchange, the Alternative Investments Markets imposes no suitability requirements regarding: (a) the company's level of capitalisation; (b) the company's trading history; and (c) the number of shares in public hands. However, although there are no rules governing the methods of issuing or distributing securities on the AIM, companies and other market participants must comply with relevant legislation. In particular, companies must meet the requirements of the Public Offers of Securities (POS) Regulations 1995.

[37] See explanation in *supra.*, (n.36).

> "Although, institutionally, there is only one Stock Exchange (in the UK), in fact it operates two markets in securities. In addition to the 'Official List' of large and established companies, which is of considerable antiquity, the Exchange, alarmed by the growth of public issues of securities which were not 'listed', decided in 1980 to institute a regulated lower-tier market. The current version of that market is the Alternative Investment Market (A.I.M.), which replaced the previous Unlisted Securities Market (U.S.M.) in 1995. The purpose of the lower-tier market is to provide a home for young companies which do not have the track record for admission to the Official List."[38]

The Zambian Context:

(a) Council Stock Exchanges

Under the 1970 and 1990 Zambian Stock Exchange Acts, the competent authority for regulating public distribution of securities could exclusively establish a Council stock exchange anywhere in Zambia.[39] Also, Council stock exchanges could be established by the competent authority in association with any persons in and for any part of Zambia.[40] In contrast to licensed stock exchanges, which are discussed below, Council stock exchanges did not have to meet stringent statutory requirements to obtain a licence.[41]

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[38] P. Davis, Gower's Principles of Modern Company Law, (London: Sweet and Maxwell, 1997), p.395.

[39] Stock Exchange Act 1970, sec. 12; and Stock Exchange Act 1990, sec. 12.

[40] See Stock Exchange Acts 1970 and 1990, (*Ibid*), sec. 12.

[41] *Ibid*., sec. 12(3).

(b) Licensed Stock Exchanges

The second type of stock exchange that could be established under the 1970 and 1990 statutes was the licensed stock exchange. This type of stock exchange could be established anywhere in Zambia by an association of not less than five persons.[42] The law also required that at least three members of such an association had to be stockbrokers and conducting their business independently and in competition with each other.[43] A partnership could also be licensed as a licensed stock exchange where a non-member of a stock exchange and a member of a stock exchange engaged in the business of stock exchange dealing. To get licensed as a stock exchange such a partnership had to furnish the competent authority with security of a prescribed amount from its assets as a way of ensuring that investors were protected.[44]

5.5. CONSTRAINTS ON THE STATUTORY DEFINITION OF SECURITIES THAT COULD BE TRADED ON THE STOCK MARKET:

Under the 1970 and 1990 Stock Exchange Acts, only listed securities could be traded on a stock market. The two statutes spelt out the types of securities that could be listed. These securities included shares, loan stock, debentures, debenture stock and options on such securities plus those on stocks, shares and rights thereto.[45]

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[42] *Ibid.*, sec. 15.

[43] See Stock Exchange Acts 1970 and 1990, (*Ibid*), sec. 15(6)(a).

[44] *Ibid.*, sec. 15(6)(b).

[45] *Ibid.*, sec. 2.

The Stock Exchange Act 1990, like its predecessor of 1970, prohibited the listing of securities that were not freely transferable without the consent or approval of directors or of any representative of the company concerned.[46] Also, the statutes prohibited the listing of securities whose transferability depended on the consent and approval of the government or local authority or statutory corporation.[47] This prohibition included the listing of any options on or rights to such government securities. The consequences of this prohibition were that government securities could only be listed if they were freely transferable and if they did not require any prior consent or approval of the government or local authority or statutory corporation.

Also, under the Stock Exchange Acts 1970 and 1990[48] a share had a different definition from that found at common law.[49] Although the Stock Exchange Acts 1970 and 1990 introduced a different definition of shares from that found at common law, the common law definition continues to be the basis on which the company law concept of a share in Zambia is today grounded. Section 2 of the Companies Act 1994 provides as follows:

> " 'equity share' means a share comprised in the equity share capital of a body corporate; ...

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[46] *Ibid.*, sec. 2

[47] See Stock Exchange Acts 1970 and 1990, (*Ibid*), sec. 2

[48] *Ibid.*, sec. 2.

[49] See for example, Pennington, "Can Shares in Companies Be Defined?" 10 Company Lawyer (1989) 140.

> 'equity share capital' means the issued share capital of a body corporate, excluding any part thereof which neither as respects dividends nor as respects capital carries any right to participate beyond a specified amount in a distribution; ...
>
> 'share' includes stock; ..."

Although the Companies Act 1994 now draws a distinction between shares *per se* and equity shares, under the 1970 and 1990 Stock Exchange Acts no such distinction was made. All securities, debt and equity, were referred to as shares and stock. There are, however, similarities between the definition of a share found in the Stock Exchange Acts 1970 and 1990 and that found in the Companies Act 1994. Like the definitions in the Stock Exchange Acts, the Companies Act 1994 definition provides that a share could include stock.[50] We propose that the definition of securities to be traded on the regional stock exchange must also include the various products traded on other stock markets in the region.

At common law, a number of attempts have been made to define the term 'shares'. In the case of Colonial Bank v. Whinney[51], Fry L.J. stated that a share is a chose in action analogous to a debt in which there can be no occupation or enjoyment by the holder other than in the fruits of such security. In that case, Fry L.J. failed to appreciate that other chose in action such as those under insurance contracts are also akin to debt. In Bradbury v. English Sewing Machine, Lord Wrenbury ruled:

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[50] See above.

[51] [1885] 30 Ch.D 261 at 286-287

"a share is, therefore, a fractional part of the capital. It confers upon the holder a certain right to a proportionate part of the assets of the corporation, whether by way of a dividend or of distribution of assets in winding up."[52]

The definition of what constitutes a share, as expounded by Fry L.J. in the Colonial Bank case and the definition offered by Lord Wrenbury in the Bradbury case, both provide a narrow view of the anatomy of a share. Simply stating that a share is analogous to debt or that a share is a fractional part of the capital structure does not complete the story. Ideally, it is the identification of a share as interests of the shareholder measured by a sum of money for purposes of the holder's liability and returns that makes Farwell J.'s *dictum* in Borland's Bank v. Steel Brothers & Co. Ltd.[53] appealing to our concept of a share. The definition in Borland's Bank shows, among other things, that the liability of members of a company is limited to the amount, if any, unpaid on the shares held by each one of them. Members of a company also have rights to returns arising from their investments in the shares. The creation and ranking of these rights are generally a matter of contract law.

[52] [1923] A.C. 744 at 767.

[53] [1901] 1 Ch.D. 279 at 288

5.6. COMPANY LAW PREREQUISITES TO PUBLIC DISTRIBUTION OF SECURITIES:[54]

Under the Companies Act 1921 of Zambia, three important requirements had to be met before securities could be distributed to the public. These requirements were:

(i) The company allotting securities must be allotting its authorised but unissued share-capital.[55]

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[54] In this section, we look at the salient features of company law that were prerequisites to public distribution of securities under the 1970 and 1990 Stock Exchange Acts. It must be observed further that at the times when the Stock Exchange Acts 1970 and 1990 were in force, respectively, the piece of legislation that governed company law in Zambia was the Companies Act 1921. Thus, as pointed out above, in the discussion that follows below we will highlight some of the important and relevant aspects of the Companies Act 1921.

Apart from prescribing company law prerequisites to public distribution of securities in Zambia, the Companies Act 1921 also laid down post-allotment obligations on the company that was allotting shares to the public. Section 79 of the Companies Act 1921 required the allotting company to file a return of allotment with the Registrar of companies stating the securities allotted and the purchasers who had acquired those securities. In England, a somewhat similar provision appears in section 88 of the Companies Act 1985.

[55] See Companies Act 1921, secs. 76, 40, 69(2)(b), and any powers of the company in the articles or memorandum of association to allot shares to the public or any such powers provided for by a duly convened meeting at which a members' resolution is passed. On the other hand, if the directors of the allotting company exceed their powers then they would be acting *ultra vires* and they would therefore be personally liable. In the United Kingdom, section 35 of the Companies Act 1985 has done away with the *ultra vires* doctrine (ss. 35, 35A and 35B substituted for this section by Companies Act 1989, s. 108(1), as from 1991, subject to transitional provisions; see SI 1990 No. 2569, arts 4(a), 7). See also section 80 of the English Companies Act 1985.

(ii) Section 5(1) of the Companies Act 1921 created a statutory obligation which required all private companies in Zambia to include in their articles of association pre-emption rights. These rights made it mandatory that before any private company in Zambia could allot its securities to the public it had to allow shareholders holding pre-emption rights to exercise or waive such rights. Only when the pre-emption rights had been exercised or waived, could a private company allot its shares to the public.[56]

(iii) Under the Companies Act 1921, a public company could allot its shares to the public freely as long as there were no pre-emption rights in its articles of association.[57]

In addition, under the Companies Act 1921 of Zambia a fresh or new issue of shares to the public could only be made if the subscribers had subscribed for at least the minimum amount fixed in the memorandum or articles of association and named in the prospectus as the amount upon which the directors could proceed to allot.[58] Where no such amount was stated in the memorandum or articles of association the subscribers had to subscribe for the entire share-capital of the company.[59] This requirement did not apply to secondary trading of securities.

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[56] See Companies Act 1921 of Zambia, sec. 5(1)(a)(c).

[57] See *Ibid.*, sec. 5.

[58] *Ibid.*, sec. 76.

[59] *Ibid.*, sec. 76.

Prospectus Requirements Under The Companies Act 1921 And Constraints Affecting The Liability of Persons Preparing The Information:

Under the Companies Act 1921, before a public company could make a primary issue of securities to the public it had to prepare a prospectus.[60] Preparation of a prospectus was important because the prospectus provided investors with information on the company. What was not addressed in the Companies Act 1921 was the liability of persons or individuals that were involved in the preparation of a prospectus. Did misleading information in the prospectus attract liability on parties involved in the preparation of the prospectus? To what extent could it be said that the 1970 and 1990 statutes made a departure from the ordinary rules of common law (*e.g.* the tort of negligence) on liability of persons directly or indirectly involved in the preparation of a company's prospectus? We shall address some of these issues in the section that follows below.

5.7. CONSTRAINTS RELATING TO MARKETING OF SECURITIES:

Both the 1970 and 1990 Stock Exchange Acts had no provisions on methods of issuing securities to the public. The Stock Exchange Acts merely vested wide discretionary powers in the Council to prescribe, by statutory instrument and with the approval of the Minister, various regulations for marketing securities on a stock market in Zambia.[61] However, no such discretionary powers were

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[60] As pointed out above, this applied to primary trading of securities only. In a typical case, primary trading would take place at the time when a company was being incorporated. It is also important to stress that since there was no stock exchange at the time when the Companies Act 1921 was enacted and that generally since the volume of off the market trade in securities was very small, the Companies Act 1921 did not have any provisions to regulate secondary trading of securities in Zambia.

[61] Stock Exchange Act 1990, sec. 28(1).

ever exercised. Apart from providing for these powers, the Stock Exchange Acts 1970 and 1990 also entrusted the Minister with discretionary powers to introduce delegated legislation to regulate stock markets in Zambia.[62] The Minister was to pass such laws when it was necessary to regulate certain forms of business conduct in the securities industry.

The closest the Stock Exchange Acts 1970 and 1990 got to stating the methods of marketing securities to the public in Zambia was in section 10(j). Section 10(j) provided that the Council could, among other things, issue securities. Nothing further was said about the marketing of securities on a stock market in Zambia. Also, the Stock Exchange Acts 1970 and 1990 did not make it clear whether or not securities had to be listed before they could be issued. Besides, it was not clear whether or not listing particulars depended on the method of issue or they varied with the type of securities being issued. The listing of partly paid-up shares was also not addressed. All these shortcomings constrained the contribution of the legal framework towards the development of a competitive stock market.

[62] See Stock Exchange Acts 1970 and 1990, sec. 28(2). The position in the securities laws of 1970 and 1990 of Zambia differed significantly from that in the Financial Services Act 1986 of the United Kingdom. In Zambia, the discretionary powers of the Minister were quite vast. The Minister could pass subsidiary legislation on any matter he deemed fit to effect the marketing of securities on a stock market. In the United Kingdom, the Statements of Principle, the Code of Practice and the Conduct of Business Rules issued by the Secretary of State under the Financial Services Act 1986 relate to specific aspects of securities regulation. Furthermore, in the United Kingdom, unlike in Zambia, specificity in the scope of subsidiary laws makes it easier to control the discretionary powers of the executive.

5.8. ATTEMPTS AT IDENTIFYING LISTING REQUIREMENTS:

Under the Stock Exchange Acts 1970 and 1990, the Zambia Stock Exchange Council had powers to consider an application for admission of securities to listing on a Council stock market.[63] The Council was under an obligation to keep separate lists of listed securities.[64] In the case of licensed stock markets, committees of these markets were also vested with powers to keep separate lists of securities listed on the markets.[65] What, then, were the requirements for listing?

Constraints Affecting Information Disclosure Obligations: The Stock Exchange Acts 1970 and 1990 did not spell out any requirements that had to be met before securities could be admitted to listing. This shortcoming meant that it was not clear what the allotting company had to include in the listing particulars or what had to be disclosed before the company could issue securities to the public. Such constraints could have presented themselves as a barrier to the contribution of the legal framework in the development of a competitive stock exchange in Zambia. In the case of the regional stock exchange, the common investment code must address these sorts of issues.

The basic idea behind listing requirements is that information must be made available to all investors so that they can make informed decisions on their investment choices. Ideally, the disclosure of information is expected to reduce investment risks, fraud, transaction costs and information

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[63] Stock Exchange Act 1970, sec. 20; Stock Exchange Act 1990, sec. 20.

[64] *Ibid.*, sec. 20.

[65] *Ibid.*, sec. 20.

gathering costs.[66] In practice, however, preparation of information in prospectuses and listing particulars can be costly.[67] Also, information disclosure could prejudice the disclosing party if the information being disclosed is a trade secret. Furthermore, there could be instances when disclosure of information might not be in the interests of the public. A good example here is that of a rights issue or a bonus issue. Under a rights issue or a bonus issue, it is likely that only the existing shareholders who are entitled to the issue would be interested in the disclosure. Such are matters which the legal framework for public distribution of securities in Zambia should have addressed.

Other constraints on the legal framework included the views that the Stock Exchange Acts 1970 and 1990 had no provisions for the regulation of information disclosure in company prospectuses. To this extent, the Stock Exchange Acts 1970 and 1990 did not adequately address the issue of investor protection. Again, one of the reasons for this feature is that the draftsman, and the parliamentarians when debating the bill, were found wanting in their knowledge on corporate law. Looking at the statutes, there is no doubt that the draftsman and the parliamentarians were unable to appreciate the significance of stating the methods of issuing securities to the public and that of specifying the requirements to be met before securities are listed. The importance of specifying these requirements are seen, for example, in the fact that a particular method of marketing securities to the public could require disclosure of much more detailed information than

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[66] The argument here follows basic theory in economics of contract law.

[67] Moreover, there is a possibility that investors on the market will have already acquired information on the securities through dealings with the allotting company or through dealings with tippees where the

another. In particular, listing requirements in bonus issues or rights issues to existing shareholders might not require the same amount of information disclosure as listing requirements in offers for sale.

Other Constraints Relating To Prospectus Provisions:

Section 2 of the Companies Act 1921 defined a prospectus as follows:

> "...'prospectus' means any prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures of a company; ..."

On the one hand, the definition in section 2 did not provide any information on the contents that were required to be included in a prospectus. On the other hand, the Companies Act 1921 required public companies to prepare further prospectuses whenever they were making new or fresh issues to investors.[68] A new or fresh issue, unlike a secondary issue, was primarily concerned with the buying and selling of securities which were being issued for the first time. However, although the Companies Act 1921 laid down a statutory obligation on the issuer of securities to issue further prospectuses each time a further issue was being made, the Act did not specify what particulars were to be found in the further prospectuses.[69] All these factors were constraints on the legal

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law on insider trading is weak. Also, investors may have formed an opinion about the estimated value of the net worth of the company based on the company's business profile.

[68] Companies Act 1921, sec. 72.

[69] _Ibid._, sec. 72.

framework for public distribution of securities. Indeed, under the Companies Act 1921, further prospectuses, like any other prospectus under that statute, could only be issued in the case of primary trading of securities.

Lack Of Statutory Provisions On Continuing Disclosure Obligations As A Constraint:

The Companies Act 1921 and the Stock Exchange Acts 1970 and 1990 did not say whether there was any need for an issuer of securities to continue disclosing information that could affect the price of securities. It was therefore not clear whether the provision in the Companies Act 1921 on further prospectuses introduced continuing disclosure obligations or merely required disclosure of new information to be made each time a fresh issue was being made. It was also not clear whether or not a company had to prepare a prospectus and get that prospectus filed with the Registrar of Companies in situations such as where the company had already complied with the listing requirements of a stock exchange.[70] All these constraints demonstrated the limitations on the legal framework to contribute effectively to the development of a competitive stock exchange in Zambia. We propose that when drafting the common investment code such issues must be addressed.

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[70] See R. Burgess, Corporate Finance Law, (London: Sweet and Maxwell, 1985), p. 301, for a distinction between prospectuses and listing particulars.

Constraints Affecting The Law On Untrue Statements in Prospectuses And In Further Prospectuses:[71] The Companies Act 1921 of Zambia prohibited company directors from authorising, adopting or ratifying untrue statements in prospectuses and further prospectuses.[72] The Act did not, however, address the problems associated with other forms of misleading statements or omissions in the prospectuses and further prospectuses. Indeed, misleading statements or omissions could arise from negligence, recklessness, dishonesty or fraud. Also, misleading statements and omissions are not necessarily untrue statements. For example, misleading statements could be true, but may not reflect the 'true and fair view' of the company.[73] Here, an appropriate

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[71] See also generally the following pieces of legislation in Zambia: the Misrepresentation Act 1968; the Law Reform (Frustrated Contracts) Act 1963; the Law Reform (Limitation of Actions, etc.) Act 1963; and the Law Reform (Miscellaneous Provisions) Act 1967.

[72] Companies Act 1921, secs. 70 and 72.

[73] The English statutory principle of 'true and fair view' (see for example Companies Act 1985, secs. 262, 226(2), and 227(3)) appears to have crystallised into a common law principle as a lot of evidence shows that this principle is now covered in the laws of many common law jurisdictions. In Zambia, the principle of true and fair view is also covered under the Companies Act 1994. In contrast to the English Companies Act 1985, the repealed Companies Act 1921 of Zambia did not have provisions on the 'true and fair view' principle and thus there was no statutory requirement for company accounts in Zambia to reflect a true and fair view. However, the Zambian accountancy profession continued to be modelled around the accounting standards of major United Kingdom accounting bodies and thus the true and fair view principle in England applied to Zambia. We are, however, mindful of the fact that accounting practice in various European countries has taken different views on what actually constitutes 'true and fair view' of a company. In Zambia though the English version of the principle, now found in the Zambian Companies Act 1994, continues to dominate. For a detailed read on 'true and fair view' see generally, D. Alexander and C. Nobes, A European Introduction To Financial Accounting, (New York: Prentice Hall, 1994).

illustration is a true, but misleading statement on the wealth of a company that has more assets than liabilities but whose liquidity is now locked up in its investments. Such a company might satisfy the net asset test of insolvency, but may not satisfy the cash-flow test of insolvency.[74]

The Common Law Liability for Untrue and Misleading Statements: At common law, a party prejudiced by fraud or negligent misrepresentation in the company's prospectus, through misleading or untrue statements, or through misleading or untrue omissions, can bring an action for damages against the offending party.[75] The misleading or untrue statement (or omission) could include matters such as financial forecasts on the profit margins of the company, liquidity ratios, and return on capital employed ratios. To recover at common law, the plaintiff must show that the defendant committed a tort, such as deceit or negligence.[76]

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[74] See R. M. Goode, Principles of Corporate Insolvency Law, 2nd ed. (London: Sweet and Maxwell, 1997), pp. 64-91.

[75] But note here that while the principle in the case of Hedley Byrne & Co. Ltd. v. Heller and Partners Ltd. [1964] AC, 465 can be applied to some untrue statements in prospectuses, it cannot be applied to all statements (or omissions) made to the public. Indeed, making this principle applicable to all statements and omissions would be tantamount to saying that the claimant has succeeded in establishing that the defaulting party did owe a duty of care to the entire world. For an insightful view on the duty of care owed by professionals such as auditors, see Caparo Industries v. Dickman [1990] 2 AC 605.

[76] See Derry v. Peek [1889] 14 AC 337 at 374; McConnel v. Wright [1903] 1 Ch. 546 at 554-555; SIB v. Pantell SA [1989] BCLC 590; Archer v. Brown [1985] Q.B. 401; Al-Nakib Investments v. Longcroft [1990] 3 All ER 321. See also Re Scottish Petroleum Co. [1882] 23 Ch. 413; Scott v. Brown, Doerring McNabb & Co. [1892] 2.Q.B. 724; SIB v. Vandersteen [1991] BCLC 206; Peek v. Gurney [1873] LR 6HL 377; Andrews v. Mockford [1896] 1 Q.B. 372; Mair v. Rio Grande Rubber Estates Ltd. [1913] A.C. 853; Karberg's case [1892] 3 Ch. 1. It is important to observe that in the United Kingdom, unlike in Zambia, legislation has made slight departures from the common law

Generally, the requirement to disclose information in listing particulars and in prospectuses is an exception to the common law doctrine of *caveat emptor.* Whereas the doctrine of *caveat emptor* says 'buyer beware', legislation places a statutory duty on the issuer of securities to disclose information that would affect the value or price of securities being sold. Here, the importance of addressing information disclosure is to ensure that all players in the market have equal investment opportunities.

Regulating Against Early And Late Disclosures:

Generally, there is need to regulate against disclosures which lead to 'unfair trading' practices.[77] These disclosures could include unreasonably early and late disclosures in the listing particulars and prospectuses. Early and late disclosures often provide true, but misleading information. For example, a party that decides to issue securities may disclose information in its prospectus or listing particulars and that information could be true at the time of making the disclosure. However, by the time the allotment is being made the information could have been superseded by new developments and thus making the old information outdated and untrue or misleading. To avoid such shortcomings, early and late disclosures must be legislated against. One of the ways of doing so is

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position. This is evidenced by the abolition of the rule in Houldsworth v. City of Glasgow Bank [1880] 5 A.C. 317 (denying damages to a shareholder who had not rescinded the contract of allotment whilst still a shareholder) by the Companies Act 1985, sec. 111A, inserted by the Companies Act 1989, sec. 131(1); See also Misrepresentation Act of England 1967, sec. 2.

by providing in the statute that an obligation to disclose would be triggered once the allotting company announces its intention to sell the securities. A time limit within which such disclosure must be made had to be spelt out in the statute. Indeed, these are matters that the regional investment code must address.

5.9. LACK OF STATUTORY PROVISIONS ON THE REGULATION OF SECURITIES ADVERTISEMENTS AS A CONSTRAINT:

Generally, provisions of the Stock Exchange Act 1990, like those of the Stock Exchange Act 1970, were inadequate on the regulation of securities advertisements. Both statutes were silent on whether or not prospectuses issued under the Companies Act 1921 could amount to unlawful advertisement of securities. Also, the Companies Act 1921 did not address this problem.

Example 1:

> What would happen if, say, regulations of a stock exchange in Zambia prohibited the unauthorised advertisement of securities to the public (*i.e.* advertisements made without approval of the stock exchange) and suddenly a company intending to allot securities to the public issued a prospectus without the approval of the stock exchange? One possible answer here would be that the issuer of securities could advance an argument that it had complied with the prospectus provisions in the Companies Act 1921. Another possible answer would be that the stock exchange could argue that the prospectus provisions in the Companies Act 1921 are supplemented by regulations of the stock

[77] Here, the term 'unfair trading practices' must not be understood in the same sense as that found in any 'unfair trading practices' legislation. In this section, the term is used broadly to mean trading practices which prejudice other market players due to the manner in which information is disclosed.

exchange and that since such regulations are in place they must be observed. The stock exchange could go on to say that given that the issuer of the prospectus did not comply with the stock exchange regulations, the issuer was in breach of the law despite having complied with other provisions of the Companies Act 1921.

In general, issuers of securities who intend to advertise or engage in trading of securities - that is, either primary or secondary trading - on a stock market must comply with regulations of that stock exchange. Where a party that was not trading on the stock market decided to advertise and sell its securities (off the stock market) to members of the stock exchange, regulations of that exchange would not have made that party liable for unlawful advertising of securities. To avoid such weaknesses in the law, the stock exchange would have had to provide in its regulations that its members are prohibited from dealing with non-member parties whose securities are not lawfully advertised on the stock market or non-member parties whose securities are being advertised to members of the exchange at a place other than on its own stock market. This would particularly be useful in the case of members of the regional stock exchange.

There was also a need to spell out in the 1970 and 1990 Stock Exchange Acts what would have constituted 'unauthorised advertisement' of securities. In this way, problems such as those encountered in the example provided above could have been avoided. In the United Kingdom, section 154 of the Financial Services Act 1986 prohibits the making of advertisements unless the contents of the advertisement have been submitted to and approved by the International Stock

Exchange.[78] Furthermore, the law in England provides that listing particulars and prospectuses can constitute advertisements.[79] Indeed, no equivalent provisions existed in the 1970 and 1990 Stock Exchange Acts of Zambia. Also, no such provision was found in the Companies Act 1921 of Zambia.

5.10. LACK OF STATUTORY PROVISIONS ON THE REGULATION OF SECURITIES TRADED ACROSS INTERNATIONAL BOUNDARIES AS A CONSTRAINT:

The Stock Exchange Acts 1970 and 1990 had no provisions on the regulation of securities traded across international boundaries.

Example 2:

Would a company that has shares cross-listed on several international stock markets and that has complied with information disclosure requirements in its country of origin be obligated to disclose in a foreign country once its shares are being traded in that foreign country's stock market? Indeed, would there be any need for such a company to comply with the disclosure requirements in a foreign country (*e.g.* investors entering Zambia as a second market for cross-listing purposes)?

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[78] Prior to 1986, the Companies Act 1985 of the United Kingdom was the main piece of legislation governing public distribution of securities in the United Kingdom. However, the Companies Act 1985 proved inadequate to regulate various aspects of public distribution of securities (including unlawful advertisements) and thus the Financial Services Act 1986 was enacted. For an insightful discussion on the relationship between provisions of the Companies Act 1985 and those of the Financial Services Act 1986, see below.

[79] See Financial Services Act 1986, sec. 154.

The failure to address such issues would have led to serious constraints on the legal framework in its promotion of multiple listing and cross-border trade in securities. Indeed, this characteristic would not only have affected the liquidity position on the stock market in Zambia, but it would also have been a constraint on market development.

Example 3:

> If there were to be laws on insider dealing in Zambia, what would be the position where a person based in a foreign country, but dealing in securities on a Zambian stock market breached Zambian insider dealing laws? Would such a person be convicted and punished under Zambian laws? If so, would this not amount to the unlawful creation of extra-territorial criminal jurisdiction? Moreover, what would be the position if the alleged insider showed that under securities law in his country, the conduct he engaged in was lawful and did not amount to insider dealing?

These are the sort of questions that should have been addressed in the Stock Exchange Acts 1970 and 1990. The statutes, none the less, said nothing about this. We have shown in Chapter Four how this can be approached in the case of the regional stock exchange. In the United Kingdom, unlike in Zambia, the position is such that there are detailed rules on the regulation of securities traded across international borders.[80] For lack of space in this work, we shall not examine these rules. Suffice it to say that in the United Kingdom an example of securities traded across international boarders include Euro-bonds. Euro-bonds are debt securities denominated in foreign currency to raise funds

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[80] See for example, Financial Services Act 1986, sec. 152(5)((6). See also R. Burgess, Corporate Finance Law, *supra*., (n.70), pp. 132-134.

internationally. These bonds are in bearer form.[81] They contain elements which are not always present in domestic bond issues.[82]

5.11. AUTHORISATION OF FINANCIAL INTERMEDIARIES:

There were two types of financial intermediaries that could be licensed to carry out functions as financial intermediaries under the Stock Exchange Acts 1970 and 1990.[83] The first type was the stockbroker. The second type was the dealer in stock. The difference between a stockbroker and a dealer in stock was that whereas stockbrokers would have had to buy and sell securities for and on behalf of others, dealers in stock would have had to buy and sell securities on their own account and hold themselves out as such to members of the public.[84] In essence, whilst both brokers and dealers could be termed financial intermediaries, legislation made a distinction between the two. Despite the statutory distinction, both stockbrokers and dealers in stock were fiduciaries at common law.[85]

Like in many other jurisdictions, in Zambia financial intermediaries were required to be licensed before they could deal in securities.[86] Unauthorised dealing in securities was a criminal offence.[87] A

[81] See Financial Services Act 1986, sec. 152(6), para. 2 of sch. 1.

[82] R. Burgess, Corporate Finance Law, *supra*., (n.70), p.132.

[83] See Stock Exchange Act 1970, sec. 2; Stock Exchange Act 1990, sec. 2.

[84] *Ibid*., sec. 2.

[85] See Armstrong v. Jackson [1917] 2 K.B. 822.

[86] Stock Exchange Act 1970, sec. 18; Stock Exchange Act 1990, sec. 18.

party that wanted to sell or buy securities on a stock market had to contract a financial intermediary to act on his or her behalf.[88] This explains why the Stock Exchange Acts 1970 and 1990 required both the stockbroker and the dealer to be members of either a Council stock exchange or a licensed stock exchange before they could deal in securities.[89]

5.12. CONCLUSION:

This chapter has examined the efficacy of the legal framework for public distribution of securities in Zambia prior to 1993. It was argued in this chapter that the time and speed at which the Stock Exchange Act 1990 was enacted are some of the indicators of the Zambian government's haste to respond to the dictates of the international political economy. In Zambia, this type of rushed enactment is generally geared towards the implementation of the structural adjustment programme.

In this chapter, constraints affecting the legal framework in the development of a competitive stock market in Zambia were identified. This discussion was linked with the idea of setting up a regional stock exchange and promoting multiple listings and cross-border trade in securities. However, no detailed analysis was made of matters such as insider dealing in Zambia because not only did the

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[87] *Ibid.*, sec. 18.

[88] In the United Kingdom, there are similar requirements. Under English law, a company that would like to have its securities admitted to listing on the International Stock Exchange must be represented by a stockbroking member of the International Stock Exchange. The company itself, or a merchant bank acting as a sponsor to a new issue, appoints the stockbrokers. On this see for example J. Freear, The Management of Business Finance, (London: Pitman, 1980), p. 178.

[89] Stock Exchange Act 1970, sec. 3(b); Stock Exchange Act 1990, sec. 3(b).

Stock Exchange Acts 1970 and 1990 fail to legislate against such market abuses, but there was simply no stock exchange on which such abuses could have taken place. Similarly, no analysis was made of the regulation of collective investment schemes in Zambia. The Stock Exchange Acts 1970 and 1990 did not even have provisions on the regulation of collective investment schemes. Overall, it was observed that the political centralisation of power in the Minister as the sole appointing authority of officers of the Council and the Board of Appeal and the degree of accountability of these institutions to the Minister demonstrated that the development of the legal framework for public distribution of securities in Zambia is influenced by, *inter alia*, the political economy.[90]

[90] We have already established this point in Chapter One.

CHAPTER SIX

DEVELOPMENTS IN SECURITIES LAW

This chapter examines the efficacy of the legal framework for public distribution of securities in Zambia after the repeal of the Stock Exchange Act 1990. The chapter is underscored by the theme that a number of constraints on the legal framework retard the development of the stock market in Zambia. Faced with such constraints, Zambia must now consider the promotion of multiple listings and cross-border trade in securities as an important step towards the development of competitive capital markets in Eastern and Southern Africa. Indeed, the promotion of cross-border trade and the setting up of a regional stock exchange must be seen as important solutions to overcoming liquidity constraints on stock markets in the region.

In this chapter, provisions of the Securities Act 1993[1] on types of stock markets that can be set up, securities that can be traded, disclosure requirements and market abuses are examined. The

[1] The original draft of the Securities Act 1993 was drafted by a local legal practitioner, Mr. Ben Ngenda, whose experience in drafting stock exchange laws is unknown. See *Interview* with Mr. Mumba Kapumpa, Chief Executive, Securities and Exchange Commission, Lusaka, 18th December, 1996, (Appendix C, question 3): "... the Securities Act was drafted by, I think, a collection of various people. First of all, the initial, as it were, very skeleton like framework, was prepared by Ben Ngenda, who is a legal practitioner and at that time was the Chairman of the Zambia Stock Exchange Council. He

enactment of the Securities Act 1993 was generally a response to dictates of the international capitalists, under the structural adjustment programme, to have the Zambian government limit its interventionist role in the national economy.[2] We saw in Chapter One that in its programme to attract international private capital, the Zambian government has enacted legislation which is expected to codify dictates of the international capitalist institutions.[3] Similar developments have occurred in other African countries where the structural adjustment programme is being pursued.[4]

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subsequently left the country and then arising out of that very broad framework, we then contracted, as a government, consultants from the UK who came and worked with the Stock Exchange Council to now put flesh to the draft. The draft itself was discussed by Ben Ngenda, myself, and one or two other people at the Ministry of Legal Affairs to produce a Bill." The consultants invited to assist with the preparation of the Securities Bill came under a World Bank / IFC technical assistance project; see *Interview* with Mr. Charles Mate, Chief Executive, Lusaka Stock Exchange, Lusaka, 20th December 1996, (Appendix A, question 3).

[2] See Government of Zambia, Hansard, 29th July, 1993, p. 545.

[3] This view is supported by evidence from parliamentary debates preceding the enactment of the Privatisation Act 1992; see R. Penza, Minister of Commerce, Daily Parliamentary Debates, 18th June 1992, p. 114, where he argues that Zambia must comply fully with requirements under the structural adjustment programme. See also *Interview* with B. Ngenda, Chairman, Zambia Stock Exchange Council, Lusaka, 23rd August, 1993.

I. MARKET STRUCTURES AND THE VETOING OF OFFER DOCUMENTS.

6.1. THE COMPETENT AUTHORITY:

Part II of the Zambian Securities Act 1993 establishes the Securities and Exchange Commission as the competent authority for regulating public distribution of securities in Zambia. The Commission replaces the Council of Stock Exchanges, a body corporate under the repealed Stock Exchange Act 1990, as the new competent authority. In the Securities Act 1993 it is spelt out that the Securities and Exchange Commission is a body corporate.[5] Section 1 of the First Schedule to the Securities Act 1993 provides that:

> "(1) The Commission consists of seven members, being nominees from each of the following organisations:
>
> (a) the Bank of Zambia;
>
> (b) the Law Association of Zambia;
>
> (c) the Zambia Institute of Chartered Accountants;
>
> (d) the Non-Governmental Organisation Coordinating Committee;
>
> (e) the Lusaka Stock Exchange; and
>
> (g) the Ministry of Legal Affairs.

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[4] For example, in Ghana the Stock Exchange Act 1971 was repealed and replaced by the Securities Industry Law 1993; see *letter* from the Ghana Stock Exchange to this author dated 15th June, 1993.

[5] Securities Act 1993, sec. 3(1).

(2) The members of the Commission shall be nominated by their respective organisations and shall be appointed by the Minister.

(3) Two of the members shall, in and by the terms of their respective appointments, be appointed as Chairman and Vice-Chairman of the Commission."

However, unlike the case of the Zambia Council of Stock Exchanges (under the Stock Exchange Act 1990), members of the Securities and Exchange Commission are generally not required to be accountable to the minister. Functions of the Commission include supervising and monitoring activities of securities exchanges; settling transactions in securities; co-ordinating with other supervisory bodies in Zambia and abroad; licensing and monitoring securities exchanges, dealers, investment advisers and representatives of both dealers and advisers; approving constitutions and regulations of securities exchanges; providing and enforcing rules to regulate the conduct of participants in the securities industry; revoking and suspending licences; supporting the operation of a free, orderly, fair, secure and properly informed securities market; promoting high standards of investor protection; and promoting a self-regulatory securities industry in the country.[6]

Some Empirical Evidence On The Performance Of The Competent Authority:

When asked whether the Securities and Exchange Commission in Zambia has been performing its functions effectively, more than 90 per cent of the interviewees observed that so far there have been no major complaints.[7] A number of these interviewees noted that some of the reasons that explain

[6] *Ibid.*, sec. 4.

[7] See generally Appendices A to J.

why the Commission has not had major failures or faced great challenges are that the Commission is a new body and that potential weaknesses could have been thwarted by the Commission's good work in regulating financial services.[8] In addition, it was pointed out that trading activity on the Lusaka Stock Exchange is still small and that as a result it is not yet possible to determine some of the major weaknesses of the Commission.[9]

The Shortcoming Of Disclosure Obligations During Meetings Of The Competent Authority As A Constraint:

Under the Securities Act 1993, persons with interests in any matter being discussed by the Securities and Exchange Commission or its committees are required to disclose such interests.[10] Here, the disclosure obligation applies only when such persons are attending the Commission's or the committee's meeting. In the case of the regional stock exchange, the common investment code must avoid spelling out a restrictive class of 'interested' persons. Instead, the code must provide that the disclosure obligation extends not only to nominees of 'interested' persons, but to other fiduciaries as well, so long as these persons are in attendance at the meetings.

Some Constraints Arising From Funding of the Commission: Generally, the Securities and Exchange Commission is funded from parliamentary allocations.[11] Like the case of the Zambia Council for Stock Exchanges under the Stock Exchanges Acts 1970 and 1990, parliamentary

[8] See generally *Ibid.*, Appendices A to J.

[9] See generally *Ibid.*

[10] Securities Act 1993, schedule 1, para. 7.

funding here could lead to constraints such as state control through finances. Other sources of funding for the Securities and Exchange Commission include moneys earned by the Commission from charging licence fees and from transaction commissions. [12] Also, funding of the Commission could come from any other moneys accruing to this body corporate or from assets vesting in it.

The Law On Judicial Immunity Of Members Of The Commission:

Section 75 of the Securities Act 1993 provides that members of the Commission enjoy judicial immunity against civil claims relating to matters done or omitted to be done in the course of business. This provision does not apply to situations that involve criminal activities such as insider dealing or other forms of market abuses. The same reasoning could be applied to the case of the regional stock exchange. What then are the markets, under the Securities Act 1993, on which securities can be traded?

6.2. SECURITIES AND STOCK MARKETS:

The Securities Act 1993 defines securities markets as places where securities are bought and sold and where information pertaining to such transactions is supplied.[13] The statute then defines a securities exchange as an exchange established and operated by a company licensed to do so under

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[11] *Ibid.*, schedule 1, para. 9.

[12] *Ibid.*, schedule 1, para. 9.

[13] Securities Act 1993, sec. 2.

the Act.[14] There is, however, no statutory distinction between a 'stock exchange' and a 'securities exchange'. For example, section 17 of the Securities Act 1993 provides that:

> "(1) A person other than a licensed securities exchange who takes or uses, or has attached to or exhibited at any place -
>
> (a) the title 'securities exchange' or 'stock exchange'; or
>
> (b) any title which closely resembles either of those titles as to be likely to deceive,
>
> shall be guilty of an offence..."

Constraints On The Statutory Definitions Of Securities Exchanges And Stock Exchanges:

It is somewhat evident from section 17 of the Securities Act 1993 (reproduced above) that the draftsman could have intended that the term 'securities exchange' means something else other than a 'stock exchange'. An alternative interpretation here could be that the draftsman might have thought that the labels 'securities exchange' and 'stock exchange' were alternative descriptions of the same thing. The position is thus unsettled. These are matters that must be avoided when drafting the common investment code of the regional stock exchange. However, for purposes of this work, the view that the draftsman might have thought that the labels 'securities exchange' and 'stock exchange' were alternative descriptions of the same thing facilitates a coherent interpretation of the Securities Act 1993.

Although the Securities Act 1993 provides definitions of securities markets and securities exchanges,[15] the statute does not define 'stock markets' and 'stock exchanges'. The Act simply

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[14] *Ibid.*, sec. 2.

talks of securities exchanges and stock exchanges in a manner that denotes that the two are different. However, the definition of securities exchanges in section 2 of the Securities Act 1993 includes 'any exchange, including a stock exchange, that is operated by a licensed company'. To this extent, it is argued that the definition of securities exchanges treats at a stock exchange as simply an example of a securities exchange.

(a) ***The Lusaka Stock Exchange:*** This is the only stock exchange that has been established in Zambia. Section 9(2) of the Securities Act 1993 requires the Lusaka Stock Exchange to comply with provisions of schedule II to that Act. Provisions in schedule II spell out the requirements that must be met by applicants applying for licenses to set up securities exchanges.[16] The Lusaka Stock Exchange has to comply with such requirements not later than six months after the coming into force of the Securities Act 1993.[17] If not, the Lusaka Stock Exchange will be deemed to have ceased to be licensed.[18] If the Lusaka Stock Exchange complies with provisions of schedule II to the Securities Act 1993, the coming into force of the Securities Act 1993 is deemed to be the time when the Lusaka Stock Exchange was licensed.[19]

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[15] See above.

[16] Examples of these requirements include the requirement to provide sufficient financial resources, the requirement that five members must independently be dealing in securities and in competition with each other and the requirement to maintain high standards of integrity and fair dealing by members.

[17] Securities Act 1993, sec. 9(2).

[18] *Ibid.*, sec. 9(3).

[19] *Ibid.*, sec. 9(1).

(i) The Central Depository System Of The Lusaka Stock Exchange:

Although the Lusaka Stock Exchange, through its central depository system, operates a 'unified market' where virtually all securities trading is mediated through a stock exchange, the central market design of the Zambian market means that securities of public companies that are not listed are *quoted* and traded on a second tier within the Lusaka Stock Exchange market.[20] The Lusaka Stock Exchange points out that the following are some of the advantages of its 'unified market' system:[21]

1. It channels all trading activity through one market. This is expected to enhance liquidity and market depth. (We have already examined the concepts of liquidity and market depth in Chapter Three).
2. It avoids duplication and makes more efficient use of resources.
3. It gives maximum transparency in securities dealing and this reduces the opportunity for malpractice and improves the reliability of pricing. Regulation of the market and investor protection is therefore stronger and easier to enforce. This leads to greater confidence from all participants and promotes the use and success of the market.

[20] Lusaka Stock Exchange, How To Raise Capital On The Stock Exchange For Small And Large Companies, (Lusaka: Lusaka Stock Exchange, 1996), p. 4.

[21] See *Ibid.*, p. 4.

(ii) The Statutory Powers Of the Minister To Close Down The Lusaka Sock Exchange:

Under the Securities Act 1993, the Minister may close down any securities exchange on the grounds that the orderly transaction of business on the securities exchange is being or is likely to be prevented:[22]

a) because of a natural disaster that has occurred in Zambia; or

b) because of an economic or financial crisis, whether in Zambia or elsewhere, or other like circumstance; or

c) because the exchange has ceased to meet the conditions set forth in the second schedule to the Securities Act 1993.

In the case of the regional stock exchange, such political interventions must be avoided. If anything, interventionist powers under the common investment code must vest in the regional competent authority so that investor confidence is encouraged.

(b) *Constraints On The Statutory Provisions For Setting Up Securities Exchanges:*

Apart from the Lusaka Stock Exchange, no other formal market has been set up in Zambia. The reason for this development follows the empirical evidence presented in Chapter Three that the volume of trade in securities of a long term or permanent nature in Zambia is still small. Also, industry in Zambia has not grown to levels where the setting up of several stock exchanges could be regarded as necessary.

[22] Securities Act 1993, sec. 12(1).

Under the Securities Act 1993, only companies may be licensed as securities exchanges in Zambia.[23] The Securities Act 1993 does not state the types of companies that could qualify for licensing. Should the term 'company' be construed as meaning any company incorporated in Zambia or/and companies incorporated outside Zambia but permitted to do business in Zambia?[24] There is no doubt that the ambiguity in the law here entails that private companies, public companies, unlimited liability companies, companies limited by guarantee and companies limited by shares can all be considered for licensing as securities exchanges. However, these companies must comply with schedule II to the Securities Act 1993 to satisfy the licensing requirements.[25] The Securities and Commission must be satisfied that it is in the interests of the public to license the applicant companies as securities exchanges.[26] The criterion of defining 'public interest' is not spelt out by the Securities Act 1993.

(c) ***The 'Fictitious Markets' Concept As An Example Of Constraints Arising Out Of Poor Draftsmanship:*** Under the Securities Act 1993, there are two types of markets, the informal market and the prohibited market, that carry misleading headings. These markets appear under the headings 'trading unlisted securities' and 'unlawful securities market'. The misleading titles can be attributed to poor drafting of legislation. Such matters must be avoided when drafting the common investment code.

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[23] _Ibid._, sec. 8.

[24] On authorisation of foreign companies to operate in Zambia see Part XII of the Companies Act 1994.

[25] Securities Act 1993, sec. 8.

Under the heading 'unlawful securities market', in section 7 of the Securities Act 1993, the following provision appears:

> "A person shall not establish or assist in establishing or maintaining, or hold himself out as providing or maintaining, a securities market that is not the securities market of a securities exchange established by a company licensed under this Act to do so."

It is clear that the Securities Act 1993 prohibits the setting up of securities markets that are administered by companies that are not licensed under the Securities Act 1993.[27] The provision does not, to the contrary, provide for the establishment of any securities market. The second structure with a misleading heading relates to trading of unlisted securities. Under the title "trading of unlisted securities", in section 36 of the Securities Act 1993, the following provision appears:

> "A person who deals in any unlisted, registered securities otherwise than through a securities exchange and who does not forthwith report that dealing to the prescribed securities exchange shall be guilty of an offence..."

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[26] *Ibid.*, sec. 8.

[27] *Ibid.*, sec. 7.

In essence, the Securities Act 1993 establishes an informal market where unlisted securities can be traded on condition that dealers in such securities report their dealings to the concerned securities exchange.[28]

Lack Of Judicial Review Of Decisions Of The Competent Authority On The Granting Or Renewal Of Securities Exchange Licences As A Constraint:

Generally, appeals against directions of the Securities and Exchange Commission on the granting or renewal of securities exchange licences must be lodged with the Minister.[29] The High Court can only hear appeals relating to decisions of the Commission on the granting or renewal of licences of financial intermediaries.[30] We shall look at the regulation of financial intermediaries in Chapter Seven. Here, suffice it to say that in the case of granting or renewing securities exchange licences, the Minister's decision on the matter is binding and final.[31] Appeals against decisions of the Minister to a court of law can only be made on matters of law and not matters of fact.[32]

Liability of Members of Securities Exchanges: It has already been established that only companies can be licensed as securities exchanges in Zambia. This means that under Part II of the

[28] Ibid., sec. 36.

[29] Ibid., sec. 11(1). The appeal must be made within thirty days after the date of the direction.

[30] Securities Act 1993, sec. 26(1). The appeal must be made within thirty days after the date of the decision.

[31] Securities Act 1993, sec. 11(3).

Companies Act 1994 of Zambia, limited liability applies to members of a company limited by shares or by guarantee, which is subsequently licensed as a securities exchange.[33] Members of such a securities exchange enjoy limited liability in accordance with rights and liabilities under the law.[34] Where an unlimited company is licensed as a securities exchange the members of that exchange do not enjoy any limited liability.[35] They would instead be liable to the full extent of their private estates for liabilities incurred by the exchange.

6.3. SOME CONSTRAINTS ON THE STATUTORY PROVISIONS RELATING TO SECURITIES THAT CAN BE TRADED ON THE LUSAKA STOCK EXCHANGE:

In many cases, the legal framework for public distribution of securities in a country will spell out the types of securities that can be traded on a stock exchange. In this section, an analysis of the types of securities that are traded on the Lusaka Stock Exchange is made. Such an account provides an insightful background into the ways in which the legal framework contributes to the development of a competitive stock exchange. Indeed, placing a limit on the variety of products on the market could be one of the reasons why there are liquidity constraints on the Lusaka Stock Exchange.

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[32] *Ibid.*, sec. 11(3).

[33] Companies Act 1994, secs. 14, 17 and 19.

[34] In Zambia, under the Companies Act 1994 there is no statutory requirement for a company to have a memorandum of association. See Part II of the Companies Act 1994. A company is only required to have articles of association. See Companies Act 1994, secs. 6, 7, and 8.

[35] See Companies Act 1994, secs. 20, 265 and 266.

In contrast to the repealed Stock Exchange Act 1990, the Securities Act 1993 has a definition of securities and that of shares.[36] In the Securities Act 1993, a share is only one type of security. Under the Stock Exchange Act 1990 both equity and debt securities were labelled as 'shares and stock'.[37] The Securities Act 1993 now distinguishes the generic term 'securities' from 'shares'.

> " 'securities' means-
>
> (a) shares, debentures, stocks or bonds issued or proposed to be issued by a government;
>
> (b) shares, debentures, stocks, bonds or notes issued or proposed to be issued by a body corporate;
>
> (c) any right or option in respect of any such shares, debentures, stocks, bonds or notes; or
>
> (d) any instruments commonly known as securities or which are prescribed by rules made by the Commission to be securities for the purposes of this Act;"[38]

By contrast, a share is defined as follows:

> " 'share' means a share in the capital of a company, and includes the stock or any part of the stock of a company;"[39]

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[36] See Stock Exchange Act 1990, sec. 2. *Cf.* Securities Act 1993, sec. 2.

[37] Stock Exchange Act 1990, sec. 2.

[38] Securities Act 1993, sec. 2.

[39] *Ibid.*, sec. 2.

This definition of a share does not, however, tell us if partly paid-up shares can be distributed on a stock exchange. Besides, could it not be argued that under the Securities Act 1993 both equity and debt securities can be traded on a securities market since they fall under the generic term 'securities' in section 2? Furthermore, given that securities that can be distributed to the public in Zambia include government securities, could it not be argued that the Zambian government can distribute some of its securities on the Lusaka Stock Exchange?[40] In Chapter Three, we saw that there are now proposals to introduce government securities on the Lusaka Stock Exchange. Generally, the Securities Act 1993 prohibits governments from issuing or proposing to issue notes on the market.[41] Section 2(a) of the Securities Act 1993, which deals with securities that a government can issue on a securities market, does not include 'notes'.[42] However, other market players are not prohibited from issuing such securities.

6.4. METHODS OF MARKETING SECURITIES TO THE PUBLIC:

Before equity or debt securities can be distributed to the public in Zambia, the following requirements must be met:

" i) The applicant company (issuer) must be incorporated in Zambia as a public company.

ii) The securities must be registered under Part V of the Securities Act 1993.

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[40] See *Ibid.*, sec. 2.

[41] See below.

[42] Loan notes are generally short - to medium-term loan agreements which are usually unsecured obligations; see T. Stocks, Corporate Finance: Law and Practice, (London: Longman, 1992), pp. 12-13.

iii) The applicant company should have a trading record of at least 3 years under one management. The Exchange may accept a shorter period in exceptional cases.

iv) There must be an adequate market in the securities and sufficient public interest in the business of the issuer.

v) There must be an open market in the securities. This is determined by either of the following decision rules namely:

- The minimum percentage of securities in public hands must be 20% with a minimum of 100 shareholders OR
- The greater of the issuer's market value or shareholders funds must be not less than 2,000 million Kwacha with not less than 2,000,000 shares held by a minimum of 1,000 shareholders.

The securities for which listing is sought must be freely transferable."[43]

Although the Securities Act 1993, like the repealed Stock Exchange Act 1990, does not state the methods of marketing securities to the public, Chapter 4 of the Lusaka Stock Exchange Official Listing Rules 1993 spells out the methods of marketing securities on the Lusaka Stock Exchange. This means that any other securities exchange that could be set up in Zambia has the option of either adopting rules of the Lusaka Stock Exchange or setting up its own rules. Following below are some of the methods of marketing securities to the public on the Lusaka Stock Exchange. These methods are akin to methods in the United Kingdom, although recent amendments to the listing rules of the International Stock Exchange have made some important

[43] See Lusaka Stock Exchange, How To Raise Capital On The Stock Exchange For Small And Large Companies, *supra*., (n. 20), p. 9. See also sections 65 and 122 of the Zambian Companies Act 1994.

departures.[44] It is, however, not the purpose of this section to delve into intricacies of how securities are issued on the International Stock Exchange or on other stock exchanges.

(a) ***Offer for Sale or Subscription:***[45] Where the offer is not by the company itself, but by an existing shareholder it is called an offer for sale and the persons who acquire the securities are known as purchasers.[46] Where the company itself offers shares this is known as an offer for subscription and the persons who acquire the securities directly from the company are known as subscribers.[47] The offer for subscription method is one of the two methods recognised by the

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[44] See for example International Stock Exchange, Amendment 5 to the Listing Rules ('Yellow Book'), Covering Letter, August 1995. For other developments see International Stock Exchange Report, Initial Public Offers (1990); Director General of Fair Trading, Rules of the London Stock Exchange Relating to Market Makers: A Report To The Chancellor Of The Exchequer By The Director General Of Fair Trading Under The Financial Services Act 1986, (London: Office of Fair Trading, March 1995); Securities and Investments Board, Regulation of the United Kingdom Equity Markets: Report By The Securities And Investments Board, (London: SIB, June 1995); and Director General of Fair Trading, Financial Services Act 1986: Trade Publication And Price Transparency On the International Stock Exchange, (London: Office of Fair Trading, April 1990).

[45] See Lusaka Stock Exchange, How To Raise Capital On The Stock Exchange For Small And Large Companies, *supra*., (n. 20), p. 8.

[46] See J.H. Farrar, N.E Furey, and B.M. Hannigan, Farrar's Company Law, (London: Butterworths, 1991), p.551: They argue that all privatisation in England are of this type since it is usually the appropriate Government Minister who is selling the shares vested in his office. In some cases its the parent company selling shares in a subsidiary. Thus, in Zambia this method would provide an effective way to privatise parastatal companies on the Lusaka Stock Exchange. The Zambian Government, through ZIMCO Ltd., has majority shareholding in most of the parastatal companies in Zambia. See also Zambia's Companies Act 1994, sec. 120.

[47] See explanation in *supra*. (n. 46).

Lusaka Stock Exchange as governing the distribution of listed securities in small companies to the public.[48] The other method is the private placing method which we shall examine below. On the offer for sale or subscription, Farrar *et al* observe:

> "In practice both the company and the existing shareholders will often make use of the services of an issuing house which will acquire the shares from the company or the existing shareholders and then offer them for sale to the public. Alternatively, the company or existing shareholders may use the issuing house purely as an agent without the shares being allotted or transferred to the issuing house."[49]

In Zambia, the concept of an issuing house is a relatively new one. Whereas there are several stockbroking firms and a few venture-capital funds participating on the Lusaka Stock Exchange, there are hardly any issuing houses participating on the exchange.[50] It is proposed here that distribution methods such as an offer for sale and an offer for subscription must be adopted by the regional stock exchange. These methods can help to promote market transparency by providing a level playing field for the larger part of the public.

(b) ***Placing:***[51] This is selective marketing where primary or secondary issues are given to a small or carefully chosen section of the public.[52] A broker or company's sponsor may act as an

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[48] See Lusaka Stock Exchange, supra., (n. 20), p. 5.

[49] See J.H. Farrar, N.E Furey, and B.M. Hannigan, Farrar's Company Law, supra., (n. 46), p.551.

[50] See Chapter Three, supra.

[51] See Lusaka Stock Exchange, supra., (n. 20, p. 8. This could involve private or public placing.

agent selling securities in the company to its own client base. This method is meant to enhance freedom in selecting how to raise capital[53]and is normally cost efficient in terms of publicity and advertising. Placings, like offers for sale and offers for subscription, must be provided for in the common investment code of the regional stock exchange.

(c) ***Rights Issue:***[54] This method of distributing securities to the public involves offers of new issues being made to existing shareholders of a company in proportion to their existing holdings.[55] Generally, such issues are made at a discount to the ruling market price.[56] Shareholders who do not wish to take up their rights may sell them on the market.[57] Such pre-emption rights could facilitate privatisation of state owned enterprises in Zambia. Enforcement of the pre-emption rights would enable existing minority shareholders in parastatal companies to acquire

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[52] See J.H. Farrar, N.E Furey, and B.M. Hannigan, Farrar's Company Law, *supra*., (n. 46), p.553; D. Keenan, Smith and Keenan's Company Law, (London: Pitman, 1987), p.115. Indeed, this method would be ideal for helping upcoming companies in Zambia acquire securities since the client-base is identified. This approach is one way of avoiding monopolistic powers of big investors on the market. The method would be appropriate where, for example, the Zambian government wanted to issue some securities in parastatal companies to domestic investors.

[53] London Stock Exchange, Going Public, (London: International Stock Exchange, 1992), p. 9.

[54] See Lusaka Stock Exchange, *supra*., (n. 20), p. 8.

[55] In the case of the United Kingdom, see also Companies Act 1985, sec. 89; J.H. Farrar *et al*, Farrar's Company Law, *supra*., (n. 46), p.164; S. Barc and N. Bowen, Tolley's Company Law, (Croydon: Tolley Publishing Company, 1987), pp. 1177-1184.

[56] See R. Burgess, Corporate Finance Law, (London: Sweet and Maxwell Ltd., 1985), p. 264.

[57] *Ibid*., p. 264.

securities that are under majority share ownership of the State (mainly through ZIMCO Ltd and the Minister of Finance). The same reasoning could be extended to marketing of securities on the regional stock exchange.

(d) ***Bonus or Capitalisation Issue:***[58] In bonus issues, shareholders are not expected to make any new payment to the company when shares are allotted.[59] This method involves the company capitalising profits or revenue reserves or some other permissible fund.[60] Here, the company applies proceeds of the permissible accounts in paying up bonus shares which normally go to the existing members in proportion to their entitlement to a dividend.[61] Funds mentioned above provide the shareholders with additional and usually fully paid up shares in the company.[62] As Farrar *et al* observe:

> "The total value of the shares is not altered, ...what happens is that members hold more shares, but each is worth less than before."[63]

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[58] See Lusaka Stock Exchange, *supra*., (n. 20), p. 9.

[59] J. H. Farrar, N.E Furey, and B.M. Hannigan, Farrar's Company Law, *supra*., (n. 46), pp. 163-164.

[60] Depending on the articles of association of the company, the company could have some other permissible fund from which capital could be obtained for capitalisation.

[61] In the case of the United Kingdom see also Companies Act 1985, sec. 263(3); J.H. Farrar, N.E Furey, and B.M. Hannigan, Farrar's Company Law, *supra*., (n. 46), pp. 163-164.

[62] See J. H. Farrar, N.E Furey, and B.M. Hannigan, in *supra*., (n. 46), pp. 163-164.

[63] *Ibid*., pp. 163-164.

(e) ***Consideration issues and other methods:*** Under the rules of the Lusaka Stock Exchange, a consideration issue is an issue of equity securities by an issuer as consideration in a transaction or in connection with a take-over or merger of the division of the issuer.[64] Other methods of distributing securities to the public, such as tender issues, are not covered under the rules of the Lusaka Stock Exchange.[65] In tender issues, an offer for sale could be made in which shares are offered and underwritten at a minimum price.[66] Subscribers may subscribe at any price at or above this level, and a 'striking price' for all investors is arrived at after considering all offers.[67] Normally tender offers are ideal where there is no comparable company already listed to refer to in determining the company's value. In the case of companies on the regional stock exchange, tender issues and consideration issues might be suitable given the varying 'cross-border trade' and 'multiple listing' characteristics of these companies.

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[64] See Lusaka Stock Exchange, *supra*., (n. 20), p. 9.

[65] See *Ibid*., p. 9.

[66] London Stock Exchange, Going Public, *supra*., (n. 53), p.8; R. Burgess, Corporate Finance Law, *supra*., (n. 56), p.264.

[67] London Stock Exchange, Going Public, *supra*., (n. 53), p.8; J.H. Farrar, N.E Furey, and B.M. Hannigan, *supra*., (n. 46), p.551.

6.5. REGISTRATION[68] AND LISTING[69] OF SECURITIES:

Generally, registration of securities serves as a mechanism to give notice to the public of securities that are licensed by the competent authority as capable of being traded on any securities market. Listing of securities, on the other hand, is a function of the securities exchange to whose market an application for listing has been made. Securities are listed in accordance with rules of such an exchange.

A further distinction between registration and listing of securities lies in the fact that whereas registration requirements may not provide for stringent information disclosure obligations, listing requirements will often spell out stringent obligations on information disclosure. In Zambia, the Securities Act 1993 provides that only registered securities can be admitted to listing on a securities or stock market.[70] The Act spells out the procedure for registration of securities before they can be admitted to listing. The issuer of securities or its representative must sign a registration statement in the prescribed form and submit the statement, together with a prescribed fee, to the Securities and

[68] See generally Securities (Registration of Securities) Rules 1993; On tax liability see Stamp Duty Act 1961; Deloitte and Touche, Taxation in Zambia, (Lusaka: Deloitte and Touche, 1991), p. 35. In Oughtred v. IRC [1960] AC 206, it was established that stamp duty is imposed on instruments, not transactions, and that a transaction of sale carried out without bringing into existence an instrument which has the effect of transferring to or vesting in the purchaser the property sold attracts no duty.

[69] See generally Lusaka Stock Exchange Listing Rules 1993; see also Securities (Transitional) Rules 1993 r.3(2).

[70] Securities Act 1993, Part V; See also generally Lusaka Stock Exchange Listing Rules 1993.

Exchange Commission.[71] The Commission will then register the securities. Similar arrangements for the registration and listing of securities can be adopted by the regional stock exchange and the regional competent authority.

Under the Securities Act 1993, public distribution, promotion, advertising and offering for sale of unregistered securities is a criminal offence.[72] By contrast, as we have already established, public distribution of unlisted, but registered securities is not necessarily an offence. The case of the 'fictitious markets' concept showed that a dealer in registered but, unlisted securities is exempt from liability if he or she complies with the disclosure requirements relating to trading of unlisted securities. Furthermore, the Commission has power to declare that certain unlisted securities will be dealt in as if they were listed.[73] In addition, the Commission can provide rules for the cancellation and the suspension of securities from listing.[74] There are, however, no provisions in the Securities Act 1993 on judicial review of decisions of the Securities and Exchange Commission on de-registration of securities or removal of securities from listing on any securities or stock market. Therefore, Order 53 of the Rules of the Supreme Court of England, which applies to Zambia whenever there are no Zambian rules on judicial review, becomes

[71] Securities Act 1993, sec. 32(1).

[72] *Ibid.*, sec. 32(2).

[73] *Ibid.*, sec. 36(2).

[74] *Ibid.*, sec. 6(f).

applicable. In the case of the regional stock exchange, the common investment code must entrust the COMESA court with jurisdictional powers to hear appeals for judicial review.

Under Zambia's Securities Act 1993, a securities exchange may, subject to the approval of the Commission, make such rules as it considers necessary or desirable for the proper and efficient regulation, operation, management and control of the exchange and the securities market operated by the exchange.[75] These rules could include listing rules and rules prohibiting unauthorised advertisements of securities.[76] We pointed out in Chapter Four that at the regional level the power to pass such rules must be granted to the regional stock exchange.

Prospectus Provisions In The Securities Act 1993 And The Companies Act 1994:

Section 33 of the Securities Act 1993 establishes a mandatory requirement for issuers of securities to prepare and issue a prospectus whenever they are issuing securities to the public.[77] Indeed, as pointed in Chapter Five, the repealed Companies Act 1921 of Zambia did not adequately address the issue of preparing and issuing company prospectuses. That statute only covered prospectus provisions relating to primary trading of securities. However, section 120 of the Companies Act 1994 of Zambia now provides as follows:

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[75] Securities Act 1993, sec. 14.

[76] See _Ibid._, sec. 14 and schedule 2C.

[77] There is no exemption from this mandatory disclosure obligation. The Securities Act 1993 does not even provide for exceptions to this obligation where disclosure would prejudice an issuer of securities or where disclosure would be against 'public interest'. *Cf.* section 148 (1) of the Financial Services Act 1986 of the United Kingdom.

> "(1) Where a company allots or agrees to allot any of its shares or debentures to a person with a view to the public's being invited to acquire any of those shares or debentures, then, ..."

Section 121 continues:

> "(1) The first publication of the prospectus shall be presumed to be on the date of registration thereof.
>
> (2) Where the shares or debentures to which the invitation relates are dealt in on a stock exchange or where the prospectus states that application has been or will be made for permission to deal therein on any stock exchange, and it is necessary to advertise the prospectus in one or more newspapers to comply with the requirements of that stock exchange, the first publication of the prospectus shall be deemed to occur when the prospectus is first so advertised."

New Developments Relating To Disclosure Requirements:

Sections 120 and 121 of the Companies Act 1994, as shown above, now cover secondary trading of securities and do include market trading such as that taking place on the Lusaka Stock Exchange. Apart from the criminal sanctions for issuing misleading statements in prospectuses, as spelt out in the Securities Act 1993,[78] the Companies Act 1994 has provisions too covering criminal liability for misstatements or omissions made in the company prospectus.[79] However, the Companies Act 1994 provision goes further to provide for civil liability as well. Empirical evidence

[78] Securities Act 1993, sec. 33.

[79] Companies Act 1994, secs. 129 and 130.

at the time of writing this report showed that no abuses of an information disclosure nature have been detected so far or have been reported to the Lusaka Stock Exchange.[80] In the case of the regional stock exchange, similar requirements for disclosure obligations must be spelt out in the common investment code.

Generally, the prospectus provisions in sections 120 and 121 of the Companies Act 1994 refer to dealings both on the stock exchange and off the stock exchange. This approach resolves the problem that arose under the Companies Act 1921 where there were no prospectus provisions on secondary trading of securities in Zambia. In addition, as we have seen above, the prospectus provisions in Companies Act 1994 complement those in the Securities Act 1993. It is, therefore, submitted that the prospectus provisions in the Securities Act 1993 must take precedence over any listing requirements of a securities exchange. Section 128 of the Companies Act 1994 provides that where a prospectus has been or will be made for permission for shares or debentures offered in the prospectus to be listed on a stock market, no allotment of these shares or debentures can be made on an application made pursuant to the prospectus, unless

> "(a) ... the permission has been applied for in the form required by the stock exchange before the third day on which the stock exchange is open after the date of issue of the prospectus; or
>
> (b)...the permission has been granted before the determination day."

[80] See generally research results, Appendix K.

What remains unresolved in section 128 of the Zambian Companies Act 1994 is whether an issuer of securities could be excused from providing listing particulars where he has already furnished a prospectus or he is still required to produce the same information in the listing particulars. To overcome this problem, particularly in the case of multiple listings and cross-border trade in securities, the adoption of proposals spelt out in Chapter Four, regarding the common investment code, would prove helpful. Also, the harmonisation of listing rules by stock exchanges in the region would facilitate multiple listing and cross-border trade in securities. The proposal on harmonisation of listing rules is now considered by the African Stock Exchanges Association as an important step towards the integration and growth of African capital markets.[81]

Constraints On Continuing Disclosure Obligations: Unlike the Stock Exchange Act 1990 which had no provisions on continuing disclosure obligations, the Securities Act 1993 requires an issuer of securities to keep the public informed of all matters affecting the value of the securities immediately upon their becoming known to the directors of the issuer.[82] These duties apply to sales of securities at all times after the prospectus has been prepared so that new information affecting the value of the securities is disclosed to the shareholders and to the market in general. Similar obligations must be spelt out in the common investment code of the regional stock exchange.

[81] See *Interview* with Dr. Tukiya-Kankasa Mabula, Director of Licensing, Securities and Exchange Commission, Lusaka, 5th August 1998.

[82] Securities Act 1993, sec. 38(1),(2) and (3).

"In order to maintain their listing on the Exchange, listed companies are required not merely to continue to comply with the conditions necessary to secure admission to listing but to comply in addition with a wide range of further obligations relating to the way in which they conduct their business thereafter, especially in terms of the conduct of relations with their shareholders and the market more generally."[83]

Under Zambian law, the notice through which continuing disclosures are made could be in an advertisement placed in a newspaper of general circulation or by reports to the Securities and Exchanges Commission and reports to any securities exchange on which the securities concerned are listed.[84] Farrar *et al* observe that continuing disclosure obligations are the best bulwark against reckless and irresponsible recommendations and sale of securities.[85] However, the main shortcoming of continuing disclosure obligations under Zambia's Securities Act 1993 is that the statute does not explain what is meant by 'immediately upon their becoming *known*'. Indeed, when could it be deemed that 'matters became *known*' to the directors? These are all examples of constraints facing the regulatory framework for public distribution of securities in Zambia.

[83] P.L. Davis, Gower's Principles of Modern Company Law, 6th edition, (London: Sweet and Maxwell Ltd, 1997), p. 416. The philosophy underpinning continuing disclosure obligations in the United Kingdom is the same as that applying to the Zambian context. In the United Kingdom, the authority to impose continuing disclosure requirements is contained in section 153 of the Financial Services Act 1986 and it is expressed in wide terms. This provision is in part reflecting European Community law, notably, the Council Directive 82/121 on information to be published on a regular basis by listed companies - the Continuing Obligations Directive (Article 13 of the Admission Directive also requires issuers to provide the competent authorities and to publish all information 'appropriate in order to protect investors or ensure the smooth operation of the market').

[84] Securities Act 1993, sec. 38(1), (2) and (3).

6.6. CONSTRAINTS ON PROVISIONS FOR SECURITIES ADVERTISEMENTS:

The Securities Act 1993 is also silent on what would constitute lawful or unlawful securities advertisement. Indeed, there is no statutory provision on whether the competent authority must approve advertisements before such information is communicated to the public. The Securities (Advertisements) Rules 1993 simply spell out provisions on the contents of advertisements and where these advertisements can be found. Such constraints can affect the efficacy of the legal framework for public distribution of securities in the development of a competitive stock exchange in Zambia.

6.7. CONSTRAINTS RELATING TO THE REGULATION OF SECURITIES TRADED ACROSS INTERNATIONAL BOUNDARIES:

The Securities Act 1993 says nothing on the regulation of securities traded across international boarders.[86] It would not be free from difficulties to argue that the Zambian parliament or the draftsman intended that the power to pass regulations governing trade in securities across international boarders be left to securities and stock exchanges themselves. Matters such as these are of great importance and must not be left to private bodies to pass rules over them. In the case of the regional stock exchange, the regulation of such securities trade must be dealt with under the regional investment code. Bringing these matters under the code complements our proposal in

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[85] J.H. Farrar, N.E Furey, and B.M. Hannigan, Farrar's Company Law, *supra.*, (n. 46), p. 479.

[86] *Cf.* the position in the United Kingdom. See P.L. Davis, Gower's Principles of Modern Company Law, 6th edition, *supra.*, (n. 83), pp. 395-442.

Chapter Four to have a much more centralised regional framework for public distribution of securities.

II. CONTROL OF MARKET ABUSES.

Part VII of the Securities Act 1993 addresses the issue of improper trading practices in the securities industry in Zambia. The Securities Act 1993 prohibits the creation of false or misleading volumes of trade in securities.[87] The Act also prohibits the creation of a false or misleading market in securities and the creation of false or misleading prices of securities.[88] In addition, under the Securities Act 1993 a purchase or sale of securities does not involve a change in the beneficial ownership if a person who had an interest in the securities before the purchase or sale, or a person associated with him in relation to those securities, holds an interest in the securities after the purchase or sale.[89] Indeed, the Act prohibits a person from maintaining, inflating, depressing or causing fluctuations in the market price of securities by means of the purchase or sale of any securities that does not involve a change in the beneficial ownership of those securities or by any fictitious transaction or device.[90] Empirical evidence gathered for this work clearly shows that more

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[87] Securities Act 1993, sec. 48.

[88] *Ibid.*, sec. 48.

[89] *Ibid.*, sec. 48.

[90] Securities Act 1993, sec. 48(2); On the fiduciary duty prohibiting stock brokers and dealers from engaging in churning and switching of securities, see Norris & Hirschberg v. Securities & Exchange Commission 177 F 2d 228 [1949].

than 80 per cent of the interviewees and questionnaire respondents observed that there have not been any major abuses of such a nature on the Lusaka Stock Exchange.[91]

Under the Securities Act 1993, it is a criminal offence to induce or attempt to induce another person to deal in securities through misleading, false or deceptive published information.[92] It is also an offence to induce or attempt to induce another person to deal in securities through recklessly or dishonestly published statements.[93] Forecasting of information that is false or misleading and any dishonest concealment of material facts also constitute criminal offences.[94] Section 50 of the Securities Act 1993 extends criminal liability to any person who, directly or indirectly, in connection with any other person involved in the purchase, sale or exchange of securities employs any device, scheme or artifice to defraud other players in the market. Here, liability also applies to persons engaging in any act, practice or course of business which operates as a fraud or deception, or which is likely to operate as a fraud or deception of other players in the market.[95] There is no reason why such measures cannot be spelt out in the common investment code as a way of promoting investor protection on the regional stock exchange.

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[91] See generally research results in Appendices A to K.

[92] Securities Act 1993, sec. 49; In the United Kingdom similar provisions are contained in Part IV of the Financial Services Act 1986. See section 150 of the Financial Services Act 1986.

[93] Securities Act 1993, sec. 49.

[94] *Ibid.*, sec. 49.

[95] See *Ibid.*, sec. 50.

6.8. CONSTRAINTS ON PROVISIONS AGAINST INSIDER DEALING:[96]

We saw in Chapter Four that if an 'informal' regional stock market were to be set up in Eastern and Southern Africa, controlling insider dealing would prove to be problematic. It was argued therefore that a 'formal' stock exchange must be set up. In this section, we now turn to look at constraints on the legal framework against insider dealing in Zambia.

Empirical evidence suggests that the low levels of liquidity on the Lusaka Stock Exchange have not attracted any insider dealing and have not led to any major malpractice by financial intermediaries on the market.[97] Indeed, although there has be no evidence of insider dealing on the Lusaka Stock Exchange, our proposals to refine insider dealing rules in Zambia are pro-active and are thus grounded in the economic argument that efficient legal rules can help to promote the development of a competitive stock exchange.

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[96] See generally K.K. Mwenda, "Zambia's Securities Act 1993 On Trial: The Case Of Insider Dealing," Statute Law Review, Vol. 18, No. 2, 150. *Cf.* Part V of the Criminal Justice Act 1993 of the United Kingdom. See also generally Law Society (UK), The Law on Insider Dealing, Memorandum No. 213. 1990; T.M. Ashe, "Insider Dealing," 11 Company Lawyer, (1990), 127; J.M. Naylor, "The Use of Criminal Sanctions for Insider Trading," 11 Company Lawyer, (1990), 53; Department of Trade and Industry (UK), The Law on Insider Dealing - Consultative Document (1989); Companies Act 1989 of UK, sections 82, 83 and 84; Financial Services Act 1986 of UK, sections 47(2), 177 and 178.

[97] *Interview* with Dr. Tukiya-Kankasa Mabula, Director of Licensing, Securities and Exchange Commission, Lusaka, 5th August 1998. See also *Interview* with Mr. Lewis Mosho, Company Secretary and Legal Advisor, Lusaka Stock Exchange, Lusaka, 21st August, 1998.

Some Constraints On The Zambian Legal Framework: Taking an example of the United Kingdom, legislation that governed the law on insider dealing between 1985 and 1994 was mainly the Company Securities (Insider Dealing) Act 1985.[98] On 1st March 1994, that statute was repealed and replaced by Part V of the Criminal Justice Act 1993.[99] By comparison, in Zambia the Securities Act 1993 purports to address the law on insider dealing in one statutory provision. This section reads as follows:

> "(1) A person to whom this section applies who deals, or counsels or procures another to deal, in securities of a company concerning which he has any knowledge that -
>
> (a) is not publicly available; and
>
> (b) would, if it were publicly available, materially affect the price of the securities,...
>
> (2) This section applies to -
>
> (a) any director, officer or employee of the company concerned;
>
> (b) any person associated in a professional capacity with that company; and
>
> (c) any person who obtains such information from any of the persons mentioned in paragraph (a) or (b)."[100]

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[98] See also EEC Directive 88/627 O.J.L 348/62 (1988); and see generally D.J. Dine, "Implementation Of The EC Insider Trading Directive In The UK," 14, Company Lawyer, (1993).

[99] See generally the preamble of the Criminal Justice Act 1993.

[100] Securities Act 1993, sec. 52.

The above statutory provision covers two types of insider dealers. Paragraphs 2(a) and (b) relate to primary insider dealers whereas paragraph 2(c) relates to secondary insider dealers. Although the law on insider dealing in Zambia covers both primary and secondary insider dealers, it fails to address the liability of third parties who obtain and use information from secondary insider dealers. This is an important constraint on the efficacy of the legal framework.

Example 1:

X is a director of a company called James Brown Ltd. The company intends to float some of its securities on the Lusaka Stock Exchange. X tells his wife that it would be a good idea if his wife's parents bought shares in James Brown Ltd. because this company is in the process of acquiring majority shareholding interests in a prosperous company called Subsidiary Ltd. X's wife communicates this information to her parents who go ahead and purchase the shares in James Brown Ltd. After James Brown Ltd.'s acquisition of majority shareholding in Subsidiary Ltd. group profits go up and the value of the shares in James Brown Ltd. rises. X's in-laws have now off-loaded their shares in James Brown Ltd. on the Lusaka Stock Exchange and have made profits thirty times the original price at which they bought the shares.

Under the Securities Act 1993, X will be liable as a primary insider dealer. His wife will be liable as a secondary insider dealer. By contrast, X's in-laws will not be liable as insider dealers because the Securities Act 1993 does not cover the liability of third parties who obtain and use inside information from secondary insider dealers. As pointed out earlier, there is need to amend the law so that third party insiders are also made liable.[101]

Another constraint affecting the efficacy of the legal framework is that whereas government securities can be traded on a securities market in Zambia,[102] insider dealing law applies only to company securities. Section 52(1) of the Securities Act 1993 clearly refers to 'deals, or counsels or procures another to deal, in *securities of a company*'. In drafting the Securities Act 1993, neither the draftsman nor the members of parliament (when debating the Securities Bill) gave thoughtful consideration to a number of these factors. It is these sorts of issues that present themselves as constraints in the promotion of a competitive and developed stock exchange. The common investment code must be drafted in a careful manner to avoid such pitfalls. The Securities Act 1993 does not even spell out the length of time in which an individual could be seen as an insider.

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[101] Although under many legal systems such use of information is not regulated that does not defeat the argument that third-party insider dealers must be made liable. If investor protection hinges in part on fair (and public) use of price-sensitive information, parties gaining unfairly from use of such information must be made liable. Examples of countries where securities legislation does not address liability of third party insiders include Kenya (see generally Capital Markets Authority Act 1989) and Zimbabwe (see generally Zimbabwe Stock Exchange Act 1980).

[102] See Securities Act 1993, sec. 2.

Example 2:

> What happens to a former company director, who after resigning as company director, communicates company inside information to prospective investors? The Securities Act 1993 is silent on this.

We suggest that the law in Zambia must be amended to provide that such persons will be liable if they act within six months after leaving their employment.[103] An alternative, but less persuasive view would be to argue that the law must be amended to provide that persons such as former company directors should be made liable if they act at any time when the price-sensitive information is still not available to the public. Problems associated with the latter view are twofold. First, could it not be argued that price-sensitive information which remains concealed from the public and is possessed by potential insiders may become stale after some time? Secondly, would it not be unfair to potential insiders if an indefinite period were to be included in the statute encompassing use of information which has now ceased to be price-sensitive? These issues must be addressed to improve the efficiency of the regulatory framework for public distribution of securities in Zambia and to work progressively towards the development of a competitive stock exchange.

Absence Of Civil Remedies As A Constraint: In Zambia, the objective of insider law must be restated. Is insider dealing law meant to protect investors from market abuses or is the law meant to

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[103] Six months appears a reasonable time. *Cf.* Kenya's Capital Markets Authority Act 1989, section 33 which provides that: "...a person has at any time in the last six months been connected with a body corporate, and through his past relation to that body corporate, he was in possession of information that is not generally available, but if were; was likely to materially affect the price of those securities."

punish persons convicted of insider dealing? If the law on insider dealing in Zambia is meant to protect investors from market abuses, then investor protection and investor confidence in the market must be seen as primary objectives of the law. If, on the other hand, insider dealing law in Zambia is only meant to punish offenders and thus addresses only criminal sanctions, then investor protection under the Securities Act 1993 has not been fully addressed. Such are matters that we must lend our attention to when drafting the common investment code of the regional stock exchange.

It is clear from the statutory provision prohibiting insider dealing in Zambia that the Securities Act 1993 provides only criminal sanctions against convicted insiders and does not spell out civil remedies to parties prejudiced by insider dealing. Although section 54 of the Securities Act 1993 provides that civil action can be brought against any person convicted of an offence relating to improper trading - that is, offences such as insider dealing - the section does not provide for the type of civil remedies that could be made available to parties prejudiced by improper trading.[104] Besides, civil action can only be brought by a prejudiced party once a criminal

[104] I have argued elsewhere, see K.K. Mwenda, "The Securities Act 1993 of Zambia: A Comment On The Defective Provisions For Controlling Insider Dealing In Zambia," Stellenbosch Law Review, Vol. 8. No.2 1997, pp. 234-235, that: "The difficulty, however, in bringing civil action against the insider lies in proving that the plaintiff actually suffered loss as a result of the defendant's action. Although the insider could have made an unfair gain from his transaction, it is not easy to say precisely which party has suffered loss from the transaction(s) of the dealer. Should the buyer of the securities (the one who buys from the insider) bring an action against the insider claiming that the insider acted unfairly towards him or should the action be brought by the company that allotted the securities claiming that it has suffered a great loss as a result of the insider's action or should the action be commenced by the shareholders of the company that allotted the securities? Here we are faced with an issue of law and

conviction has been obtained.[105] Under section 54 of the Securities Act 1993, the burden of proof in civil cases lies on the plaintiff to prove, on a balance of probabilities, that the defendant committed a civil wrong against the plaintiff and that the latter is entitled to civil remedies. Some of the reasons for arguing that the Securities Act 1993 should have stated the type of civil remedies available to parties prejudiced by insider dealing include the following:[106]

1. The burden of proof in criminal law lies on the prosecution (and not on the party suffering loss). The party suffering loss is only a complainant or a witness. Although a fine could be imposed on the offender, the party suffering loss does not recover his loss;
2. The burden of proof in civil law cases lies on the plaintiff (the party suffering loss). Here, the prejudiced party can recover his loss;

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fact. The facts of each case would determine which party has the *locus standi* to bring an action. It must, however, be reiterated that the importance of having clear statutory provisions on civil remedies for parties prejudiced by insider dealing lies in part in the fact that such remedies are an incentive to promoting investor confidence in Zambia."

[105] The position in some countries, such as Kenya, is that no civil remedies are provided for under legislation dealing with insider dealing. In other countries, such as Zimbabwe and Ghana, legislation on public distribution of securities does not even cover the offence of insider dealing.

[106] See generally H. McVea, "Fashioning A System Of Civil Penalties For Insider Dealing: Sections 61 and 62 Of The Financial Services Act 1986," Journal Of Business Law, (July 1996), 344; *cf.* J.M. Naylor, "The Use of Criminal Sanctions By UK And US Authorities For Insider Trading: How Can The Two Systems Learn From Each Other? Part II," 11, Company Lawyer, (1993), pp. 83-91; B. Hannigan, Insider Dealing, 2nd edition, (London: Longman, 1994), pp. 124-132.

3. The standard of proof in criminal cases is that of beyond reasonable doubt. Here, the standard of proof is higher than in civil cases. Therefore, civil remedies must be provided for so that where the high criminal law standard of proof cannot satisfied, satisfaction of a lower civil law standard of proof could lead to the award of damages.

4. In criminal law, punishment of the offender is a fundamental objective. In contrast to criminal proceedings, civil proceedings have restitution of the parties and / or compensation of the prejudiced party as notable objectives.[107]

Shadow and De facto Company Directors As Potential Insider Dealers:

In Zambia, the Companies Act 1994 provides as follows:

> "A person not being duly appointed director of a company, on whose directions or instructions the duly appointed directors are accustomed to act shall be deemed to be a director for the purposes of all duties and liabilities imposed on directors..."[108]

This provision makes improvements to the law on directors' duties and liabilities in Zambia. The provision introduces the concept of shadow director to company law in Zambia. Under the Companies Act 1921 and under the Securities Act 1993, the concept of shadow directors was not (and is not) covered to the same extent as it is covered under English law.[109] As Goode observes, a

[107] See generally D. Harris, Remedies in Contract and Tort, (London: Weidenfld and Nicolson, 1988); A. Burrows, Remedies For Torts And Breach Of Contract, (London: Butterworths, 1994).

[108] Companies Act 1994, sec. 203(4).

[109] See the English Companies Act 1985, sec. 741(2) on shadow director.

shadow director in contrast to a *de facto* director, normally acts through someone.[110] A *de facto* director, by contrast, often acts in person. In Zambia, before the Companies Act 1994 was enacted no person materially influencing decisions of a company's board of directors (from outside the board) could be deemed a shadow director. This meant that under Zambian corporate law, no person acting as a shadow director (as would be the case under English law), and releasing inside information to investors could be made liable as a *primary* insider dealer. However, the coming into force of the Companies Act 1994 reversed this position. The Companies Act 1994 now establishes the concept of shadow director and this applies to primary insider dealing. At the regional level, similar arrangements must be provided for in the common investment code.

Under the Securities Act 1993, bodies corporate are excluded from the two categories of insider dealers. In section 52(1) of the Securities Act 1993, which reads in part 'to deal, in securities of a company concerning which *he* has any knowledge', the pronoun 'he' obviously refers to individuals.[111] Thus, bodies corporate such as merchant banks and those acting as

[110] See R.M. Goode, Principles of Corporate Insolvency Law, 2nd edition, (London: Sweet and Maxwell, 1997), pp. 444-468.

[111] Section 4 of the Zambian Interpretation And General Provisions Act 1964 provides that words and expressions in a written law importing the masculine gender include females. The statutory provision also states that words and expressions in a written law in the singular include the plural and words and expressions in the plural include the singular. Nowhere in the Interpretation And General Provisions Act 1964 and the Securities Act 1993 is it stated that the pronoun 'he' includes bodies corporate. Thus, we would be pursuing a red herring in trying to argue that the pronoun 'he' includes bodies corporate. See also K.K. Mwenda, "The Securities Act 1993 of Zambia: A Comment On The Defective Provisions For Controlling Insider Dealing In Zambia," *supra.*, (n. 104), p. 229; and see generally K.K.

underwriters, promoters or operators of collective investment schemes cannot be held liable for insider dealing in Zambia. The Securities Act 1994 does not, however, exclude members of unincorporated associations (*e.g.* partners in a partnership) from the two categories of potential insider dealers.[112] There is need, however, to show that partners or their delegates either procured parties to deal in securities, or counselled them on these dealings or dealt in securities using inside information obtained from primary insider dealers. Here, the partnership position mainly affects lawyers and accountants. In Zambia, lawyers and accountants normally organise their businesses as partnerships. Apart from the day to day practice of lawyers and accountants, and where these professionals are not acting as financial intermediaries on the stock market, they will usually be acting in a professional capacity with the allotting companies. Indeed, lawyers and accountants will quite often be advising the allotting company or auditing its accounts respectively. This position brings lawyers and accountants within provisions of the Securities Act 1993 as potential insider dealers.

Mwenda, "Zambia's Securities Act 1993 On Trial: The Case of Insider Dealing," supra., (n. 96), pp. 150-159.

[112] In Zambia, the English Partnership Act 1890 and common law govern partnership law. There are no partnerships with limited liability of partners.

Use Of Unsolicited Inside Information:

Under the Securities Act 1993, there is no need to prove that the recipient of inside information requested for the information. Insider dealing liability covers use of unsolicited inside information.[113] This position is illustrated by the example provided below.

Example 3:

> Let us assume the facts as they appear in Example 1 above. Under the Securities Act 1993, X's wife will still be liable a secondary insider despite the fact that X volunteered the information to her and she did not make any attempts to solicit the information.

We now turn to look at insider dealing liability of third parties such as journalists. Journalists are chosen here as an example because of the nature of their business, that is, they disseminate information to the public.

Constraints On The Liability Of Journalists As Potential Insider Dealers:[114]

Similar to the position in Example 1, where newspaper proprietors, publishers and non-employees of companies (*e.g.* shareholders who are not directors) engage in insider dealing activities[115] in a

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[113] See Re Attorney General's Reference [1989] 2 All ER. 1; See also E.A. Coleman, "Securities Regulation, Involuntary Recipients of Inside Information," 11 Company Lawyer (1990), pp. 18-19.

[114] See generally Re Company Securities (Insider Dealing) [1988] BCLC 76. The journalist would have been held liable as an insider dealer had Part V of the Criminal Justice Act 1993 been in force. See also Re Insider Dealing Inquiry [1988] BCLC 153.

capacity other than as primary or secondary insider dealers they cannot be held liable for insider dealing. Indeed, this presents itself as a constraint on the legal framework. The reasoning behind the exemption from liability here is that such third-party persons are using inside information obtained from a secondary insider dealer and not from a primary insider dealer.

In terms of triggering liability, there is little difference between passing inside information - obtained through primary or secondary insider dealing - to another person, and publishing it, as a primary or secondary insider, for purposes of enabling another party to use the information. Thus, where journalists pass the information on or publish it not as primary or secondary insiders dealers, the Securities Act 1993 permits them to publish or pass the information on and thereby make profits from tips paid by parties interested in the securities. Indeed, the constraints on the legal framework here can also be seen where a series of sham transactions are perpetuated by a group of individuals to make the journalist appear as though he or she was a third party insider and therefore not liable.

Example 4:

> A is a company director of General Motors Plc, a company whose securities are listed on the Lusaka Stock Exchange. A, who co-habits with his girlfriend, would like to make some 'quick money'. He decides that the best way to go about this is to get his girlfriend to acquire shares in General Motors Plc. The shares would be off-loaded later at a higher price. Indeed, A, as company director in General Motors Plc., has some price sensitive inside information on General Motors Plc. shares.

[115] For example, passing inside information on to another person or publishing inside information for the purpose of enabling another person to deal in the securities.

If A, as a primary insider, communicates inside information to B, a secondary insider, and B passes on that information to C, a journalist, C would not be an insider. C could then pass on the information, in return for a tip, to A's girlfriend and A's girlfriend could acquire the shares without infringing section 52 of the Securities Act 1993 which deals with insider dealing.

However, under section 50 of the Securities Act 1993, it is possible to hold A and the rest of the individuals involved in the above sham transaction liable for engaging in a scheme to defraud other players in the market. The courts in Zambia when faced with such a case must look at the substance rather than the form of the transaction. This could help to make the third party insiders liable once it is proven that the transaction was a sham. Furthermore, to avoid some of the constraints identified above, a clause must be inserted in the Securities Act 1993 to provide that any person who 'knowingly' transmits or receives and acts on inside information - irrespective of the mode in which the information was acquired - is liable for the offence of insider dealing. The Act must spell out what would constitute 'knowingly'.

Constraints Relating To Liability Of Financial Intermediaries:

A question could be raised here on the liability of financial intermediaries in Zambia. Do intermediaries deal in a professional capacity when undertaking their business? Whereas section 52(2) of the Securities Act 1993 provides that the law on insider dealing in Zambia covers two classes of primary insiders, that is, company directors, and officers or employees of the company, on the one hand, and persons associated in a professional capacity with the company, on the other hand, generally, financial intermediaries *per se* cannot be regarded as professionals or as persons acting in a professional capacity on the market.[116] If this view is correct, as we contend, it would be incorrect to argue that 'insider' related misconduct of financial intermediaries is covered by provisions on insider dealing in the Securities Act 1993. In the English case of Christopher Barker & Sons v. IRC[117] the appellants carried on business of stockbrokers, buying and selling stocks and shares on the market for clients, being remunerated by commission. They were also consulted professionally on the promotion of and the alterations and adjustments of capital in commercial undertakings, and they also made valuation of stocks and shares forming part of the estates of deceased persons, being remunerated for such advice and valuations by fee. It was held that stockbrokers in buying stocks and shares do not carry on a profession and that the work of advice and valuation for which the appellants were remunerated by fees was done as part of and in connection with their business as stockbrokers and not in the exercise of a profession, and that therefore the appellants were liable to excess profits duty.

[116] See Christopher Barker & Sons v. IRC [1919] 2 KB. 222. It is my contention that professionals and persons acting in a professional capacity have monopoly over their trade and skill *e.g.* surgeon, lawyer, accountant *etc.* On the other hand, upon authorization, any person can practice as a broker. For a contrary view on the position whether financial intermediaries are professionals or act in a professional capacity, discussion with Professor D.D. Prentice, Oxford University, Oxford, 25th October 1993, showed that Professor Prentice is of the view that brokers and other financial intermediaries act in a professional capacity. Professor Prentice's view could be true in a situation such as that obtaining under section 59 of the English Criminal Justice Act 1993, where the label 'professional intermediary' is used. In Zambia's Securities Act 1993, there is no such label. Thus, in Zambia the Christopher Baker & Sons case still applies.

[117] Christopher Barker & Sons v. IRC [1919] 2 KB. 222.

The consequences of the Christopher Baker & Sons case in Zambia are that intermediaries *per se* are not professionals and do not act in a professional capacity when undertaking their duties as fiduciaries. In other countries, however, this position has been reversed by legislation.[118] Under the Securities Act 1993 of Zambia, intermediaries can only be held liable for the offence of insider dealing where they have acted as secondary insiders. However, certain situations could present themselves as exceptions to the general rule here. For example, intermediaries could be held liable as primary insider dealers where they are seen to be acting as directors, officers or employees of the company. Besides, although financial intermediaries *per se* cannot be regarded as professionals or as acting in a professional capacity, rule 28 of the Securities (Conduct of Business) Rules 1993 prohibits financial intermediaries from using inside information obtained from their employees, officers or agents. Be that as it may, careful drafting of the common investment code, in the case of regional stock exchange, must be adopted to avoid the constraints seen in the case of Zambia.

Constraints Relating To What Constitutes 'Materiality' And 'Knowledge' In Insider Dealing Law:

In section 52 of the Securities Act 1993 one of the essential requirements that must be satisfied to warrant a conviction of insider dealing is that for information to be treated as inside information, it must 'materially' affect the price of securities. Also, the information must not be available to the public. The criterion of defining what constitutes 'materially (or materiality)' is not spelt out in the

[118] See section 59 of the English Criminal Justice Act 1993.

Act. It is somewhat unclear whether fraudulent omissions[119] that create inflated prices of securities could amount to insider dealing.[120] Moreover, the weakness of the local currency entails that the more the currency depreciates in value the greater the difficulty in proving the issue of

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[119] For example, where company directors with inside information make omissions in listing particulars or prospectuses.

[120] Generally, unlike the duty of disclosure that exists under insurance law, there is no such duty under insider dealing law in Zambia. See Securities Act 1993, sec 52. *Cf* Pan Atlantic Insurance Co. Ltd. v. Pine Top Insurance Co. [1994] 3 All E.R. 581, on the effect of an insured's non-disclosure. However, since section 52(1) of the Zambian Securities Act 1993 refers to an insider as an individual 'who deals, or counsels or procures another to deal, in securities', the dealing or the procurement of others to deal or the counseling of others to deal could be done while some material facts are being concealed. In this instance, though there is no general duty to disclose material facts other than those disclosed in the prospectus and the listing particulars, the price of the securities could be affected by the non-disclosure. The party advising or counseling or dealing might fraudulently choose not to disclose certain facts so that the price of the securities is affected materially. If this were to happen, the omission could lead to insider dealing. The prosecution would have to prove beyond reasonable doubt that the omission concealed relevant knowledge which was not publicly available. Consequently, this must be seen to have materially affected the price of the securities.

'materiality'.[121] Illustratively, in the American case of Cady Roberts & Company,[122] the principle in American securities law that a fact was material if it, if known, would affect the investment judgement of those with whom the insider was dealing was criticised by Commissioner Cary. He argued that this principle produced uncertainty and confusion. He, therefore, suggested the direct effect on the market value of securities as a test in addition to the 'investment judgement' principle. This dual test, however, does not establish certainty. How is market value to be determined in Zambia given a weak and fluctuating currency such as the Zambian Kwacha?

Furthermore, the Securities Act 1993 does not define what constitutes 'knowledge'. Although no statute can readily be cited as an example of a foreign piece of legislation in which the term 'knowledge' has been defined, that argument alone does not defeat the view that clarity in the meanings of statutory provisions would facilitate a smooth interpretation of the statute. In Zambia, as noted earlier, section 52 of the Securities Act 1993 reads in part 'who deals, or counsels or procures another to deal in securities of a company concerning which he has any *knowledge*'. The

[121] In Pan Atlantic Insurance Co. Ltd. v. Pine Top Insurance Co. [1994] 3 All E.R. 581, the House of Lords considered the statutory definition of 'materiality' and, by a bare majority, held that a fact is material if it is one which would have an effect on the mind of a reasonably prudent insurer considering whether or not to accept the proposed risk, even if it would not have altered his actual decision. Similarly, as R. Bradgate, Commercial Law, 2nd edition, (London: Butterworths, 1995), p. 709, observes: "In effect, therefore, a material fact is one which a reasonably prudent insurer would want to know when making an assessment of the risk... the insurer can only avoid a policy on the grounds of non-disclosure of a material fact if the non-disclosure did actually induce him to enter into the contract."

[122] 40 SEC 907 at 911. See also SEC v. Texas Gulf Sulphur Co. 401 F 2d 833.

term 'knowledge' is not defined anywhere in the Securities Act 1993. However, in Selanghor v. Craddock (No.3)[123] Ungoed-Thomas J. was of the view that 'knowledge' meant 'circumstances which would indicate to an honest and reasonable man that such design was being committed, or would put him on inquiry'. In Re Montagu's Settlements,[124] it was held that 'knowledge' is not confined to actual knowledge, but includes actual knowledge that would have been acquired but for shutting one's eye to the obvious, or wilfully and reckless failing to make such inquiries as a reasonable man would make.' Similarly, in Baden Delvaux and Lecuit v. Societe Generale, it was pointed out that:

> " ... knowledge can comprise any one of five different mental states... :
>
> (i) actual knowledge;
>
> (ii) wilfully shutting one's eye to the obvious;
>
> (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make;
>
> (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man;
>
> (v) knowledge of circumstances which would put an honest and reasonable man on inquiry."[125]

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[123] [1968] 2 All ER 1073.

[124] [1987] Ch. 264 at 285.

[125] *Per* Peter Gibson J., [1983] BCLC 325; See also El Ajou v. Dollar Land Holdings plc [1993] 3 All ER 717 at 739; Polly Peck International plc v. Nadir (No.2) [1992] 4 All ER 769; Karak Rubber Co Ltd v. Burden (No.2) [1972] 1 WLR 602 at 632; Agip (Africa) Ltd v. Jackson [1992] 4 All ER 385; Eagle Trust plc v. SBC Securities Ltd [1992] 4 All ER 488 at 499; *cf.* Belmont Finance Corporation v. Williams Furniture Limited [1979] Ch 250; P. Birks [1989] Lloyd's MCLQ 296; P. Birks (1989)

In contrast to the position in civil law, the criminal law position was spelt out in Nelson v. Larholt[126] where it was held that 'knowledge' meant more than constructive knowledge in the sense of shutting one's eyes to the obvious. In Warner v. DPP,[127] Lord Reid held that knowledge could include 'willfully shutting one's eyes to the truth.' Willful, on the other hand, could mean deliberate or reckless acts or omissions.[128]

Can Insider Dealing Vitiate An Investment Contract? As a general rule, under Zambian law insider dealing cannot vitiate an investment contract.[129] By comparison, in the United Kingdom, prior to the enactment of the Criminal Justice Act 1993, insider dealing could vitiate an investment contract.[130] This view was illustrated in the case of Chase Manhattan Equities v. Goodman,[131] where Knox J., ruling on the legal consequences of insider dealing, observed:

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105 Law Quarterly Review, 352 at 355; C.E.F. Ricket (1991) 11 Oxford Journal of Legal Studies, 598 at 602; Powell v. Thompson [1991] 1 NZLR 597.

[126] [1948] 1 KB. 339 at 344.

[127] (1968) Cr. App. 373 at 398.

[128] R v. Moys (1984) 79 Cr. App. 72. See also R v. Sinclair [1986] 1 WLR 1246.

[129] Securities Act 1993, sec. 52(3).

[130] See below.

[131] [1991] BCLC 897 at 934. For a discussion on insider dealing and the equitable remedy of rescission see B. Rider and L. Ffrench, The Regulation of Insider Trading, (London: Macmillan Press, 1979), p. 92.

"...The sale agreement is therefore...unenforceable...because it was tainted in its creation by an infringement."

The coming into force of Part V of the Criminal Justice Act 1993, replacing the Company Securities (Insider Dealing) Act 1985, made some important changes to the law in the United Kingdom. It is now provided in section 63(2) of the Criminal Justice Act 1993 that no contract shall be void by reason only of being tainted with insider dealing. Given the above arguments, it is clear that in Zambia, like in the United Kingdom, since the Securities Act 1993 provides that insider dealing cannot vitiate an investment contract, the equitable remedy of rescission is generally not available to a party prejudiced by insider dealing.[132] Be that as it may, a party prejudiced by insider dealing can bring an action at common law for damages if he can prove, on a balance of probabilities, that he has suffered loss resulting from the defendant's negligence.[133] At common law, the burden of proof lies on the prejudiced party to prove that the defendant (who is the insider) owed the prejudiced party a duty of care and that the defendant breached that duty. The defendant's breach of duty must result in the plaintiff's loss.[134]

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[132] See B. Rider and L. Ffrench, *Ibid.*, p. 92.

[133] *Ibid.*, p. 92.

[134] *Ibid.*, p. 92.

Lack Of Statutory Defences To Insider Dealing As A Constraint:

In Zambia, the general rule is that there are no statutory defences to insider dealing.[135] Thus, market players and other individuals falling within the statutory categories of potential insider dealers must always avoid breaching section 52 of the Securities Act 1993, which deals with insider dealing. By comparison, legislation in the United Kingdom on insider dealing spells out some of the defences to insider dealing.[136] These defences apply mainly to individuals who deal in securities and those that encourage others to deal in securities. Section 53(1) of the English Criminal Justice Act 1993 provides as follows:

> "(1) An individual is not guilty of insider dealing by virtue of dealing in securities if he shows -
>
> > (a) that he did not at the time expect the dealing to result in a profit attributable to the fact that the information in question was price-sensitive information in relation to the securities, or

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[135] See Securities Act 1993, sec. 52.

[136] See generally M. White, "The Implications For Securities Regulation Of New Insider Dealing Provisions In The Criminal Justice Act 1993," 16, Company Lawyer, (1995); J.M. Naylor, "The Use of Criminal Sanctions By UK And US Authorities For Insider Trading: How Can The Two Systems Learn From Each Other? Part I," 11, Company Lawyer, (1993), pp. 53-61. See also S. Goulding, Principles of Company Law, (London: Cavendish Publishing Ltd., 1996), pp. 206-216: he categorises defences to insider dealing under the Criminal Justice Act 1993 into general and special defences. Most of the defences discussed below are general defences. Special defences are found in paragraphs 1-5 (inclusive) of Schedule 1 to the Act. See also paragraphs 2-4 of Schedule 1 on one other general defence known as 'dealing insecurities.'

(b) that at the time he believed on reasonable grounds that the information had been disclosed widely enough to ensure that none of those taking part in the dealing would be prejudiced by not having the information, or

(c) that he would have done what he did even if he had not had the information."

The same defences are repeated in section 53(2). In that subsection, the defences apply to persons who encourage others to deal in securities. Such measures must be included in the common investment code in order to promote investor confidence on the regional stock exchange. Interestingly, however, section 53(3) of the English Criminal Justice Act 1993 adds:

"(3) An individual is not guilty of insider dealing by virtue of a disclosure of information if he shows -

(a) that he did not at the time expect any person, because of the disclosure, to deal in securities in the circumstances mentioned in subsection (3) of section 52;[137] or

(b) that, although he had such an expectation at the time, he did not expect the dealing to result in a profit attributable to the fact that the information was price-sensitive information in relation to the securities...

(6) In this section references to a profit include references to the avoidance of a loss."

[137] Subsection (3) of section 52 of the Criminal Justice Act 1993 provides that: "The circumstances referred to above are that the acquisition or disposal in question occurs on a regulated market, or that the person dealing relies on a professional intermediary or is himself acting as a professional intermediary."

In Zambia, there is need to have statutory defences to insider dealing so that individuals who find themselves in situations such as those covered under English statutory defences to insider dealing, can be exonerated from liability. This could help to promote fair play and investor confidence on the market.

6.9. CONCLUSION:

Underlying the discussion in this chapter has been the theme that in order to redress the problem of having weak statutory provisions that constrain the development of competitive stock exchanges (*e.g.* the underdeveloped state of the Lusaka Stock Exchange), states in Eastern and Southern Africa must begin to consider the merits of setting up a regional stock exchange and promoting multiple listings and cross-border trade in securities.

We have argued in this chapter that the legal framework for public distribution of securities in Zambia faces a number of constraints. Like the Stock Exchange Act 1990, the Securities Act 1993 fails, among other things, to address the regulation of securities traded across international boundaries and the reasonable timing of information disclosure in company prospectuses. In advancing these arguments, we looked at several aspects of the law. A critical examination of the methods of public distribution of securities in Zambia was made. The law on registration of securities and mandatory disclosure obligations was analysed. Finally, an insightful discussion on the law against insider dealing was provided. All these issues were treated in relation to the idea of setting up a competitive regional stock exchange that would stimulate increased liquidity on the capital markets in the region.

CHAPTER SEVEN

TRADING THROUGH FINANCIAL INTERMEDIARIES AND PROSPECTS OF INVESTOR PROTECTION

This chapter examines the efficacy of the legal framework governing financial intermediaries on the Lusaka Stock Exchange. In so doing, the chapter also looks at how a legal framework could be developed at the regional level to govern duties of financial intermediaries on the regional stock exchange. An argument is made that efficient legal rules to govern financial intermediaries on the Lusaka Stock Exchange and on the regional stock exchange are an important way to achieve investor protection on these markets. Although it is clear from the empirical evidence in Chapter Three that the Lusaka Stock Exchange has been experiencing some liquidity problems, our findings also show that this has not had any noticeable effect on the performance of financial intermediaries.[1] Therefore, in this chapter proposals to strengthen rules governing the conduct of financial intermediaries are drawn as pro-active measures to overcome constraints that could arise as the trading activity on the market grew. From an economist's point

[1] See *Interview* with Dr. Tukiya-Kankasa Mabula, Director of Licensing, Securities and Exchange Commission, Lusaka, 5th August 1998. See also *Interview* with Mr. Lewis Mosho, Company Secretary and Legal Advisor, Lusaka Stock Exchange, Lusaka, 21st August, 1998.

of view, the adoption of efficient legal rules could help to promote the development of a competitive stock exchange.

This chapter is divided in two parts. The first part deals with matters such as the licensing of financial intermediaries, fiduciary duties of financial intermediaries and the compensation of investors prejudiced by acts or omissions of financial intermediaries. The second part looks at the law governing collective investment schemes in Zambia. These schemes are an important way in which the Securities Act 1993 endeavours to take care of interests of small investors on securities markets.

In Zambia, the common law principles governing activities of financial intermediaries on the Lusaka Stock Exchanges are reinforced by the Securities (Conduct of Business) Rules 1993,[2] hereafter called the 'COB Rules 1993'. Also, the Securities and Exchange Commission Code on Collective Investment Schemes provides another set of rules that reinforce the common law principles.

[2] By comparison, the United Kingdom also has Conduct of Business Rules. Also, sections 47A and 48 of the English Financial Services Act 1986 authorises the Secretary of State to pass Statements of Principle.

I. AUTHORISATION OF FINANCIAL INTERMEDIARIES AND FIDUCIARY DUTIES OF THE INTERMEDIARIES.

7.1. TYPES OF INTERMEDIARIES:

Part IV of the Securities Act 1993 regulates the licensing of three kinds of financial intermediaries in Zambia.[3] The three types are dealers, investment advisers and representatives of either dealers or investment advisers.[4] The licensing of financial intermediaries formally authorises persons such as dealers and stockbrokers to act as intermediaries on the stock market in Zambia.[5] Although the licensing of financial intermediaries constitutes an act of authorisation by the Securities and Exchange Commission, financial intermediaries may also be required, by a securities exchange on whose market they are dealing, to meet requirements of that exchange which relate to regulation of financial intermediaries' business.[6] At the regional level, we spelt out proposals for the authorisation of financial intermediaries on the regional stock exchange.[7]

The Licensing of Financial Intermediaries In Zambia: The Securities and Exchange Commission is vested with statutory powers to authorise financial intermediaries to conduct

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[3] See Securities Act 1993, secs. 18, 19 and 20.

[4] See generally _supra_., (n. 3).

[5] See Securities Act 1993, secs. 18, 19 and 20.

[6] See Securities Act 1993, section 14 on powers of a securities exchange to make its own rules: "Subject to the approval of the Commission, a securities exchange may make such rules as it considers necessary or desirable for the proper and efficient regulation, operation, management and control of the exchange and the securities market operated by the exchange."

[7] See Chapter Four, _supra_.

business on a securities exchange in Zambia.[8] Persons who hold out as financial intermediaries must ensure that they are licensed. If they are not licensed, yet hold out as licensed financial intermediaries, they will be committing a crime.[9] Furthermore, it is an offence for a person to apply fraudulently for an intermediary's licence.[10] This could happen, for example, where material facts required to be disclosed by the applicant are concealed.

Under the Securities Act 1993, both bodies corporate and individuals can apply for a dealer's or investment adviser's licence.[11] The Securities Act 1993, however, prohibits the Securities and Exchange Commission from granting a representative's licence to bodies corporate.[12] Only individuals can be licensed as representatives of either dealers or investment advisers. The Securities and Exchange Commission is also vested with powers to issue conditional licences.[13] Conditional licences are issued to representatives of either dealers or investment advisers. The conditions on which these licenses are granted could include binding obligations that the representative's licence is conditioned on the licensee being employed or acting only as the representative of a particular dealer or only as the representative of a particular investment

[8] Securities Act 1993, secs. 18, 19 and 20.

[9] *Ibid.*, secs. 18, 19 and 20; Securities (Transitional) Rules 1993, r. 3.

[10] Securities Act 1993, sec. 30.

[11] *Ibid.*, secs. 18, 19 and 20.

[12] *Ibid.*, sec. 22(3).

[13] *Ibid.*, sec. 20.

adviser.[14] Generally, unless sooner revoked, suspended or surrendered, an intermediary's licence remains in force for the period specified in the licence.[15] Also, the licence is subject to the terms and conditions attached to it.[16] A licence may be granted or renewed subject to such conditions as the Commission might think fit to specify in the licence at the time of grant or renewal, and the Commission may at any time, by notice served on the licensee, vary the conditions for the time being attached to it or impose further conditions.[17]

Capacity To Act As Intermediary: The Securities Act 1993 prohibits persons under the age of twenty-one, persons that cease to carry on business in Zambia[18] and those that fail to meet minimum solvency requirements under the Securities Act 1993 from acting as financial

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[14] Securities Act 1993, sec. 20(2). It could be argued, however, that at common law the reasonableness of such conditions must be observed and that if the conditions are unreasonable a number of conditional licences might restrain the trading activities of representatives of dealers and investment advisers. The position is otherwise where legislation, as in the case of Zambia, provides for the issuance of conditional licences. Indeed, on the common law position regarding contracts in restraint of trade, see Attwood v. Lamont [1920] 3 K.B. 572, C.A; Nordenfelt v. Maxim Nordenfelt [1894] A.C. 5353, H.L.; Mason v. Provident Clothing & Supply Co. Ltd. [1913] A.C. 724, H.L.; Herbert Morris Ltd. v. Saxelby [1916] 1 A.C. 688, H.L.; Esso Petroleum Co. Ltd. v. Harper's Garage (Stoutport) Ltd. [1968] A.C. 269, H.L.; A Schroeder Music Publishing Co. Ltd v. Macaulay [1974] 3 All E.R. 616, H.L.; Goldsoll v. Goldman [1915] 1 Ch 292, C.A.

[15] Securities Act 1993, sec. 23(1).

[16] *Ibid*. sec. 23(2).

[17] *Ibid*., sec. 23(3).

[18] *Ibid*., sec. 24(2)(g).

intermediaries.[19] The requirements in the Securities Act 1993 on the licensing of dealers are similar to, but much broader than the requirements in the Zambian Companies Act 1994 on the capacity of a person to act as a company director.[20] The Securities Act 1993 requirements include the views that an applicant for a dealer's licence must not be an undischarged bankrupt and that he must be of good repute or character.[21] Like the repealed Stock Exchange Act 1990, the Securities Act 1993 requires dealers and advisers to furnish financial security before they can be licensed to conduct business as authorised financial intermediaries.[22] Also, under the Securities Act 1993, the Commission may refuse to grant or renew a dealer's or an investment adviser's licence on the grounds that:[23]

> 1). the applicant has not provided the Commission with such information relating to it or any person employed by or associated with it, or to any circumstance likely to affect its method of conducting business;
>
> 2). any director of the applicant has become incapable mentally or physically of performing his duties in connection with the activities to which the applicant's licence relates; and
>
> 3). where any officer concerned in the management of the applicant's business or any employee of the applicant has been convicted, whether in Zambia or elsewhere, of an offence involving fraud or

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[19] *Ibid*., sec. 22.

[20] See generally Companies Act 1994, Part X; See also generally P. Davies, Gower's Principles of Modern Company Law, 6th edition, (London: Sweet and Maxwell, 1997); P. Loose, J. Yelland and D. Impey, The Company Director: Powers and Duties, (Bristol: Jordans, 1993).

[21] Securities Act 1993, sec 22(2).

[22] *Ibid*., sec. 31.

[23] *Ibid*., sec. 22(3).

dishonesty, or has been convicted of an offence against the Securities Act 1993 or the rules made under the Act relating to financial intermediaries.

Similar measures can be included in the common investment code to regulate financial intermediaries on the regional stock exchange. Indeed, the international arena in which the these intermediaries would be dealing should provide a level playing field. Use of tighter regulatory rules can help to achieve this since international law in general has limited policing and enforcement mechanisms.

Does The Securities Act 1993 Distinguish Brokers From Dealers? The Securities Act 1993, unlike the repealed Stock Exchange Act 1990, does not distinguish stockbrokers from dealers.[24] Under the Securities Act 1993, a broker can also be referred to as a dealer.[25] The Securities Act 1993 provides that a dealer is a person who carries on the business of dealing in securities, whether as principal or agent.[26] Thus, although a stockbroker is regarded as an agent at common law,[27] he could be regarded as either a principal or an agent under the Securities Act 1993.[28] Besides, the status of an agent enjoyed by stockbrokers at common law can be altered by regulations of a

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[24] See Stock Exchange Act 1990, sec. 2; *cf.* Securities Act 1993, sec. 2. See also Securities (Licensing and Fees) Rules 1993, rr. 2 and 3.

[25] See Securities Act 1993, sec. 2.

[26] *Ibid.*, sec. 2.

[27] Armstrong v. Jackson [1917] 2 K.B. 822; Christopher Barker & Sons v. IRC [1919] 2 K.B. 222; Rothschild v. Brookman [1831] 5 Bligh (NS) 165.

[28] See Securities Act 1993, sec. 2.

securities exchange.[29] The regulations could require a stockbroker to participate on the market as a principal.[30] We propose that financial intermediaries must participate on the regional stock exchange as principals so that they can be made accountable for their acts and omissions. However, stockbrokers continue to retain fiduciary duties to their customers.[31]

Investment Advisers: The other category of financial intermediaries covered by the Securities Act 1993 is that of investment advisers.[32] Investment advisers provide investment advice to persons desirous of such information.[33] The statutory provision that deals with investment advisers does not include in its definition of investment advisers institutions such as banks registered under banking or financial institutions laws, insurance companies under the Insurance Act, advocates or accountants acting in their professional practice, licensed dealers and their representatives, and proprietors or publishers of newspapers where financial news is made available in the ordinary and incidental course of newspaper business and not for a specific commission or consideration.[34] One of the reasons for the above exclusions is that dealers and the other groups mentioned above provide investment advice when they engage in their ordinary course of business. Providing advice is part of their business. Moreover, since most of these financial institutions and professionals will have been

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[29] See for example the wide statutory powers conferred on securities exchanges in section 14 of the Securities Act 1993, (reproduced above) to make their own regulatory rules. The Lusaka Stock Exchange has, however, not made rules requiring financial intermediaries to do business as principals on the stock market.

[30] See explanation in *supra*. (n. 29).

[31] See *supra*. (n. 29).

[32] Securities Act 1993, sec. 19.

[33] *Ibid.*, sec. 2.

[34] *Ibid.*, sec. 2.

licensed by the bodies that regulate their business, there is no need to license them for a second time (as investment advisers). In a number of cases, where a person in Zambia is authorised under some law to conduct financial business (*e.g.* banks) that person will be subject to the regulatory framework governing his profession or trade. It is often under such legal framework that the person will be authorised to carry on his profession or trade.

On the whole, activities of persons such as investment advisers must be monitored carefully. The importance of monitoring these activities lies in the fact that this could ensure that investors are protected from certain forms of misfeasance committed by intermediaries.

7.2. POWERS OF THE COMMISSION TO INVESTIGATE INTERMEDIARIES AND RESTRICT THEIR BUSINESS ACTIVITIES:

The Securities Act 1993 authorises the Securities and Exchange Commission to inspect, under conditions of secrecy, the bank accounts,[35] documents and transactions of any person licensed as a financial intermediary in Zambia.[36] It is an offence for a person to fail, without reasonable excuse, to produce any book, account or document to the inspector, or to furnish any information or to afford the use of any facilities.[37] Also, the Securities Act 1993 gives the Commission power to stop

[35] Securities (Accounting and Financial Requirements) Rules 1993 reinforces section 45 of the Securities Act 1993. Rule 13 of the Securities (Accounting and Financial Requirements) Rules 1993 emphasises that a 'true and fair view' of an intermediary's accounts must be shown in the balance sheet. Here, the concept of 'true and fair view' is analogous to that found in the English Companies Act 1985, secs. 226(2), 227(3), 262(1) and 271(2).

[36] Securities Act 1993, sec. 53.

[37] *Ibid.*, sec. 53(5).

an intermediary from conducting his business.[38] In addition, the Commission has power to stop an intermediary from dealing in any of his assets or in assets of another person within Zambia or outside Zambia.[39]

Constraints Relating To Powers Of The Commission:

Under the Securities Act 1993, financial intermediaries are required to maintain their assets and assets of their customers properly.[40] However, empirical evidence shows that although the liquidity constraints on the Lusaka Stock Exchange have not led to any noticeable malpractice by financial intermediaries on the market, many intermediaries have not observed the statutory duty to keep their assets and assets of their customers properly.[41] This issue is now being investigated by the Lusaka Stock Exchange and the Securities and Exchange Commission. Indeed, we saw in Chapter Three how the empirical evidence suggested that financial intermediaries transacting on the Lusaka Stock Exchange need specialist training to improve their performance.

Other statutory powers vested in the Securities and Exchange Commission include the power to petition for winding-up of any company carrying on the business of a financial intermediary where it

[38] Ibid., sec. 56.

[39] Ibid., sec. 57.

[40] Ibid., sec. 58.

[41] See *Interview* with Mr. Lewis Mosho, Company Secretary and Legal Advisor, Lusaka Stock Exchange, Lusaka, 21st August, 1998.

appears necessary to protect investors.[42] At the time of writing this report, this statutory power had not been exercised. However, in spelling out the grounds on which the Commission may present a petition for winding up, the Securities Act 1993 simply cross-refers to the Companies Act.[43] Section 61 of the Securities Act 1993 provides as follows:

"*Winding up orders*	**61.** If, in the case of a company licensed under Part IV, it appears to the
Cap. 686	Commission that it is desirable for the protection of investors that the company should be wound up under the Companies Act (Cap. 686) the Commission may present a petition for it to be wound up under that Act on the ground that it is just and equitable that it should be wound up."

Even with such an attempt at spelling out the grounds on which the Securities and Exchange Commission may present a winding up petition, the Securities Act 1993 fails to state what constitutes 'just and equitable' arguments in the winding up of 'intermediary' companies. It is submitted here that the grounds on which a winding up petition may be presented by the Securities and Exchange Commission are thus unclear. At the time when the Securities Act 1993 was coming into force, the Companies Act 1921, which was still in force, had no provisions on the power of the Securities and Exchanges Commission to present a petition for winding-up of a company. Under the repealed Companies Act 1921, such a petition could only be presented by

[42] Securities Act 1993, sec. 61.

[43] See *Ibid.*, sec. 61.

the Commission if the Commission was a creditor or contributory to the insolvent company.[44] The Companies Act 1994 has not made any changes to the law in order to permit the Securities and Exchange Commission to petition for winding up of companies.[45] One possible interpretation of the law here is that the powers of the Commission to wind up 'intermediary' companies are confined exclusively to the Securities Act 1993. This interpretation is not free from difficulties. What are the policy justifications of having a company incorporated under a Companies Act, yet brought under another piece of legislation for the sole reason of winding up?

Under the Securities Act 1993, the Commission also has power to petition for receiving orders in bankruptcy where it appears necessary to protect investors.[46] What is deemed 'necessary to protect investors' is not spelt out in the Act. Section 5 of the Bankruptcy Act 1967 does not even provide the Commission with *locus standi* - other than as a creditor - to petition for a receiving order. In addition, section 2(3)(c) of the Debtors Act 1938 protects fiduciaries such as financial intermediaries from imprisonment where they have defaulted in payment of fixed sums.

[44] Companies Act 1921, sec. 139.

[45] See Companies Act 1994, sec. 271.

[46] Securities Act 1993, sec. 62.

7.3. PROVISION FOR JUDICIAL REVIEW OF DECISIONS ON THE GRANTING OR RENEWAL OF INTERMEDIARIES LICENCE:

We observed earlier[47] that the Securities and Exchange Commission has power to refuse to grant or renew a dealer's licence.[48] Given the vast discretionary powers vested in the Securities and Exchange Commission on the issuing and revocation of intermediaries licences, the Securities Act 1993 also provides for an appellate structure which permits applicants for intermediaries licences, who are not satisfied with the decisions of the Commission, to appeal to the High Court.[49] The appeal is one for judicial review of administrative action. We now turn to look at the law relating to fiduciary duties of financial intermediaries in Zambia.

7.4. FINDING OUT WHO IS A FIDUCIARY AS THE GENESIS OF THE INQUIRY:[50]

Although at the time of writing this report there was no Zambian judicial decision on fiduciary duties of financial intermediaries, we examine below the legal aspects of fiduciary duties with a view not only to examining how the law applies to Zambia, but also with a view to making some recommendations which can be helpful in providing the bases for the development of a competitive

[47] See above.

[48] See Securities Act 1993, sec. 22.

[49] *Ibid.*, sec. 26(1).

[50] For detailed discussions on fiduciary duties of financial intermediaries in the United Kingdom, see generally Law Commission (England), Consultation Paper No. 124, "Fiduciary Duties and Regulatory Rules," (London: HMSO, 1992); and Law Commission (England), Report No. 236 of 1995, "Fiduciary Duties and Regulatory Rules," (London HMSO, 1995).

stock exchange. We submit that there are generally three elements that underpin the discussion on fiduciary duties of financial intermediaries. These elements are:

(i) Giving advice to customers;

(ii) Selling and buying securities, plus negotiating on behalf of customers; and

(iii) The relationship between the common law and statutory duties of financial intermediaries.

7.4.1. Fiduciary Duties Of Financial Intermediaries:

The question 'who is a fiduciary?' provides an interesting starting point to our inquiry of what constitutes fiduciary duties. The nature and forms in which fiduciary duties present themselves cannot be reduced to one succinct statement.[51] As Hannigan observes:

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[51] See Securities and Exchange Commission v. Chenery Corporation 318 U.S. 80. In the United Kingdom, the Law Commission, Report No. 236 of 1995, "Fiduciary Duties and Regulatory Rules," *supra.*, (n. 50), as reproduced in See C. Bamford, "Banker / Customer Relationship: Fiduciary Duties And Conflict Of Interest," International Business Lawyer, Vol. 25 No. 2 (February 1997), p. 79, observed that: "Our legal system primarily deals with such conflicts by treating the relationship between the provider and recipient of such services as giving rise to fiduciary duties on the part of the provider and conferring on the recipient rights of action for breach of the obligations imposed on the provider. Broadly speaking, a fiduciary relationship is one in which a person undertakes to act on behalf of or for the benefit of another, often as an intermediary with a discretion or power which affects the interests of the other who depends on the fiduciary for information and advice." Indeed, the Law Commission Report (1995) simply lists down examples of fiduciary duties (*i.e.* the 'no conflict' rule, the 'no profit' rule, the undivided loyalty rule, and the duty of confidentiality rule) without saying crucially the exact scope of the fiduciary's obligations. The report acknowledges only that the consequences of breach vary according to the particular circumstances.

> "It is now generally agreed that the word 'fiduciary' does not of itself identify a single class of relationships, nor can fiduciary duties be reduced to a single set of rules and principles which apply to all such relationships.[52] Before considering liability for breach of fiduciary duty, therefore, it is necessary first to determine whether ... would be regarded as fiduciaries and to whom they are fiduciaries; secondly, it is necessary to consider the particular duty or duties relevant to imposing liability..."[53]

In line with the view that the word 'fiduciary' does not of itself identify a single class of relationships, we look at what judges have said in England, the United States of America and Australia. In the English case of Re Coomber,[54] Fletcher L.J. observed:

> "...Fiduciary relations are of many different types; they extend from the relation of myself to an errand boy who is bound to bring me back my change up to the most intimate and confidential relations which can possibly exist between one party and another where one is wholly in the hands of the other because of his infinite trust in him. All these are cases of fiduciary relations, and the courts have again and again, in cases where there has been a fiduciary relation, interfered and set aside acts which, between persons in a wholly independent position, would have been perfectly valid..."[55]

[52] See L.S. Sealy, Fiduciary Relationships," Cambridge Law Journal, (1962), 69.

[53] B. Hannigan, Insider Dealing, 2nd edition, (London: Longman, 1994), p. 132.

[54] [1911] 1 Ch. 723 at 728.

[55] *Ibid*., at 728.

Similarly, in the American case of Securities Exchange Commission v. Chenery Corporation,[56] Frankfurter J. stated:

> "...to say that a man is a fiduciary only begins the analysis, it gives direction to further enquiry. To whom is he a fiduciary...?"

The courts in Australia have often applied the 'undertaking test' when determining whether or not a fiduciary relationship exists.[57]

> "[A fiduciary] is, simply, someone who undertakes to act for on behalf of another in some particular matter or matters. That undertaking may be of a general character. It may be specific and limited. It is immaterial whether the undertaking is or is not in the form of a contract. It is immaterial that the undertaking is gratuitous. And the undertaking may be officiously assumed without request."[58]

In general, there are two types of fiduciary relationships. The first type is a fact-based fiduciary relationship. The second type relates to status-based fiduciary relationships. In the case of fact-based fiduciary relationships, it is the facts of a given case that determine whether or not a fiduciary relationship has arisen. In the status-based fiduciary relationship, it is mainly the status of the financial intermediary (*e.g.* the professional status of lawyers and accountants towards their clients) that determines whether or not a fiduciary relationship exists. Thus, in

[56] 318 U.S. 80, 85.

[57] See Finn, Fiduciary Obligations (1976), in G. Moffat, Trusts Law: Text and Materials, (London: Butterworths, 1994), p. 548.

both these situations it is clear that where there is a fiduciary relationship the financial intermediary owes his customers fiduciary duties. These duties vary from case to case. As Bamford observes:

> "The kinds of conflicts of interest can be divided into three separate categories, two of which have further sub-divisions:
>
> *Conflict of opportunity*
>
> In commercial life a person will often find himself in a position where his commercial interests offer two opportunities, only one of which can in practice be accepted...
>
> *Conflict of duties*
>
> A second kind of conflict of interests is a conflict between legal obligations. The conflictee finds himself in a position where he has a positive obligation (whether imposed by public law or private law), the performance of which is incompatible with the performance of another such obligation to which he is also subject.
>
> (i) The problem may arise as a conflict between a public duty on the one hand and a private duty (for a example a contractual obligation) on the other...
>
> (ii) The second situation is where there is a conflict between two public law duties, owed to authorities in two different jurisdictions...

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[58] See materials cited in <u>supra</u>., (n. 57).

(iii)... where an institution has a positive obligation to perform a contractual term undertaken in the ordinary course of business, and finds the performance of that obligation will involve a breach of a public law obligation.

(iv) The final kind of conflict between duties is the one which causes most difficulty. This is the situation where there is a conflict between two contractual duties, where an institution has undertaken an obligation to two counterparties, in circumstances where performance of the obligation to one will involve a breach of the contractual obligation owed to the other."[59]

Bamford then addresses the third category, which he calls 'conflict between duty and opportunity', and argues:

"In commercial life it commonly happens that an organisation or individual is presented with a business opportunity, but finds that it has an obligation (whether under private or public law), the performance of which will preclude the opportunity being taken. For example, a bank which is holding a charge over listed securities may have concluded that its interests require that they should be sold in order to repay the loan. However, the terms of the UK Criminal Justice Act 1993 may mean that the bank, as an insider, is under a duty not to deal in those

[59] See C. Bamford, "Banker / Customer Relationship: Fiduciary Duties And Conflict Of Interest," supra., (n. 51), pp. 75-76. *Cf.* generally Law Commission (UK), Report No. 236 of 1995, "Fiduciary Duties and Regulatory Rules," supra., (n. 50). C. Bamford adopts the analogy used by the Law Commission in its 1995 report on fiduciary duties of financial intermediaries.

shares. The resolution of the conflict is simple; the law expects the bank to refrain from taking the opportunity in order to comply with its public law duty."[60]

Following below are examples of some of the important fiduciary duties of financial intermediaries. These duties apply not only to intermediaries on the Lusaka Stock Exchange, but also to intermediaries on the proposed regional stock exchange. In certain cases, however, legislation, treaty obligations, rules of a stock exchange and principles of private international law may alter the common law position.

(a) The duty to obey instructions of the customer:[61]

The common law position is that an intermediary's duty to obey a customer's instructions rests on questions of fact.[62] Generally, this duty applies to intermediaries on the Lusaka Stock Exchange and the regional stock exchange. What is important is to inquire whether or not an intermediary followed his customer's instructions. If the instructions were not clear and the intermediary interpreted them on the basis of the clear part of the instructions then the intermediary did discharge his fiduciary duty to obey the customer's instructions.[63]

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[60] C. Bamford, "Banker / Customer Relationship: Fiduciary Duties And Conflict Of Interest," supra., (n. 51), pp. 76-77.

[61] Mitchell v. Newhall (1846) 15 M & W 308.

[62] See *Ibid.*, (1846) 15 M & W 308.

[63] *Ibid.*, (1846) 15 M & W 308.

(b) The duty to obtain the best price for the customer:[64]

At common law, an intermediary is under a fiduciary duty to obtain *diligently* and *carefully* the best deal available for his customer.[65] A similar position obtains on the regional stock exchange. In the case of Thompson v. Meade,[66] it was held that where a customer gets a broker to buy securities for him at a stipulated price and the intermediary buys at a lower price, and thereafter discloses an inflated price to the client, the broker will receive payment for his services on the basis of the lower price.

Where an intermediary is given *general* authority by the customer to buy or sell securities (at a reasonable market price) the intermediary must act for the customer as he would have acted for himself.[67] Taking the case of Thompson v. Meade as an example, once a reasonably expected market price has been reached and the intermediary delays hoping to get a better price for the securities, equity will deem him to have bought or sold the securities at that 'reasonable' price.[68]

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[64] Thompson v. Meade (1891) 7 TLR 698; Loring v. Davis (1886) 32 Ch 625; COB Rules 1993 rr. 21, 22, 23, 24. See also Office of Fair Trading (UK), Rules of the London Stock Exchange Relating To Market Makers: A Report To The Chancellor Of The Exchequer By The Director General Of Fair Trading Under The Financial Services Act 1986, (London: HMSO, March 1995), p. 25.

[65] See generally materials cited in *supra*., (n. 64).

[66] (1891) 7 TLR 698.

[67] See generally *Ibid*., (1891) 7 TLR 698.

[68] *Ibid*., (1891) 7 TLR 698.

(c) The duty to give the customer's orders priority:[69]

At common law, an intermediary is under a fiduciary duty not to put his interests before those of his customer.[70] Again, this applies to the case of the regional stock exchange. The case of Thompson v. Meade, discussed above, provides a good illustration here. Besides, to obtain a good price for his customer, an intermediary must not engage in insider dealing. We saw in Chapter Six that the Securities Act 1993 prohibits insider dealing.[71] In the case of the regional stock exchange, recommendations on the prohibition of insider dealing were spelt in Chapters Four and Six.

(d) Is there a duty to advise customers on the suitability of securities?[72]

Generally, the position at common law is that there is no duty on an intermediary to advise customers on the suitability of investing in particular securities on the market. In Zambia, however, where an 'investment adviser'[73] is asked by a customer to provide investment advice and the intermediary agrees to provide that advice, he or she must provide *competent* and *honest* advice.[74] At the regional level, it could be argued that the common law position on the suitability of securities applies to dealings on the regional stock exchange.

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[69] Thompson v. Meade (1891) 7 TLR 698; Loring v. Davis (1886) 32 Ch 625.

[70] See cases cited in *supra*., (n. 69)

[71] Securities Exchange Act 1993, sec. 52.

[72] Stafford v. Conti Commodity Services Ltd. [1981] 1 All ER. 691.; R.H. Deacon & Co. Ltd. v. Varga [1973] 30 DLR 3d 653; COB Rules 1993, r.18.

[73] Securities Act 1993, sec. 19.

[74] On the licensing of investment advisers in Zambia and on the functions of these advisers, see above.

(e) The duty to keep customers' orders in confidence and with care:[75]

At common law an intermediary owes his customer a duty of confidentiality.[76] However, the information being guarded must have the necessary quality of confidence to merit protection. By contrast, if the information is 'public property and public knowledge', no duty of confidence arises.[77] In Zambia, this fiduciary duty is reinforced by rule 33 of the COB Rules. By parity of reasoning, a similar analogy could be extended to the legal framework governing public distribution of securities on the regional stock exchange.

In general, an action for breach of confidentiality may be based on some express or implied contractual obligation,[78] or on 'a broad principle of equity that he who has received information in confidence shall not take unfair advantage of it.'[79] At common law, in determining whether or not a fiduciary ought to have known of the obligation of confidence, the courts[80] have applied the reasonable man test spelt out by Meggary J in Coco v. AN Clark (Eng) Ltd:

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[75] See Standard Investments v. CIBC [1985] 22 DLR (4th) 410, noted (1987) 12 Can. Bus. Law Journal 96, 21. See also COB Rules, r.33.

[76] Standard Investments v. CIBC in *Ibid*.

[77] *Per* Lord Greene MR in Saltman Engineering Co. Ltd. v. Campbell Engineering Ltd. [1963] 3 All E.R. 413 at 415. See also Mustad & Sons v. S Allcock & Co. Ltd and Dosen [1963] 3 all E.R. 416.

[78] Thomas Marshall (Exporters) Ltd v. Guinle [1978] 3 All E.R. 193; Lamb v. Evans [1893] 1 Ch 218.

[79] *Per* Lord Denning MR, Seager v. Copydex Ltd [1967] 2 All ER 415, at 417. See also Saltman Engineering Co. Ltd. v. Campbell Engineering Ltd. [1963] 3 All E.R. 413 at 414, *per* Lord Greene MR; Argyll v. Argyll [1967] Ch 302; Coco v. A N Clark (Eng) Ltd [1969] RPC 41; Schering Chemicals Ltd v. Falkman Ltd [1981] 2 All E.R. 321; Attorney General v. Guardian Newspapers Ltd (No. 2) [1988] 3 All E.R. 545.

[80] See generally cases cited in *supra*., (n. 79).

"It seems to me that if the circumstances are such that a reasonable man standing in the shoes of the recipient of the information would have realised that upon reasonable grounds the information was being given to him in confidence, then this should suffice to impose upon him the equitable obligation of confidence. In particular where information of commercial or industrial value is given on a business-like basis and with some avowed common object in mind... I would regard the recipient as carrying a heavy burden if he seeks to repel a contention that he was bound by an obligation of confidence."[81]

As a general rule, an intermediary must keep orders of his customer in confidence and with care. In Indata Equipment Supplies Ltd. (trading as Autofleet) v. ACL Ltd.[82] Lord Justice Simon Brown, Lord Justice Otton and Mr. Justice Owen held that when a finance house with whom a broker was arranging finance for a client used confidential information provided by the broker as the basis for making an agreement directly with the client, thus cutting out the broker, the mere fact of the receipt of confidential information did not create a fiduciary relationship between the finance house and the broker so as to give rise to fiduciary obligations. However, a blatant disregard for what should be commercial ethics and practice in the misuse of confidential information did amount to a breach of the equitable doctrine of confidence, and could also constitute the tort of unlawful interference with business. Arguments on the distinction of fiduciary obligations from the equitable doctrine of confidence are of little relevance here. Suffice it to say that the court further ruled that where parties enter into contractual relations at arm's length and understand what they are agreeing

[81] [1969] RPC 41 at p. 47.

[82] Reported in the Times Newspaper, (Court of Appeal), Thursday 14th August 1997, p. 28.

to, there is little scope for the law to add the extra dimension of fiduciary duties to the relationship which they have selected.[83]

By contrast, where the intermediary is an organisation and one of its departments is influencing the other departments by providing them with information on a customer trading in competition with customers of the other departments, the transmission of information could prejudice the first customer. Indeed, this would bring into play the concept of attribution of knowledge. In Kelly v. Cooper,[84] an intermediary acted for both the buyer and the seller. It was held that where the nature of the intermediary's business is such that he deals with various parties in competition with each other, on either side of the buyer or seller, then the nature of the contracts between the intermediary and these customers respectively would determine whether or not there is a fiduciary duty to disclose instructions of one customer to the other. To overcome such problems, Chinese walls have been advocated by many commentators as a way of segregating information of customers.[85] Even

[83] See Times Newspaper, Thursday 14th August 1997, *per* Lord Justice Otton, at p. 28. The relationship of broker to finance house was held not to fall within the established categories already recognised by the law. The parties were at all times at arm's length in the market. See also Clark Boyce v. Mouat [1994] 1 A.C. 428.

[84] [1992] 3 WLR. 936; see also Target Holdings Ltd. v. Redferns [1995] 3 WLR 352; Mortgage Express Ltd. v. Bowerman and Partners [1995] EGCS 129; Halifax Mortgage Services Ltd. v. Stepsky [1995] 3 WLR 701; A. Alcock, "Kelly v. Cooper - a timely decision," 14(7), Company Lawyer, (1994), 134-136.

[85] See Lipton and Mazur, "The Chinese Wall: A Reply to Chazen" 51 NYULR (1976), 579; Lipton and Mazur, "The Chinese Wall Solution to the Conflict Problems of Securities Firms," 50 NYULR (1975), 459; Chazen, "Reinforcing the Chinese Walls: A Response," 51 NYULR (1976), 552. According to the Law Commission (UK), Report No. 236 of 1995, "Fiduciary Duties and Regulatory Rules," *supra*., (n. 50), p. 97: "Chinese walls are broadly 'procedures for restricting flows of

so, the law courts have usually taken the view that Chinese walls do not afford a solution to the problem of attribution of knowledge.[86] A similar view has been advanced by the Law Commission in England. Addressing the position of law firms in England, the Law Commission observes:

> "...Chinese wall has not been seen as providing satisfactory protection for interests of the former client and, despite the existence of a wall, the courts have required the law firms not to act on behalf of the new client..."[87]

By contrast, the regulatory rules set by the Securities and Investment Board (SIB) in the United Kingdom are underscored by the view that Chinese walls do provide effective segregation of information in certain instances.[88] As Bamford observes:

> "The SIB (Securities and Investment Board) rules however recognise that the different divisions of an integrated securities house may well find themselves in such a position. The rules therefore permit the house to continue to act in these situations subject to the imposition of 'Chinese walls' which effectively prevent the transfer of contaminating information from one department to another. However, the legal rules dealing with the imputation of knowledge within companies might well have

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information within a firm to ensure that information which is confidential to one department is not improperly communicated (and this includes inadvertent communication) to any other department within the conglomerate'."

[86] Re a Solicitor [1992] 1 All ER. 353; Slade v. Shearson Hammill & Co. (1974) 517 F. 2d 398.
[87] See Law Commission (UK), Consultation Paper No. 124, "Fiduciary Duties And Regulatory Rules," *supra*., (n. 50), p.144; For a contrary, but less persuasive view, see Supasave Retail Ltd. v. Coward Chance [1991] 1 All ER. 668.

[88] See for example SIB Core Rule 36.

the effect of ignoring the existence of the Chinese wall arrangement and produce the result that a securities house was in breach of its contractual obligation to its client even though the individuals within the securities house were unaware that the company was performing an act which amounted to a breach of contract with one of its clients."[89]

In contrast to the viewpoint of the Securities and Investment Board, the Law Commission, in its 1995 report, observes:

> "a Chinese wall would not prevent the attribution of knowledge between the component parts of a company (although it might do so as between different companies which form part of a group)... unless appropriate provision is made in the contract between firm and customer, a Chinese wall cannot in all cases be relied upon, as a matter of private law, to limit the fiduciary duties the firm owes to the customer."[90]

In the case of large partnerships, such as big law firms and big accounting firms in Zambia, attribution of knowledge to partners would not be easy to prove. By contrast, the case of group trading companies provides a relatively straight forward case. Without proof of fraud or other factors that lead to the lifting of the corporate veil, attribution of knowledge to subsidiaries in a

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[89] C. Bamford, , "Banker / Customer Relationship: Fiduciary Duties And Conflict Of Interest," *supra*., (n. 51), p. 78; see also Meridian Global Funds Management Asia Ltd. v. Securities Commission [1995] 2 A.C. 400.

[90] Law Commission (UK), Report No. 236 of 1995, "Fiduciary Duties and Regulatory Rules," *supra*., (n. 50), p. 97.

group or to the parent would flout the legal personality of these companies.[91] Commenting on instances when the corporate veil can be lifted, Prentice observes:

> "...There is a likelihood that the court will pierce the corporate veil in a parent-subsidiary situation were:
>
> (a) the subsidiary is grossly under-capitalised,
>
> (b) the affairs of the parent and the subsidiary are commingled, or
>
> (c) the subsidiary is set up to enable the parent to perpetrate a fraud, although as regards this aspect of the rule the desire to limit liability does not constitute fraud."[92]

Thus, for group companies attribution of knowledge could occur mainly where the corporate veil has been lifted. At the regional level, different trading customs recognised widely in various national jurisdictions could require non-disclosure or full disclosure to be made to the affected customers by the intermediary concerned. To resolve this problem, the proposed regional investment code must include guidelines on how such an issue can be addressed.

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[91] Adams v. Cape Industries Plc. [1990] 2 WLR. 657.

[92] D.D. Prentice, "Group Indebtedness," in C.M. Schmitthoff and F. Wooldridge (ed.), Groups of Companies, (London: Sweet and Maxwell, 1991), pp. 55-80 at p.77.

(f) Lumping of customers' orders:[93]

Lumping of customers' orders normally occurs where an intermediary sells securities of different customers together.[94] Seldom does lumping occur where an intermediary sells different securities of one and the same customer that were meant to be sold separately. The reason for this is that the second case is covered under the duty to obey a customer's instructions.[95]

In Zambia, whenever intermediaries decide to lump orders of customers together they must first inform their customers about the decision to lump orders together before they undertake the actual market transaction.[96] The customers must agree to this lumping of orders. If the customers do not agree or if they are not informed, lumping of orders could result in breach of fiduciary duties by the intermediary.[97] Generally, the lumping of orders does reduce transaction costs.

At the regional level, the regional investment code must set out guidelines to govern transactions relating to lumping of customer's orders. This would be useful in the case of multiple listings and cross-border trade in securities and also with regard to dealings on the regional sock exchange. Where municipal law of one state permits the lumping of customers' orders (*e.g.* the law of the state to which one customer belongs) and the law of another state does not (*e.g.* the law of the

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[93] Scott & Horton v. Godfray [1901] 2 KB. 726; Beckhusen v. Hamblet [1900] 69 LJQB 431; COB Rules 1993, Statements of Principle 4.

[94] See materials cited in *supra*., (n. 93).

[95] This duty has already been discussed above.

[96] See COB Rules 1993, Statements of Principle 4. See also Scott & Horton v. Godfray [1901] 2 KB. 726; Beckhusen v. Hamblet [1900] 69 LJQB 431.

[97] See materials cited in *supra*., (n. 96).

state of the other customer or to which the intermediary belongs), regulations of the common investment code must prevail.

(g) Marrying of customers' orders:[98]

Marrying of customers' orders arises when an intermediary acts in a 'dual' capacity linking the buyer to the seller, and vice versa.[99] In such a situation, the intermediary finds himself co-ordinating interests of both the seller and the buyer. However, although the intermediary has a fiduciary duty to get the best price for his customers,[100] he cannot determine the price of the securities. The intermediary's role is simply one of acting with diligence to get the best price for both customers. This entails that the intermediary must obtain the lowest price for the buyer and the highest price for the seller. Here, a conflict of interests inevitably arises. How does the intermediary resolve this issue?

Again, we propose that the regional investment code must provide guidelines to resolve this matter where trading takes place on the regional stock exchange or it involves multiple listings and cross-border transactions. At common law, the position of an intermediary acting for both the buyer and the seller could give rise to a fiduciary duty on the intermediary to disclose his double-commission position to both parties.[101] Here, we are faced with the situation of a fact-based fiduciary duty. On

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[98] Jones v. Canavan [1972] 2 NSWLR 236.

[99] See *Ibid.*, p. 236.

[100] See above.

[101] Kelly v. Cooper [1992] 3 WLR. 936, establishes that the nature of an intermediary's business and the contract he enters can determine whether or not there is a duty to disclose.

the other hand, to avoid breaching any fiduciary duties, an intermediary who decides not to disclose his double-commission position would have to rely on a reasonable and well established custom. This custom must show that there is no obligation on the intermediary to disclose to either the seller or the buyer that he is acting on behalf of both parties. Also, regulations of a stock exchange, on whose market the intermediary is trading, might require the intermediary to make the disclosure.

(h) The duty to be loyal to customers:

This fiduciary duty is closely linked to the fiduciary duty to obey customers' instructions. We have already examined the fiduciary duty to obey customers' instructions.[102] At common law, an intermediary owes a fiduciary duty of loyalty to his customers.[103] This duty entails that the intermediary must not favour one customer over the other whenever he is acting in a dual capacity. A similar analogy could be extended to dealings on the regional stock exchange.

(i) The duty not to engage in churning and switching of securities:[104]

At common law, intermediaries are under a fiduciary duty not to engage in churning and switching of securities.[105] In Zambia, this fiduciary duty is reinforced by legislation under rule 27 of the COB Rules. The duty not to engage in churning and switching of securities is illustrated in the American

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[102] See above.

[103] *cf.* Kelly v. Cooper; Fullwood v. Hurley [1928] 1 KB. 498; Re A Debtor [1927] 2 Ch. 367; North & South Trust Co. v. Berkeley [1971] 1 All ER. 980.

[104] COB Rules 1993, r.27

[105] Norris & Hirschberg v. Securities & Exchange Commission 177 F 2d 228 [1949].

case of Norris & Hirschberg v. Securities & Exchange Commission.[106] In that case, it was held that where a corporation engaged in business as a securities broker and dealer, which had complete confidence of its customers, personally sold unlisted stocks to its customers and bought the stocks from its customers, without disclosing to the customers the true capacity in which it was acting and with considerable profit to itself, the Securities Commission properly revoked the corporation's registration because of the corporation's fraudulent behaviour.

In Eastern and Southern Africa, at the regional level, the fiduciary duty not to engage in churning and switching of securities must be codified in the common investment code.

(j) The duty not to engage in scalping:[107]

Scalping is a form of market abuse which involves financial intermediaries recommending to investors to purchase securities on a securities market so that the price of these securities goes up. Generally, scalping is used by intermediaries when they want to push the prices of securities up. This form of market abuse enables the intermediary to get higher commissions from the customer selling the securities.

At common law, there is a fiduciary duty on financial intermediaries not to engage in scalping. A similar rule must be provided for in the regional investment code to control possible malpractice by intermediaries on the regional stock exchange.

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[106] *Ibid.*, 177 F 2d 228 [1949].

[107] SEC v. Capital Gains Research Bureau Inc. 375 US 180 [1963]; Gillet v. Peppercone [1840] 3 Beav 78; Zweig v. Hearst Corp 594 F 2d 1261 [1979].

(k) The duty not to engage in excessive charging and mark-up:[108]

At common law, where an intermediary sells securities and retains the balance of the price without disclosing to the seller that he has made an 'unfair' gain he would be required to disgorge.[109] In Zambia, this duty, like most of the fiduciary duties discussed above, is reinforced by legislation.[110] At the regional level, a similar approach must be taken to codify the fiduciary in the regional investment code. An example of the fiduciary duty not to engage in excessive charging and mark-up follows below.

Example 1:

> X, an authorised financial intermediary, is approached by Zambia Hungry Co. Ltd. This company would like to sell some of its shares to the public. The shares are already listed on the Lusaka Stock Exchange and X has customers who are interested in the shares. The price of the shares is communicated by the seller to X. However, when X approaches the prospective buyers he decides to inflate the price of the shares three times the stipulated price. The securities are now sold at the inflated price and X wants to hold on to the mark-up price. Zambia Hungry Co. Ltd. have already been paid the full amount of the price they had asked for.

Is this sort of dealing by X permissible at common law? Or, is X under any fiduciary obligation to desist from such behaviour? Alternatively, could it be argued that X is simply a lucky gambler? At

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[108] Nicholson v. Mansfield [1901] 17 TLR 259; Lucifero v. Castel [1887] 3 TLR 371; Stange & Co. v. Lowitz [1898] 14 TLR 468; Charles Hughes & Co. Inc. v. SEC 139 F 2d 434 [1943].

[109] See generally materials cited in *supra*., (n. 108).

[110] COB Rules 1993, r.19.

common law, an intermediary is under a fiduciary duty to disclose to the seller the mark-up price for the securities.[111] Apart from seeking consent from the customer to retain the mark-up earnings, the intermediary can be permitted to retain the mark-up earnings if the amount is not unreasonable or if he or she can show that he/she relied on a well established custom within the trade.[112] Similar views must be enshrined in the regional investment code.

(l) The duty not to engage in making secret profits: [113]

At common law, an intermediary is under fiduciary obligations to desist from making secret profits. Similarly, we propose that the regional investment code must provide for such a rule. In Bray v. Ford,[114] Lord Herschell held that:

> "It is an inflexible rule of a court of equity that a person in a fiduciary position... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict."[115]

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[111] See above.

[112] Similar arguments on using an established custom as a defence are advanced above.

[113] Turnbull v. Garden [1869] 20 LT 218; Williams v. Barton [1927] 2 Ch. 9.

[114] [1896] A.C. 44. See also Keech v. Sandford (1726) Sel Cas Ch 61; Ex parte James (1803) 8 Ves 337; Parker v. McKeena (1874) L.R. 10 Ch 96; Imperial Mercantile Credit Association v. Colemen (1871) L.R. 6 Ch App 558.

[115] [1896] A.C. 44 at 51. Although the no-profit rule was originally regarded as an aspect of the no-conflict rule, it is now well established as a separate rule in its own right. The distinction between the two rules is, however, not always clearly spelt out in the cases.

This fiduciary duty includes aspects of the duty not to engage in excessive charging and mark-up. Where intermediaries make secret profits from mark-ups they will be liable to account to the customer under whose instructions they are acting. The liability to account is not diminished by the mere fact that the intermediary acted *bona fide* throughout the transaction. As Lord Russell observes in Regal (Hastings) Ltd v. Gulliver[116]:

> "The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of *bona fides*; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the said circumstances, been made. The profiteer, however honest and well intentioned, cannot escape the risk of being called upon to account."[117]

(m) Duty not to hold out as actual seller or buyer (self-dealing):[118]

At common law, an agent who is employed to execute a transaction on behalf of a customer must not hold himself out as the principal.[119] There are, however, some exceptions to this view. The first exception is that intermediaries can deal as principals on a securities or stock market as long as they establish that they are relying on a widely recognised custom which indicates that intermediaries must be treated as principals. Such a custom could be seen where the law permits blanket

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[116] [1942] 1 All E.R. 378.

[117] [1942] 1 All E.R. 378 at p. 386.

[118] Armstrong v. Jackson [1917] 2 KB. 822; Solloway v. Mclaughlin [1938] AC. 247.

[119] See generally cases cited in *supra*., (n. 118).

disclosures that an intermediary must always be seen as a principal. Blanket disclosures provide an important exception to the duty on financial intermediaries to desist from engaging in self-dealing. Where no such custom exists, to avoid breaching the duty to desist from self-dealing, intermediaries must continue disclosing that they have authority to act as principals and are acting as such. Indeed, this view also applies to intermediaries trading on the regional stock exchange.

The second exception to the duty not to engage in self-dealing is found where legislation or regulations of a securities exchange provide that intermediaries are to be treated as principals on the market.[120] However, as noted above, both the dealers and stockbrokers continue to retain fiduciary duties to their customers. By parity of reasoning, intermediaries transacting as principals on the regional stock exchange would also continue to hold fiduciary obligations towards their customers.

(n) The duty to maintain proper records of accounts:[121]

At common law, there is a duty on financial intermediaries to keep properly audited books of accounts. We saw earlier on in this chapter that in Zambia although this fiduciary duty has been reinforced by legislation,[122] intermediaries have generally not abided by the law. Breach of the

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[120] *Cf.* the position in the United Kingdom where intermediaries are treated as principals on the market. See Office of Fair Trading, Financial Services Act 1986: Trade Publication And Price Transparency On The International Stock Exchange: A Report By The Director General Of Fair Trading To The Secretary Of State For Trade and Industry, (London: HMSO, April 1990), p. 18: "Brokers/dealers may trade directly in equities either as principals on their own account or by 'matching' buy and sell orders of their own customers."

[121] Clarke v. Tipping [1846] 9 Beav 284; Lord Chedworth v. Edwards [1802] 8 Ves. 46.

[122] See Securities Act 1993, secs. 24(3)(j) and 45.

statutory obligation to maintain proper records of accounts constitutes a criminal offence.[123] Under trusts law, culpable or innocent depletion of clients' assets by an intermediary (and/or any constructive trustee) could attract equitable remedies.[124] In Zambia, the Compensation Fund can also provide compensation to parties prejudiced by the conduct of intermediaries.[125]

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[123] See *Ibid.*, sec. 45(3).

[124] For a detailed reading, see G. Moffat, Trusts Law: Text and Materials, (London: Butterworths, 1994), pp. 575-583; *Cf.* Royal Brunei Airlines Sdn Bhd v. Tan [1995] 2 A.C. 378 and Brinks Limited v. Abu-Saleh & Others [1995] 1 WLR 1478. In Brinks Limited, the defendant was a lady who had accompanied her husband on trips to Zurich, during which he laundered funds handed to him by a friend. The source of the funds was the theft, several years before, of gold bullion under the custody of Brinks Limited. The theft had occurred because a security guard had assisted robbers to gain entry to the premises he was guarding. The argument in the case was that the lady concerned was liable to Brinks Limited as a constructive trustee, following the principles laid down in Royal Brunei Airlines. The argument was that she had behaved dishonestly, and that her behaviour had assisted a breach of trust. The claim failed, on the basis that her presence on trips with her husband did not provide assistance in any relevant manner. See also P. Todd, Textbook On Trusts, (London: Blackstone 1991), pp. 360-390; S. Gardner, The Law Of Trusts, (Oxford: Clarendon Press, 1996), pp. 226-234; D.J. Hayton, The Law of Trusts, (London: Sweet and Maxwell, 1989), pp. 16-20 and 124-129; D. J. Hayton, Cases and Commentary On The Law Of Trusts, (London: Stevens and Sons, 1975), pp. 351-385; E.H. Burn, Trusts And Trustees Cases And Materials, (London: Butterworths, 1996), pp. 249-250; and J.G Riddall, The Law Of Trusts, (London: Butterwoths, 1996), pp. 434-439.

[125] See Securities Act 1993, Part IX.

7.5. THE COMPENSATION FUND:

Apart from the possibility of getting remedies in equity for the trustee's breach of trust,[126] a party prejudiced by the default of an intermediary is now given statutory protection by provisions of the Securities Act 1993 relating to the Compensation Fund. Under the Securities Act 1993, the Minister has power to establish and maintain a Compensation Fund.[127] The purpose of the Fund is to operate in line with such terms and conditions as the Minister may determine for the purpose of compensating persons who suffer pecuniary loss occasioned by any default of a licensed dealer or licensed investment adviser, or any employee of such dealer or advisor.[128] At the regional level, the regional investment code must empower the competent authority to set up such a fund. In claiming compensation, the prejudiced party must show that the loss he or she has suffered relates to money, securities, or other property which was entrusted to or received by the financial intermediary in the ordinary course of the intermediary's business.[129]

Some Constraints On The Rules Governing Compensation in Zambia:

Under the Securities Act 1993, victims of insider dealing could also ask for compensation from the Compensation Fund if they can prove that the financial intermediary who has been convicted of insider dealing is the person who, by that dealing, caused their loss. However, due to poor drafting

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[126] See Space Investments v. Canadian Imperial Bank [1986] 3 All ER 75; Clayton's Case [1816] 1 Mer 572; Re Montagu [1992] 4 All ER 308; Eagle Trust v. SBC [1992] 4 All ER 488.

[127] Securities Act 1993, sec. 64. See also Securities (Compensation Fund) Regulations 1993.

[128] Securities Act 1993, sec. 67.

[129] *Ibid.*, sec. 67.

of the Securities Act 1993, the Act does not spell out the criteria for setting the level of compensation. Ideally, compensation could be based either on tort liability or on contractual liability. Commenting on a similar position in the United Kingdom, Davies observes:

> "To be assessed presumably on the tort measure, *i.e.* to restore the claimant to his or her former position."[130]

We propose, by contrast, that compensation should be based on the contractual measure. In our view, the contractual basis is a better way to determine compensation of prejudiced investors. In contrast to the tort basis, the contractual basis does not require the prejudiced party to establish that there was a duty of care owed to him by the intermediary and that the duty was breached by the intermediary, thereby resulting in loss suffered by the plaintiff.[131]

Funding Of The Compensation Fund:

Funding of the Compensation Fund is done from, *inter alia*, moneys collected from financial intermediaries when the intermediaries are applying for licences.[132] Other sources of finance for the Compensation Fund include damages awarded to the Compensation Fund in any right of action

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[130] P. Davies, Gower's Principles of Modern Company Law, 6th edition, (London: Sweet and Maxwell Ltd.), p. 429. See also Clark v. Urquart [1930] A.C. 28, H.L. It is unclear whether the plaintiff will always be limited to the difference between the price paid and the value of the securities at the date of acquisition: *cf.* Smith New Court Securities Ltd. v. Scrimgeour Vickers (Asset Management) Ltd. [1996] 4 All E.R. 769, H.L. (a case of fraud).

[131] See D. Harris, Remedies in Contract And Tort, (London: Weidenfeld and Nicholson, 1988), pp. 39-50, 94-104, 189-192.

[132] Securities Act 1993, secs. 66 and 67.

against a defaulting party.[133] Here, the Fund first pays the party prejudiced by the intermediary's default and then recovers its own litigation costs from the surplus moneys.[134]

7.6. PROPOSALS TO STRENGTHEN FIDUCIARY DUTIES OF INTERMEDIARIES:

As a general rule financial intermediaries cannot provide for a clause in a contract to exempt them from liability for gross negligence or fraud.[135] Such a clause would operate against public policy and would therefore be struck down by a court of law as being invalid.[136] By parity of reasoning, financial intermediaries cannot provide for a clause in a contract to exempt them from liability for breach of fiduciary duties.[137] At common law, the *contra proferentum* rule applies to fundamental breach relating to exclusion clauses in contracts.[138] The principle of construction *contra proferentum* means that the exemption clause is construed against the party at whose instigation the

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[133] *Ibid.*, sec. 66.

[134] *Ibid.*, secs. 66 and 67.

[135] For a detailed reading, see G.H. Trietel, The Law Of Contract, (London: Sweet and Maxwell, 1995), pp. 202-204, 223-224. Also, on exclusion of liability for fraud, see Walker v. Boyle [1982] 1 W.L.R. 495; *cf.* Schneider v. Heath (1813) 3 Camp. 506 and Re Englefield Holdings [1962] 1 W.L.R. 1119.

[136] See S. Pearson & Sons Ltd. v. Dublin Corporation [1907] A.C. 351, 352, 362; *cf.* Garden Neptune Shipping Ltd. v. Occidental Worldwide Investment Corp. [1990] 1 Lloyd's Rep. 330, 335.

[137] Gluckstein v. Barnes [1900] A.C. 240. See also G.H. Trietel, The Law Of Contract, *supra.*, (n. 135), p. 223.

[138] Re Dorman Long & Co. Ltd. [1934] Ch 635 at 670- 671.

clause was included in the contract and who now seeks to rely on it.[139] However, what happens where a laxer rule made by the stock exchange attempts to release a fiduciary from the common law obligation? We submit that in such a case the common law must prevail. The same analogy must be extended to rules of the regional stock exchange.

Generally, where legislation governing duties of financial intermediaries releases the intermediary from a common law obligation, legislation must take precedence over the common law duty.[140] In a similar manner, provisions of the regional investment code must prevail over the common law and over matters of a customary law nature.

Where intermediaries deal in securities on a securities exchange they must comply with regulations of that exchange. Where the Securities and Exchange Commission has set regulations to be met by financial intermediaries,[141] and these regulations attempt to release the fiduciary from a common law obligation, two possible situations must be envisaged. First, if the regulations passed by the Securities and Exchange Commission are subsidiary legislation (or treaty obligations in the case of a regional stock exchange), understandably, the regulations must prevail over the fiduciary duty. Secondly, if the regulations are not subsidiary legislation, but contractual rules, then the fiduciary

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[139] In the present context, this view necessarily points to the same party, even though in other contexts this may not be the case: see Youell v. Bland Welch & Co. Ltd. [1992] 2 Lloyd's Rep. 127, 134.

[140] Law Commission (UK), Consultation Paper No. 124, "Fiduciary Duties and Regulatory Rules," *supra.*, (n. 50), pp. 61-162, 217-231.

[141] For example COB Rules 1993. These rules provide for duties such as impartiality, disclosure of interest in securities, fair and true statements in advertisements of securities, and prohibition of inducements *etc.*

duty must prevail. In Zambia, almost all of the rules made by the Securities and Exchange Commission are subsidiary legislation.[142]

Where professional bodies and self-regulatory organisations make rules to regulate their members and it occurs that these rules do not meet the standard of the common law on fiduciary duties of intermediaries, the common law must prevail. To a large extent, implementation of such proposals would provide incentives for financial intermediaries to act diligently. Intermediaries would have to ensure that they not only satisfy the rules of regulatory bodies, but that they also meet the standards of the common law on fiduciary duties.

[142] See for example The Securities (Registration of Securities) (Investment Companies) Rules, 1993 (*i.e.* Statutory Instrument No. 38 of 1993).

II. COLLECTIVE INVESTMENT SCHEMES AND THE SPREADING OF INVESTMENT RISK[143]

We saw in Chapter Three that empirical evidence suggests that there is an urgent need to have collective investment schemes participate on the Lusaka Stock Exchange so that constraints such as inadequate liquidity on the market are overcome. We saw, too, that collective investment schemes provide an important mechanism through which domestic and small investors can participate on the stock market. At the regional level, it has already been established in Chapter Four that COMESA views the setting up of financial institutions such as the COMESA Investment Fund, COMESA Unit Trusts and other schemes as important mechanisms to enable direct private equity investments to take place in the region. Overall, it is clear that the expected contribution of collective investment schemes to the development of competitive capital markets in the region cannot be underestimated. We submit, therefore, that the discussion in this section, on the legal framework in Zambia, must also be taken as a helpful guide on which the development of a regional framework on collective investment schemes can be based.

In Zambia, the Securities Act 1993 defines a collective investment scheme as:

> "...any arrangements with respect to money or other property of any description, under which -

[143] See generally the Securities and Exchange Commission Code on Collective Investment Schemes 1993. *Cf.* the UK Financial Services Act 1986, Chapter VIII.

(a) provision is made for other persons taking part in the arrangements to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income;..."[144]

The Act provides for the establishment of three types of collective investment schemes in Zambia.[145] The first type relates to schemes whose property is owned by 'investment companies'. The second type relates to schemes administered as unit trusts. The third type of scheme relates to schemes operated by 'open-ended investment companies'. There is a fourth scheme, the bond scheme, provided for by the Securities and Exchange Commission Code on Collective Investment Schemes. Rule 2.1 of that Code describes 'bond schemes' as schemes with the primary object of investing in debt securities having remaining maturity periods of one year or more. These schemes are not provided for in the Securities Act 1993. In contrast to collective investment schemes provided for in the Securities Act 1993, bond schemes have restrictions on products in which to invest. Furthermore paragraph 13 of the schedule to rules 4 to 7 of the Code establishes 'self-managed schemes' which are to be managed by their own board of directors, performing functions of a management company. These schemes are also not covered in the Securities Act 1993. Generally in the case of schemes provided for under the Securities Act 1993 these are to be administered by bodies corporate called 'operators' of the scheme.[146] The Act

[144] Securities Act 1993, sec. 72(a).

[145] See *Ibid*., sec. 72.

[146] *Ibid*., sec. 72; See also rule 3.1 of the SEC Code on collective investment schemes.

spells out that persons who can apply for an intermediary's licence include trustees of unit trusts, operators of collective investment schemes, and any other person not prohibited by law.[147]

7.7. REGULATING COLLECTIVE INVESTMENT SCHEMES:

The Securities and Exchange Commission has power to authorise the establishment of collective investment schemes in Zambia.[148] The Commission also regulates the conduct of business of collective investment schemes.[149] At the regional level, the common investment code must include provisions empowering the regional competent authority to authorise COMESA unit trusts and other collective investment schemes. In principle, there would be two ways in which collective investment schemes could get authorised under the common investment code. The first way would be for the regional competent authority to authorise collective investment schemes set up by COMESA. The second manner would be to authorise schemes from Eastern and Southern Africa and from other foreign states so that these schemes can also participate on the regional stock exchange.

Some Empirical Evidence On Constraints Affecting the Zambian Legal Framework:

Under Zambia's Securities Act 1993, it is a criminal offence to advise, invite and procure any persons to participate or advertise anything in relation to collective investment schemes without the

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[147] See Securities Act 1993, secs. 18 and 21. For grounds on which a prospective applicant is disqualified from applying for an intermediary's licence, see above.

[148] Securities Act 1993, sec. 73.

[149] *Ibid.*, sec. 73.

authority of the Securities and Exchanges Commission.[150] Similar provisions must be spelt out in the regional investment code. Constraints affecting the Zambian legal framework include evidence showing that institutions such as Manifold Global Fund have been operating collective investment schemes for some time without obtaining authorisation from the Securities and Exchanges Commission.[151] By December 1996, the Commission had not taken any legal action against Manifold Global Fund to stop Manifold from operating a collective investment scheme illegally.[152]

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[150] Securities Act 1993, sec. 74; Securities (Transitional) Rules 1993, r.3. There is evidence of one such scheme and the Securities and Exchange Commission is considering instituting criminal proceedings against the managers of that collective investment scheme. See below.

[151] See *Interview* with Mr. Mumba Kapumpa, Chief Executive, Securities and Exchange Commission, Lusaka, 18th December 1996, (Appendix C, question 10): "Manifold Global Fund, although it was the very first collective investment scheme created in this country, it has never been brought on to the market because for some reasons the managers and organisers of that particular fund don't seem to have faith in the capital market that we are developing. They have entirely refused and in fact any time now there is likely to be a court case where I am bringing them to court because they are operating illegally." See also *Interview* with Mr. Nduba Namoonde, Stockbroker and Chief Executive, Finance Securities Ltd., Lusaka, 20th December 1996, (Appendix B, question 13): "...I would like to take this privilege to comment on another collective investment scheme in Zambia called Manifold Global Fund. It's unheard of... just this morning I had a client who came to ask whether they still existed. I mean, you might even see a shareholder who doesn't know that where she has put money, you know... the institution is still in existence or it has gone under. The Securities and Exchange Commission has tried to ask Mr. Chabi, the owner of whatever...Manifold Global, to come to the fore so that ..you know... he falls under the existing regulations, but they have not received any co-operation." (Efforts to reach Manifold Global Fund for their views were futile).

[152] See explanations in supra., (n. 151).

At that time, the Securities and Exchange Commission was contemplating to instigate legal proceedings against Manifold Global Fund.[153]

The Legal Nature Of Unit Trusts:

In countries such as South Africa, collective investment schemes are generally referred to as unit trusts.[154] Generally, the underlying principle behind the concept of unit trusts is the same in many countries. Trustees purchase holdings in a large number of companies and then invite members of the public to purchase units in the trust fund.[155] Unit trusts are therefore seen as a common means by which individual investors indirectly trade in securities on a securities or stock market.[156] In the United Kingdom, there is a marked difference between unit trusts and other forms of collective investment schemes such as investment trusts.[157] Many investment trusts under English law are

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[153] As in supra., (n. 152). It is somewhat unclear why the Securities and Exchange Commission did not appoint an investigating officer to inspect books of accounts and other documents relating to Manifold Global Fund. Indeed, the Commission has statutory powers to do so under the Securities Act 1993. Section 76 of Securities Act 1993 provides that it is an offence to obstruct the Securities and Exchange Commission or a public officer appointed under the Act from exercising any of his statutory duties. On powers of the investigating officer to inspect books of accounts relating to the intermediary's business, see above.

[154] See Unit Trust Control Act of South Africa, No. 54 of 1986, sec. 1. See also Stock Exchanges Control Act of South Africa, No. 1 of 1985, sec. 17(4) and 16(a)(b).

[155] See D. Parker and A. Mellows, The Modern Law of Trusts, (London: Sweet and Maxwell, 1983), p. 3.

[156] For example in the United Kingdom, in South Africa and in Hong Kong.

[157] See A.C. Page and R.B. Ferguson, Investor Protection, (London: Weidenfeild & Nicholson, 1992), p.300; See also Financial Services Act 1986 (Restriction of Scope of Act and Meaning of Collective Investment Scheme) Order 1988, (SI 1988 No. 803), which amends the Financial Services Act 1986,

closed-ended investment companies.[158] They do not generally engage in open-ended investment.[159] By contrast, unit trusts, as open-ended investment institutions, can easily invest in various portfolio in order to diversify the risks of investors and minimise chances of the investors loosing out on their investment.[160] Indeed, commenting on the distinction between open-ended investment and closed-ended investment, Hayton observes:

> "The capital held by the investment trust is *fixed* (so that the fund is 'close-ended' unlike the 'open-ended' unit trust where the investment 'kitty' *fluctuates* depending on numbers of new subscribers and numbers of unit holders requiring the managers to redeem their units) and the price of shares of the investment trust company reflects demand (whereas the price of units directly reflects the underlying value of the unit's portfolio)."[161]

In trying to provide a legal framework in which investor protection can be promoted, the Zambian Securities Act 1993 spells out that funds held under a collective investment scheme must be invested with the aim of spreading investment risks.[162] One of the ways in which a collective

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sec. 75, sch. 1, paras. 12, 13 and 14; S. Barc and N. Bowen, Tolley's Company Law, (Croydon: Tolley Publishing Company, 1988), pp. 981-986.

[158] See generally materials cited in *supra*., (n. 157).

[159] See generally *Ibid*.

[160] See E.W. Davis and J. Pointon, An Introduction To Corporate Finance: Finance And The Firm, (Oxford: Oxford University Press, 1994,), p. 100.

[161] D.J. Hayton, The Law Of Trusts, (London: Sweet and Maxwell, 1989), p. 45.

[162] Securities Act 1993, sec. 72; This explains 'open-ended investment.' See also Trust Restriction Act, No. 64 of 1970.

investment scheme can spread its investors' risks is by engaging in open-ended investment. We have already shown that unit trusts are one type of collective investment scheme that engages in open-ended investment. Indeed, open-ended investment reduces the risks on the investment returns in the sense that where returns on one investment portfolio are not enough, returns on the other investment portfolio could make up for that.

Further Distinctions Between Unit Trusts And Other Types Of Collective Investment Schemes:

Under the Securities Act 1993, unit trusts are collective investment schemes in which property is held on trust for the participants in the scheme by persons *other than* the operator of the scheme.[163] Besides, whilst interests of investors in an open or closed-ended investment company would be described as 'shares', interests of investors in unit trusts are described as 'units'.[164] The Securities Act 1993 does not spelt out the difference between shares and units. In practice, however, unit trusts, as trusts in the legal sense, can hold investments on behalf of investors. By contrast, investment companies will rarely hold interests as trustees of the investors. Thus, investors under a scheme set up by an investment company have interests in the shares in the investment company itself. The investors' returns are, therefore, conditioned by issues such as the availability of distributable profits from which dividends can be distributed.[165] Generally, the value of units (in the case of unit trusts) and shares (in the case of investment companies) will go up and down as the

[163] Securities Act 1993, sec. 72.

[164] *Ibid.*, sec. 72(c),(2)(b).

[165] See Re Exchange Banking Co., Flicroft's Case (1882) 21 Ch D 519; Lee v. Neutchatel Asphalte Co. (1889) 41 Ch D 1; Verner v. General and Commercial Investment Trust [1894] 2 Ch 239; Amonia

value of shares (or units) in which the fund is invested goes up and down.[166] Also, the more specialised the investment scheme, the greater the risk,[167] since specialisation reduces the prospects of spreading investment risks. Measures such as polarisation in the case of collective investment schemes may lead to specialisation. In its simple form, polarisation is seen where a person is authorised to sell investment products to an institution to which he is tied. This means that the tied person would sell only one type of product.

In Zambia, another distinction between unit trusts and investment companies is that whereas operators of collective investment schemes such as those run by investment companies are bodies corporate, operators of unit trusts need not necessarily be bodies corporate.[168] Individuals and associations such as partnerships[169] can be operators (trustees) of unit trusts.[170] Furthermore,

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Soda Co. Ltd v. Chamberlain [1918] 1 Ch 266; Dimbula Valley (Ceylon) Tea Co. Ltd v. Laurie [1961] Ch 353, [1961] 1 All E.R. 769.

[166] See Linklaters and Paines, Unit Trusts: The Law and Practice, (London: Longman, 1992), Part C, Appendix 5429.

[167] *Ibid.*, Appendix 5429.

[168] The Securities Act 1993 does not prohibit individuals from acting as trustees. Rule 3 of the SEC Code on Collective Investment Schemes simply stresses that the code applies to schemes owned by, or managed by or on behalf of, open-ended investment companies.

[169] Partnership law in Zambia does not cover partnerships with limited liability of partners. In Zambia, like in the United Kingdom, section 9 of the English Partnership Act 1890 - an Act of Parliament which applies to Zambia - provides that partners are jointly and severally liable for all debts and obligations of the firm incurred whilst they are partners, and after their death their estates are also severally liable for such debts and obligations.

[170] See above.

whereas the standard of care for individual trustees is that of the ordinary prudent man of business acting honestly in relation to his own property,[171] the standard of care required of companies holding property on trust is that of companies at similar levels.[172] Generally, in Zambia liability of trustees is to the full extent of their private estates whereas that of members of operators (*i.e.* operators that are bodies corporate) is limited by the concept of limited liability under company law.

Drawing Distinctions Between Investment Companies And Open-ended Investment Companies: The Securities Act 1993 distinguishes an investment company, which owns the property that is subject to a collective investment scheme, from an open-ended investment company.[173] The latter company denotes first, a company whose scheme makes provision for the redemption or repurchase by the investment company of securities held by participants in the scheme. However, the Securities Act 1993 does not set the level of prices at which securities may be redeemed or repurchased.[174] This feature presents itself as a constraint on the legal framework.

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[171] Speight v. Gaunt [1883] 22 Ch. 727; The standard is higher for paid trustees, professionals and institutions. Similarly, equity doctrines apply to the standard required of trustees when they are undertaking duties to invest trust moneys or assets. The Securities Act 1993 is silent on this.

[172] Bartlett v. Barclay's Bank Trust Co. [1980] Ch. 515.

[173] Securities Act 1993, sec. 72.

[174] For the position in the United Kingdom, *cf.* Part IV of Authorised Unit Trust Scheme (Pricing of Units and Dealings by Trustee and Manager) Regulation 1988. See also Financial Services Act 1986, sec. 75(8)(b), which does not attract Chapter VII of Part V of the Companies Act 1985.

The second feature of open-ended-investment companies is that these companies are permitted by law to authorise participants in the investment scheme to sell their securities on a securities or stock exchange at a price related to the value of the property which is subject to the scheme.[175] Thus, an open-ended investment company allows investors to unlock their capital out of the scheme. In contrast to closed-ended investment companies, open-ended investment companies may make fresh issues of shares to redeem investors' securities. Here, investors can sell their securities to open-ended investment companies.

In general, the position is such that operators of investment companies receive dividends on the investments from the various companies in which investments have been made. After paying administration expenses, operators either distribute the remainder of the income among those who have purchased shares in the investment company, or re-invest the income to increase the value of the company, and so of the individual shares in it.[176] Thus, in principle, a shareholder in an investment company has no legal or equitable interest in the shares and other assets owned by the company.[177] His shareholding in the company will have a value depending not only on the value of shares and other assets owned by the company, but also on the investment and dividend policy of its directors.[178]

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[175] Securities Act 1993, sec. 72.

[176] See D. Parker and A. Mellows, The Modern Law of Trusts, *supra*., (n. 155), pp. 3-4.

[177] D.J. Hayton, The Law Of Trusts, *supra*., (n. 161), p.45.

[178] *Ibid*., p. 45.

7.8. CONSTRAINTS RELATING TO PROTECTION OF ASSETS OF INVESTORS UNDER A COLLECTIVE INVESTMENT SCHEME:

In many countries, collective investment schemes are an important institution through which investor protection is managed. Through these schemes, risk averse investors can invest their capital in units of unit trusts for a better realisation of economic returns. In Zambia, however, like in many other emerging markets,[179] the law on collective investment schemes does not adequately address the protection of assets of investors. Under the Zambian Securities Act 1993, apart from provisions on the Compensation Fund which apply generally to securities investment done through intermediaries on securities markets, there are no provisions in the Act on the need for collective investment schemes to protect small (usually risk averse) investors from market abuses. Market abuses could range from investment companies misappropriating customer funds or not taking proper care in the selection of investment portfolio to matters such as investment companies profiting from use of inside information. Also, apart from the need to have securities legislation in Zambia redress these shortcomings, it would be prudent to provide for appropriate measures to protect investors who have interests in collective investment schemes (under an investment company) that are undergoing liquidation. Similar proposals are recommended for inclusion in the regional investment code.

[179] See generally M.T. Porter, "Closed-end Emerging Country Funds Review," in K.H. Park and W. Van Agtmael, (eds), The World's Emerging Stock Markets, (Chicago: Probus Publishers, 1993); C.B. Barry and L.T. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995).

7.9. CONCLUSION:

This chapter has examined the legal aspects of protecting investors from the misfeasance of financial intermediaries on the Lusaka Stock Exchange and the regional stock exchange. It was argued that although the low levels of liquidity on the Lusaka Stock Exchange have not affected the performance of financial intermediaries, a pro-active approach must be taken to ensure that tighter regulation of financial intermediaries leads to efficient legal rules that can help to develop a competitive stock exchange in Zambia. Similar views were advanced for the regulation of financial intermediaries on the regional stock exchange.

Several possible means of improving and strengthening the law on duties of financial intermediaries were explored. In Zambia, with the advent of the Lusaka Stock Exchange, there is now need to train brokers and dealers in securities how to conduct financial intermediary business on the stock market.[180]

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[180] See K.K. Mwenda, "Intermediation And Investor Protection In Zambia," Zambia Law Journal, Vol. 25-28 (1993-96), pp. 123-124. See also K.K. Mwenda, "Revisiting Common Law Fiduciary Duties Of Financial Intermediaries: From Developed Stock Markets To An Emerging Stock Market," Journal For Juridical Science, (SA), Vol. 22, No. 1 (1997), pp. 1-16.

CHAPTER EIGHT

GENERAL CONCLUSIONS

8.1. INTRODUCTION:

The thesis has attempted to address the question of whether the legal framework for public distribution of securities in Zambia, adopted in 1993, has facilitated the development of a competitive stock exchange. The thesis started out by providing a historical background to the setting up of the legal framework. It was noted that the Zambian legal framework is composed of various levels at which securities regulation is conducted. These levels, which constitute the backbone of the regulatory framework,[1] comprise the following:

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[1] A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," Virginia Journal of International Law, 39 (1999), 607, at pp. 613-614, observes that the legal framework that governs securities activities in a country plays an important role in determining the efficiency of that capital market. A. Guzman, *Ibid.*, pp. 613-614, argues that: "A disclosure based regime, for example, is designed to solve the asymmetric information problem that exists between an issuer and potential investors. In other words, the issuer and its insiders know the value of the security better than other investors. The issuer has an incentive to disclose some of the inside information it possess in order to increase the price investors will be willing to pay. The issuer and insiders,

(i) the role of the Securities and Exchange Commission as the competent authority for authorising the conduct of securities business and trade in Zambia;[2]

(ii) the power of the Minister to close down a stock exchange;[3]

(iii) the role of the Securities and Exchange Commission in scrutinising applications for the registeration of securities;[4]

(iv) the role of the Securities and Exchange Commission in regulating financial intermediaries, such as securities dealers, brokers and collective investment schemes;[5]

(v) the role of the Securities and Exchange Commission, in collaboration with the Lusaka Stock Exchange, in identifying and prosecuting market abusers such as insider dealers;[6]

(vi) the role of the Lusaka Stock Exchange in vetting of information in securities advertisements, prospectuses, and listing particulars;[7]

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however, may have only a limited incentive to release information and may, as a result, release too little. On the other hand, a regulatory regime that demands too much disclosure may impose costs on issuers that exceed the value of the disclosure. If there is too little disclosure in the market, investors will take this into account and reduce the cost of issuing securities. In either case, the disclosure dilemma will increase the cost of capital in the market. As a result, investors will overlook some of the valuable projects and seek other vehicles for their funds."

[2] See Part II of the Securities Act 1993, which has already been discussed in Chapter Six of this work.

[3] Securities Act 1993, sec. 12(1).

[4] See explanation in *supra* (n.2); see also Chapter Six, *supra*., and Securities (Registration of Securities) Rules 1993.

[5] See Chapters Six and Seven, *supra*.

[6] See Chapter Six, *supra*.

[7] See generally *Ibid*.

(vii) the role of the Lusaka Stock Exchange's central depository system, plus that of a prompt and timely deal settlement system;[8] and

(viii) the role of the Lusaka Stock Exchange in listing and de-listing securities.[9]

Generally, there are a number of constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. Among the constraints, the issue of inadequate liquidity and that of poorly drafted statutory provisions are prominent.[10] The conclusion reached in the thesis is that the legal framework has not provided adequate incentives to stimulate increased liquidity and market development of the Lusaka Stock Exchange.[11] Supporting the above argument are a number of material facts. As explained below, the main reason behind this view is that the Lusaka Stock Exchange and the regulatory framework for public distribution of securities in Zambia were designed primarily to facilitate the privatisation of state owned enterprises. In setting up the exchange and establishing the regulatory framework, other interests in the market, such as those that do not relate to privatisation, were not a determinant variable. This feature explains why other market interests were not provided with the same incentives as the privatisation programme.[12] Guzman observes:

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[8] See generally *Ibid.*

[9] See generally *Ibid.* See also generally Lusaka Stock Exchange Listing Rules 1993; see also Securities (Transitional) Rules 1993 r.3(2).

[10] See Chapter Three, *supra.*

[11] See generally Appendices A to K, *infra.*

[12] See generally materials referenced in *Ibid.*

"In order to attract capital, it is necessary to have a set of substantive legal rules in place that meets a set of clear, well functioning, and reliable securities laws. These rules can take many forms. Indeed, in some markets, the best set of rules may allow parties to define their own obligations through contract.[13] Such rules must not only be clear and predictable, the interested parties must also perceive that the rules are stable over time. Rules that are expected to change with each new government or with each crisis offer no comfort to would-be issuers and investors."[14]

In Chapter Three of the thesis it was noted that the highest priority of the Zambian Government on the privatisation of state owned enterprise underpins the idea of setting up the legal framework for public distribution of securities in Zambia. Indeed, shortcomings such as inadequate liquidity and poorly drafted statutory provisions serve only to support the view that the Lusaka Stock Exchange and the regulatory framework were hurriedly set up to deal with the privatisation programme.[15] But then, as it transpired later not all securities in state owned enterprises were off-loaded on the Lusaka Stock Exchange.[16] In addition, the absence of a well articulated and pro-active strategy to deal with post-

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[13] *Cf.* Coase theorem. For an elaborate discussion on the Coase theorem, see S. G. Medema, The Coase Theorem, Working Paper, (Denver, Colorado: CRESP, Center for Research on Economic and Social Policy, University of Colorado at Denver, 1995); I. R. Segal, Contracting with externalities, Working Paper, (Berkeley, California: University of California at Berkeley, Dept. of Economics, 1997); and P.V. Goldberg, The Coase Theorem and some puzzles on the tort/contract boundary, Working Paper, (New York, N.Y: Center for Law and Economic Studies, Columbia University School of Law, 1995).

[14] A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," *op. cit.*, p. 618.

[15] See results of the field study which was conducted by this author, as set out in Chapter Three, *supra*.

privatisation investments on the Lusaka Stock Exchange is another factor contributing to the underdeveloped state of the Lusaka Stock Exchange.[17] To overcome such problems, the thesis proposed that a regional stock exchange must be set up in Eastern and Southern Africa. The setting up of the regional exchange should be complemented by the promotion of multiple listings and cross-border trade in securities.

This chapter sets out the arguments made in the preceding chapters with a view to suggest mechanisms for setting up an effective regional framework for public distribution of securities in Eastern and Southern Africa. The chapter is divided into four main sections. The first part of the chapter explains the context in which the performance of the Lusaka Stock Exchange, its background and operations may be understood. Research findings on the performance of the exchange are analysed. The second part examines the legal aspects of a regulatory framework for public distribution securities at the regional-wide level in Eastern and Southern Africa. The advantages and disadvantages of adopting a regional stock market (*i.e.* either an informal market or a formal one) are discussed.

In the third section of the chapter lessons from other regions are provided. Also included is a strategy for implementing both ideas on the setting up of a regional stock exchange and the promotion of multiple listings. The dangers of adopting a foreign model are set out and the adoption of such a model is discouraged. Further, an analysis is made of the propriety of the Common Market for Eastern and Southern Africa (COMESA) to

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[16] See generally *Ibid*.

[17] See generally *Ibid*.

facilitating a regional stock exchange. It is argued, for example, that COMESA not only has a regional financial instrument,[18] a clearing house, and a trade and development bank, but that it also has a large membership whose objective is trade creation and regional integration.[19] Added to these advantages, the COMESA Treaty provides for integration of capital markets in the region[20] and COMESA has already undertaken feasibility studies on this.[21]

The various alternative ways in which a regional stock market in Eastern and Southern Africa can be set up are explored. The alternatives include the setting up of a formal regional stock exchange, the promotion of multiple listings (as a way of setting up an informal regional market), and the setting up of a COMESA Equity Fund. The chapter concludes by reiterating the view of the Chairman of the African Stock Exchanges Association on the need for African stock exchanges to integrate. Indeed, the Chairman's statement is in line with the thesis on the setting up of a regional stock exchange and the promotion of multiple listings.

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[18] The COMESA financial instrument is known as 'UPTA'. However, once the COMESA Free Trade Area is formally established in October 2000 the UAPTA instrument can then be promoted into a regional currency. This effort would make payments and deal settlements much easier, and faster too, in transactions relating to cross-boarder trade in securities. COMESA can adopt and adapt examples such as those of the Euro in the European Union to suit its own context.

[19] See generally Chapter Four, _supra_.

[20] See generally _Ibid_.

[21] See generally _Ibid_.

8.2. THE LUSAKA STOCK EXCHANGE: THE CONTEXT AND RESEARCH FINDINGS

Chapter One of the thesis set the context of the study. The aim and objectives of the thesis are to understand the reasons behind, and the shortcomings associated with, the setting up of the Lusaka Stock Exchange. It was argued that Zambia has undergone three successive economic development phases. The first of these phases was the accommodation development strategy. Then came the re-organisation development strategy. Thereafter, the third phase was the re-introduction of the accommodation development strategy. Chapter One provided a background analysis and explained how municipal laws relating to economic development in Zambia were (are) developed. It was shown that there is a strong correlation between the political economy in Zambia and the development of municipal law on business and economic matters.

Closely related to the correlation between the political economy and the development of law in Zambia are constraints affecting the efficacy of the legal framework for public distribution of securities. It was noted that these constraints have impeded the framework's contribution to the development of the Lusaka Stock Exchange.[22] In dealing with this issue, the thesis argued for the setting up of a regional stock market. The proposal took into account the political economy, and the socio-cultural and technological factors prevailing in the region. In developing this argument further, Chapter Two provided an overview of some of the important constraints and incentives affecting the

[22] This point has not only been addressed above, reasons have also been provided to explain and support the point.

efficacy of the legal framework for public distribution of securities in emerging markets generally.[23]

(i) *Some of the advantages and disadvantages of investing in emerging markets*

An argument was made that whereas the attractiveness of emerging markets included views such as emerging markets represented a fast growing part of the world economy and that they delivered superior returns,[24] the disadvantages of investing in these markets included constraints such as inadequate liquidity, restrictive regulations on banking

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[23] See M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), <u>The World's Emerging Stock Markets</u>, (Chicago: Probus Publishers, 1993), p. 460; C.B Barry and L.J Lockwood, "New Directions in Research on Emerging Capital Markets," <u>Financial Markets, Institutions and Instruments</u>, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995), p. 17. See also generally C.B. Barry, "Financial Institutions and Markets and the Economic Development of Four Asian Countries," in <u>Recent Developments in Capital Markets in Turkey: Proceedings of the OECD - CMB Conference</u>, (Istanbul: Capital Market Board, 1986); K.L. Gupta, <u>Finance and Economic Growth in Developing Nations</u>, (London: Groom Helm, 1984); C.B Barry and L.J Lockwood, "New Directions in Research on Emerging Capital Markets," <u>Financial Markets, Institutions and Instruments</u>, Vol. 4, No. 5, (Oxford: Blackwell Publishers, 1995); A. Demirguc-Kunt and V. Maksimovic, <u>Capital Structures in Developing Countries: Evidence from Ten Countries</u>, Policy Research Working Paper 1320, (Washington: The World Bank Policy Research Department, July 1994); International Finance Corporation, <u>Investment Funds In Emerging Markets: Lessons of Experience Series</u>, (Washington D.C, 1996); and P.J. Montiel, P.R. Agmnor and N.U. Haque, <u>Informal Financial Markets in Developing Countries</u>, (Oxford: Blackwell Publishers, 1995).

[24] See K.K. Mwenda, <u>Contemporary Issues in Corporate Finance and Investment Law</u>, (Washington DC: Penn Press, 2000), pp. 106-128. See also K.K. Mwenda and G.N. Muuka, "Prospects and Constraints To Capital Markets Integration In Eastern and Southern Africa," <u>Journal of African Business</u>, Vol. 2, No. 1, 1999; and M.T. Porter, "Closed-end Emerging Markets Country Funds Review," in K.H. Park and W.Van Agtmael, (eds), <u>*Ibid*</u>., p. 460.

systems, restrictive regulations on investment of pension assets, heavy reliance on privatisations as a source of capital growth, and poor financial reporting and limited access to information.[25] Overall, it was seen that the advantages of investing in emerging markets outweighed the disadvantages.[26] Emerging markets are, indeed, attractively valued and underweighted in global portfolios.[27] Emerging markets were thus seen as attractive in providing further diversification of global portfolios.[28] Chapter Two concluded that there

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[25] See generally K.K. Mwenda, "Securities Regulation and Emerging Markets: Legal and Institutional Issues for Southern and Eastern Africa," Murdoch University Electronic Journal of Law, Vol. 7, No. 1, March 2000, at the following web page: <<http://www.murdoch.edu.au/elaw/issues/v7n1/mwenda71nf.html>>. See also generally C.B Barry and L.J Lockwood, "New Directions in Research on Emerging Capital Markets," *op. cit.*, p. 17; C.B. Barry, "Financial Institutions and Markets and the Economic Development of Four Asian Countries," in Recent Developments in Capital Markets in Turkey: Proceedings of the OECD - CMB Conference, *op. cit.*

See also K.K. Mwenda, An Analysis of Corporate Finance in Emerging Markets in Africa, [published] Occasional Paper No. 13, Spring 2000, Center for Advanced Study in International Development (CASID), Michigan State University, Lansing, Michigan, USA; K.K. Mwenda, Regulation of Foreign Direct Investment in Zambia, [published] Occasional Paper No. 14, Spring 2000, Center for Advanced Study in International Development (CASID), Michigan State University, Lansing, Michigan, USA.

[26] See generally K.K. Mwenda, "Multiple Listings And The Setting Up Of A Regional Stock Exchange As Means to Stimulating Increased Liquidity On Stock Markets In Eastern and Southern Africa," unpublished seminar paper, Michigan State University, African Studies Centre, Lansing, Michigan, USA, 17th November 1999.

[27] See generally and K.K. Mwenda, "Theoretical Issues Underpinning Corporate Finance Law In Emerging Markets: A Case For The Attractiveness of Emerging Stock Markets," unpublished seminar paper, Michigan State University, Centre for Advanced Study of International Development, Lansing, Michigan, USA, 18th November 1999.

[28] See generally *Ibid*. See also K.K. Mwenda, "Securities Regulation and Emerging Markets: Legal and Institutional Issues for Southern and Eastern Africa," Murdoch University Electronic Journal of Law, *op.cit.*

is no convincing reason to believe that emerging markets are generally inefficient.[29] In that respect, the integration of these markets, through means such as multiple listings and cross-border trade in securities, would help to overcome constraints affecting the development of competitive stock markets in Eastern and Southern Africa. As Guzman observes:

> "The globalization of capital markets, therefore, can lead to a greater and faster movement of capital from investment projects in response to a suboptimal regulatory scheme – or towards such projects in response to an optimal regime – than is the case when each national market is isolated from the global market. In other words, globalization implies that all countries... face a much more elastic supply of capital than they would if capital markets were constrained by national borders. A increase in the elasticity of the supply of capital implies that regulatory differences between countries can cause large capital flows. A

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[29] See for example the following studies: C.B. Barry and L.J. Lockwood, "New Directions in Research on Emerging Capital Markets," Financial Markets, Institutions and Instruments, *op. cit.*, p. 21; R. Aggarwal and P. Rivoli, "Seasonal and Day-of-the-Week Effects in Four Emerging Stock Markets," Financial Review Studies 1, (1988), 541-550; M. Gultekin and N.B. Gultekin, "Stock Market Seasonality: International Evidence," Journal of Financial Economics, 12, (1983) 469-481; S. Claessens, S. Dasgupta and J. Glen, "Return Behaviour in Emerging Markets," World Bank Economic Review, 9, (1995), 131-151; A. Corhay, G. Hawawini and P. Michel, "Seasonality in the Risk-Return Relationship: Some International Evidence," Journal of Finance, 42, (1987), 49-68; and generally K.K. Mwenda, "Securities Regulation and Emerging Markets: Legal and Institutional Issues for Southern and Eastern Africa," Murdoch University Electronic Journal of Law, *Ibid*. For an elaborate read on the semi-strong form tests of emerging markets see for example, M. Herrera and L.J. Lockwood, "The Size Effect in the Mexican Stock Market," Journal of Banking and Finance, 18, (1994), 621-632. For a working definition of 'market efficiency', see R.A. Brealey and S.C. Myers, Principles of Corporate Finance, (New York: Mcgraw-Hill, 1991), p. 290.

country with a regulatory system that does not appeal to investors and issuers will fail to attract foreign capital and local capital will flow to other countries. A country with a system that satisfies the needs of market participants, on the other hand, will enjoy capital inflows."[30]

(ii) *The underdeveloped state of the Zambian economy and performance of the Lusaka Stock Exchange*

In Chapter Two it was noted that Zambia does not fit the criteria of the first wave of developing countries with strong economic conditions.[31] Zambia may be found at the bottom or lower end of developing countries.[32] Botswana, Sudan and Swaziland are in the same group of countries as Zambia. In that context (*i.e.* given that Zambia has an underdeveloped economy), the question arises as to the motivation behind the setting up of the Lusaka Stock Exchange in 1994.

The evidence provided in Chapter Three shows that Zambia's poor economic conditions make a stock market initiative difficult to support. Chapter Two also shed light on this view by looking at some of the markets that are considered as 'emerging markets' by the Economist and the International Finance Corporation. The Zambian market, and many other African markets, are not listed as emerging Markets by the *Economist.* In Chapter

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[30] A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," op. cit., p. 614. Indeed, the development of information technology and securities regulation in the region could make it possible for investors to engage in international transactions at low cost.

[31] Information was presented, for example, in Chapter Three supra., on Zambia's GDP, to support this view.

[32] See explanation in Ibid.

Two, Figure 2.2.1 (*i.e.* 'Lion Markets of Africa: Their Capitalisation and Quoted Companies'), based on some 1996 statistics, showed that Zambia had eight companies quoted on the Lusaka Stock Exchange. The total market value of the Lusaka Stock Exchange was estimated at only 220 million (Pounds Sterling).[33] By the end of 1995, the market capitalisation of the Lusaka Stock Exchange had declined. The decline was, however, not drastic and it did not imply the success or failure of the market. Rather, the decline could be attributed mainly to the price discovery process in a start-up market.

Chapter Three of the thesis explained that a number of factors were influential in the setting up of the Lusaka Stock Exchange. It was noted that 80 percent of the respondents in a survey on the Lusaka Stock Exchange indicated that the structural adjustment programme and the privatisation of state owned enterprises were *very important* factors in the setting up of the exchange. This response is supported by evidence presented in Chapter Three, showing that securities trade on the Lusaka Stock Exchange started and continued with the privatisation of state owned enterprises.[34] The privatisation of Chilanga Cement Plc and Rothmans of Mall Pall Plc on the Lusaka Stock Exchange was followed

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[33] By 1996, the Lusaka Stock Exchange had been in operation for two years only. This fact helps to explain the small market capitalisation of the exchange. Indeed, we have already discussed the performance of the Lusaka Stock Exchange in Chapter Three. Chapter Two also provided figures and tables showing the market capitaisation of Africa's stock exchanges and how these markets have performed. For further readings on related matters, see K.K. Mwenda, "Securities Regulation and Emerging Markets: Legal and Institutional Issues for Southern and Eastern Africa," Murdoch University Electronic Journal of Law, *op. cit*.

[34] See Lusaka Stock Exchange, LuSe: Update and Overview, (Lusaka: Lusaka Stock Exchange, 1996), p. 2.

by similar public distribution of securities in parastatal companies.[35] A number of these companies had moderately small capital bases[36]

With such compelling evidence on the small market capitalisation of the Lusaka Stock Exchange, and given the pre-occupation of the Zambian Government with privatising large parastatal enterprises on the Lusaka Stock Exchange, it is submitted that the policy bases underlying the introduction of the legal framework for public distribution of securities in Zambia was to facilitate the introduction and implementation of privatisation strategies. In that sense, the structure of the Lusaka Stock Exchange had a specialised and clearly defined objective. The main objective was to facilitate privatisation of state owned enterprises. The legal framework in Zambia, like in many other developing countries, was not designed to provide incentives to other market transactions that are often associated with stock exchanges.[37] By contrast, we saw in Chapter Two that the International Stock

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[35] See Chapter Three, *supra*.

[36] See Lusaka Stock Exchange, LuSe: Update and Overview, *op. cit*., p. 6. By 1996 Chilanga Cement Plc had a market capitalisation of K10,402 million, while Bata Plc had a market capitalisation of K3,507 million. Other listed companies in that year included Rothmans of Pall Mall Plc, with a market capitalsation of K6,451 million; Zambia Sugar Plc, with a market capitalisation of K124,820 million; New Capital Bank Plc, with a capitalisation of K2,525 million; Standard Chartered Bank Plc, with a capitalisation of K32,760 million; Farmers House Plc, with a capitalisation of K3,267 million; and ZCCM Plc, with a capitalisation of K169,663 million.

[37] *Cf.* A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," *op. cit*., p. 611, who argues that the creation of a well-functioning and liquid secondary market for the shares in newly privatised companies increases the value of the new shares and allows a privatisation programme to proceed more easily. This view raises a number difficulties. Notably, Guzman assumes that a market can develop and become more liquid mainly on the basis of pursuing a privatisation programme. But, what happens where some of the privatisation activities are

Exchange, like many other developed markets, was designed to play two vital, inter-linked, roles.[38] These roles are as follows:[39]

(a) to enable government and industry to raise capital with comparative ease; and

(b) to provide a secondary market where existing investors can sell and where prospective investors can buy.

Contrasted with the case of stock markets in developed countries, the establishment of stock exchanges in Africa have to a large extent resulted from the need to undertake privatisation programmes.[40] In line with this view, another reason that was cited by respondents to the survey questions was that the Lusaka Stock Exchange was set up as part of the IMF/World Bank economic recovery programme. Indeed, as part of the World Bank supported legal reform programme,[41] the enactment of the Securities Act 1993 of Zambia came soon after the decision to set up the Lusaka Stock Exchange was made.[42] I

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undertaken off the stock market and where only a small fraction of these activities is confined to the stock market?

[38] N.F. Stapley, The Stock Market: A Guide For The Private Investors, (Cambridge: Woodhead-Faulkner, 1986), p. 16.

[39] *Ibid*., p. 16.

[40] See for example A. Galal, L. Jones, P. Tandon and I .Vogelsang, "Synthesis of Cases and Policy Summary," in Proceedings of the World Bank Conference on the Welfare Consequences of Selling Public Enterprises, (Washington: World Bank, 1992); and generally, International Finance Corporation, Privatization Principles and Practices: Lessons Of Experience Series, (Washington D.C., 1995).

[41] See W. Paatii Ofosu-Amaah, Reforming Business-Related Laws to Promote Private Sector Development, (Washington DC: The World Bank, 2000), pp. 29-32.

[42] See generally *Ibid*. See also Chapters One and Six, *supra*.

have argued elsewhere that the shortcomings relating to statutory provisions such as those on insider dealing in Zambia are a result of poor and over-ambitious drafting.[43] A number of these shortcomings are discussed in Part II of the thesis.[44] We have already seen, for example, that the Securities Act 1993 does not provide for liability of third-party insider dealers.[45] In many cases, the manner in which the laws of developing countries are drafted is summarised in the words of Professor Ghai, as follows:

> "Legislation is ambitious, enacted without sufficient regard to social and economic conditions... merely symbolic... subjecting politico-economic power to legal ordering."[46]

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[43] See generally K.K. Mwenda, "Redefining Insider Dealing Law For Emerging Markets: A Comparative Legal Study," Zimbabwe Law Review, Vol. 14, (1997), pp. 29-46. In *Interview* with Mr. Ben Ngenda, then Chairman of the Zambia Stock Exchanges Council, Lusaka, 23rd August, 1993, Mr Ngenda gave an indication that he drafted the Securities Act 1993. However, in a newspaper article by the current Chief Executive of the Securities and Exchange Commission, Mr Mumba Kapumpa, (replying to an earlier newspaper article by this author in the Financial Mail of Zambia, 2nd April, 1996), Mr Kapumpa indicated that the Securities Act 1993 was drafted by experts in the field of securities regulation from various countries which included the United States and the United Kingdom; see Mr Kapumpa's article in Sunday Times of Zambia, 11th April, 1996. Further still, in a discussion with Mr E.Chipimo Jr., then Secretary of the *ad hoc* committee on overseeing the establishment of the Lusaka Stock Exchange (Lusaka: 30th August, 1993), Mr Chipimo submitted that most of the provisions in the Securities Act 1993 were drawn from legislation in the United States, the United Kingdom, Canada and Australia.

[44] See also generally K.K. Mwenda, "Zambia's Securities Act 1993 On Trial: The Case of Insider Dealing," Statute Law Review, Vol.18, No.2, 1997.

[45] See also generally *Ibid*.

[46] Y. Ghai, "Law and Public Enterprise," in Y. Ghai *et al*, The Political Economy of Law, (Delhi: Oxford University Press, 1987), p. 554.

We saw in Chapter Five how the Chief Executive of the Securities and Exchange Commission in Zambia, Mr. Mumba Kapumpa, conceded that when drafting the Stock Exchange Act 1990 he simply reproduced verbatim the Stock Exchange Act 1970. At that time, eighteen years had lapsed since the Stock Exchange Act 1970 was repealed. Added to the problem of poor and over-ambitious drafting is fact that there was absence of a proper vision of the purposes and type of stock exchange that would be appropriate for a developing country such as Zambia.[47] The purposes for which a stock exchange is established often explain the shortcomings and successes of the exchange. A stock market set up on the basis of political agenda, such as where a country is adhering to the IMF/World Bank structural adjustment programme, must have its purposes specifically tailored towards such goals. This point explains, for example, why the Lusaka Stock Exchange, like its counterparts in the region, is today facing problems of inadequate liquidity. Zambia's privatisation programme, once considered by many analysts as the

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[47] This clear from the discussions and dialogue with Mr Ngenda, Mr Kapumpa and Mr Chipimo Jr; see generally *Ibid*. (n.43) for full citation and further details. Also, I have argued elsewhere (see generally K.K. Mwenda, "The New Corporate Law: De-mystifying The Myth Of A Stock Exchange," Zambia Law Journal, Special Edition 1998) that whereas the Lusaka Stock Exchange is a limited liability company, the Securities Act 1993 does not acknowledge it as such. The Securities Act 1993 simply refers to it as "Lusaka Stock Exchange". In Zambia, a company that was incorporated under the Companies Act 1921 of Zambia was required by that statute to include the letters "Ltd" after its name. Indeed, this was to be part of the company's lawful name. The company would be addressed as such in all legal documents. However, although the Lusaka Stock Exchange was incorporated under Companies Act 1921, the Securities Act 1993 does not refer to it as a limited liability company (Ltd). Some possible interpretations here are that either the draftsman forgot to provide that the Lusaka Stock Exchange was a statutory body or that he forgot to acknowledge it as a limited liability company. It is, indeed, not clear what was intended to be the legal personality of the Lusaka Stock Exchange.

success story of Africa,[48] was over-ambitious and very hurried.[49] The expected internal development of the market did not take place and some privatised companies ended up in liquidation.[50]

Weaknesses faced by the Lusaka Stock Exchange include the fact that financial institutions such as commercial banks, pension funds, insurance companies and building societies have not been active participants on the stock market. There are several commercial banks, and a few merchant banks, in Zambia today. Zambia also has a few pensions funds, insurance companies and building societies. A number of reasons can be provided, however, to explain why these financial institutions have not been active participants on the Lusaka Stock Exchange. Most of these companies, as our fieldwork results show, have not been exposed to and sensitised about the business of securities investment.[51] Another argument is that there are inadequate incentives to attract these companies to the stock market. One other category of potential investors missing from the Lusaka Stock Exchange is that of venture capital funds. Like in many other developing countries, there have been no venture capital funds in Zambia.[52]

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[48] I have discussed this point, in greater detail, elsewhere: K.K. Mwenda, Corporate Finance Law In Emerging Markets: Zambia's Stock Exchange And Privatisation Programme, Chapter Seven, (*forthcoming*, 2000).

[49] See generally *Ibid*.

[50] See generally *Ibid*.

[51] See Chapter Three, *supra*.

That said, it is important to observe that the few companies that have participated on the Lusaka Stock Exchange can be grouped into five categories; namely, manufacturing, agriculture, banking, property and mining. Shares in these companies are traded on the Lusaka Stock Exchange and they have had a satisfactory market performance so far. In Chapter Three, we examined the market performance of these securities. Here, suffice it to say there have been instances when prices of these shares have fallen due to factors such as the price discovery process in a start-up market.[53] Other factors that were identified by participants in a survey included the view that the Zambian public is generally not sensitised enough about prospects of investing in securities. Also, it was argued that since trading is only confined to the urban areas, collective investment schemes were needed to galvanise resources from the rural sector on to the stock market.[54]

The study further showed that not only banks, pension funds, insurance companies and building societies should be encouraged take part in securities trade on the Lusaka Stock

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[52] For a discussion on strategies leading to market entry and exit, see generally K.K. Mwenda, "Collective Investment Schemes and the Accommodation of Small Investors on the Stock Market," African Journal of Comparative and International Law, Vol.11, Pt. 3, 1999.

[53] The term price 'price discovery process' has already been defined in Chapter Three, *supra*. Here, suffice it to say that there are many factors that could affect the price discovery process in a start-up market. They include issues such as the speed and degree at which the market formalises, after it has been set up; the lack of market-depth; the sensitivity to trading patterns and trading seasonalities; and the lead and signalling factor where big investors make important decisions on the market.

[54] The respondents to the survey further indicated that inflation in the economy has affected the prices of shares generally. Overall, it was noted that all the quoted shares on the Lusaka Stock Exchange have had some price stability.

Exchange. Collective investment schemes must also be encouraged to do so. Indeed, collective investment schemes provide a less costly mechanism for small and risk averse investors to enter and exit the market. Chapter Three argued that utilities companies and football companies must also be encouraged to list their securities on the market. On the other hand, it was noted that the Lusaka Stock Exchange has succeeded in providing a medium for the privatisation of some parastatal companies in Zambia. The first listings, for example, to be admitted to the Lusaka Stock Exchange market were shares in parastatal companies that were being privatised. Chilanga Cement Plc and Rothmans Pall Plc were the first two companies to be privatised through public distribution of securities on the Lusaka Stock Exchange. Indeed, the Privatisation Act 1992 provides a number of ways in which a parastatal company can be privatised.[55] Included on the list of alternatives is public distribution of securities on a stock exchange. Therefore, the Lusaka Stock Exchange has a limited role. We have already established that the limitations on the exchange, as set out in the thesis, were not fully addressed by the Zambian Government.

The Lusaka Stock Exchange has, however, succeeded in providing a market for the trading of both debt and equity securities. Although some weaknesses in the regulatory framework (*e.g.* on insider dealing and disclosure requirements) were noted, it was argued that due to the small volume of trade in securities these weaknesses have not had major adverse impacts on the development of the Lusaka Stock Exchange. The exchange, whose stock market is regulated by various laws, including the Securities Act 1993 and its

[55] See generally K.K. Mwenda, "Privatisation Of State Owned Enterprises In Zambia: Reflections On The Legal Framework," The Accountant - ZICA Review, April-June 1998.

subsidiary legislation, has operated both listed and unlisted tiers of the market. The listing and de-listing of securities, and the admission of securities to these tiers, are matters dealt with by the Lusaka Stock Exchange.

On the other hand, the Securities and Exchange Commission is the competent authority for authorising a person to conduct business relating to securities trading and investment in Zambia or abroad. In essence, and as established already, there are various levels at which securities regulation is conducted in Zambia. That said, the Commission, unlike the Lusaka Stock Exchange, is a statutory body established pursuant to provisions of the Securities Act 1993. The future development of the Lusaka Stock Exchange may, however, be enhanced by the question of whether a regional stock exchange might facilitate inward investment.

8.3. THE LEGAL FRAMEWORK FOR A REGIONAL STOCK EXCHANGE: THE OPTIONS

Part II of the thesis addressed the question of whether a legal regime for a regional stock market might have an effective mechanism to stimulate growth in securities trade in Zambia. Part II looked at a number of constraints affecting the efficacy of the legal framework for public distribution of securities in Zambia. Constraints such as inadequate liquidity and the absence collective investment schemes on the market were explained as shortcomings facing the Lusaka Stock Exchange. In Chapter Three, the performance of the Lusaka Stock Exchange was examined and a case was made for the introduction of a regional stock exchange. It was argued that some of the institutional arrangements necessary for the support of a buoyant stock exchange were lacking in Zambia. As noted above, financial institutions such as banks, venture capital funds, pension funds, building societies and insurance companies have not played an active role in promoting the distribution of securities to the public in Zambia.

In making a case for a regional stock exchange, Part II of the thesis showed - in the case of Zambia, for example, that heavy reliance placed on the privatisation programme as a source of activity on the Lusaka Stock Exchange proved disappointing.[56] There are many transactions relating to privatisation in Zambia that have been carried out off-the stock market. But, how does the creation of a regional stock exchange and the promotion of multiple listing of securities affect the legal and institutional arrangements for public distribution of securities in Zambia?

8.3.1 A system of multiple listings and cross-border trade in securities

Recognising that the regulatory framework for public distribution of securities in Zambia faces a number of constraints, Chapter Four of the thesis argued that the introduction of a regional securities market could facilitate the development of more efficient and competitive markets throughout Eastern and Southern Africa. Although a number of economies in the region are at different stages of development, the concept of a regional stock exchange could, none the less, be implemented. What is important is finding areas of common interest and mutual benefit. The adoption and implementation of such an

[56] This point has already been developed above. Here, suffice it to say, a narrow view of functions of a stock exchange as being confined to privatisations could adversely affect the development of the Lusaka Stock Exchange.

approach could lead to the creation of poles of growth in the region which would spread development to weaker parts of the region. Economic strength for the region could result from such poles of growth. Indeed, the achievement of regional economic strength in Eastern and Southern Africa could also help to overcome political weaknesses of the region. A number of political problems facing the region are rooted in economic causes. Further, it is important to point out that the achievement of economic strength in the region could help to promote better international economic relations for Africa. Such a strategy for the improvement of Africa's image and participation in the international economy would complement other international efforts pointing towards the same goal. A notable case in point here is the recently enacted US law on US-Africa trade relations; that is, the Africa Growth and Opportunity Act.[57]

In this work, two possible alternatives to setting up a regional stock market have been explored. First, a regional stock market could be established formally by setting up a stock

[57] For a detailed discussion of the Africa Growth and Opportunity Act (AGOA), see generally G.N. Muuka and K.K. Mwenda, "AGOA: Finally the Right Prescription for Africa's Economic Transformation and Development?" The Global Challenge of African Business and Economic Development in the New Millennium, (International Academy of African Business and Development, International Conference 2000 Proceedings, hosted by Saint Joseph's University Business School, Atlantic City, New Jersey, USA, April 11-14, 2000). AGOA was passed after a long and highly dramatized battle for and against the Bill. The United States Senate, on Wednesday, November 3, 1999, passed the AGOA Bill, by a vote of 76 to 19 (see PROSI Magazine, November 1999). The Bill, which was signed by President Clinton on May 18, 2000, immediately became US law upon receiving Presidential assent (see Thomas, (2000), Bill Summary & Status for the 106th Congress, at the following web site, visited on July 6, 2000: <<http://thomas.loc.gov/cgi-bin/bdquery/D?d106:1:./temp/~bdmCXi:@@@Xl/bss/d106query.html>>).

exchange which could operate as a regional market. Secondly, a regional stock market could be established informally through the promotion of multiple listings and cross-border trade in securities. We now proceed to examine the impact of an informal institutional arrangement on the legal framework for public distribution of securities in Zambia.

(i) *The relationship between an informal institutional arrangement of a regional stock market and Zambia's regulatory framework*

It is important to begin by posing the following question: what would be the strategy for implementation of an informal market arrangement? This question touches on a number of vital points which include the need to examine the usefulness and possibilities of adopting certain lessons of experience.[58] While the case of the regional stock exchange in francophone West Africa[59] shows that there was hardly any need to look at prospects of promoting multiple listings when setting up that exchange,[60] since the only stock exchange that existed in that region was the Cote d'Ivoire stock exchange,[61] the position of Eastern and Southern Africa is somewhat different. There are several stock exchanges in the

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[58] In particular, we examine below two cases relating to prospects for the setting up of a regional stock exchange in Eastern and Southern Africa. The two cases are: (a) the case of the regional stock exchange in francophone West Africa; and (b) the abandoned debate on the setting up of a European Union regional stock exchange.

[59] Located in Cote d'Ivoire, this regional stock exchange is known as *Bours Regionale des Valeurs Mobilieres*, or simply after its acronyms, as 'BRVM'.

[60] *Interview* with Ms. Solange A. Alliali, Counsel, Legal Department, the World Bank, Washington DC, USA, 12th April, 2000. Ms. Alliali drafted the law that governs public distribution of securities on the regional stock exchange in francophone West Africa.

[61] See generally *Ibid.*

Eastern and Southern African region.[62] Therefore, one of the strategies for implementing the multiple listings goal would be to harmonise the various business laws of COMESA member states. The adoption of such a strategy would provide for comparable standards of regulation in the region. In essence, this would lead to a situation of comparable and somewhat identical incentives in the national regulatory frameworks. Indeed, by June 1999, national stock exchanges in the SADC region - a region which, as we have already seen in Chapter Four, encompasses a large number of COMESA member states - had completed harmonising their listing rules.[63] But this effort alone is not enough. There are other areas of the law that must be harmonised if the concept of an informal regional market is to succeed. Examples of such laws include disclosure requirements and prospectus provisions in the securities and companies laws of various states.[64] Other laws that would need to be harmonised include municipal laws for the prosecution of market

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[62] For a detailed list and discussion on stock markets in this region see K.K. Mwenda, An Analysis of Corporate Finance in Emerging Markets in Africa, *op.cit.*, pp. 2-9.

[63] Electronic mail, to this author, from Mr. Charles Mate, the chief executive and general manager of Lusaka Stock Exchange, Lusaka, Zambia, 3rd June 1999.

[64] The idea here is to avoid the duplication of information which has already been disclosed on another market. A second disclosure of the same information (this time, in a new market) could be costly. However, this view does not discount the importance of having continuing disclosure obligations in the regional investment code or in municipal laws of COMESA member states. In line with this view, Chapter Four argued that where a company is listing for the first time on the regional stock exchange and that company's securities are not listed on any other stock exchange (*i.e.* where there is no cross-listing), the listing requirements that must be met by such a company must be more stringent than where a company is entering into cross-listing on a regional stock exchange.

offenders (*e.g.* insider dealers involved in cross-border transactions[65]), municipal laws governing financial intermediaries, municipal laws to regulate competition and anti-trust activities, and municipal laws governing tax incentives for listed securities. Thus, a country such as Zambia has to collaborate with other states in the region in order to adopt common standards that apply throughout the region. Such an effort would require some changes in the municipal laws of all states involved.

Closely related to the argument for a regional stock exchange, countries in the SADC region recently completed harmonising their national listing rules. The harmonisation of national listing rules in the SADC region indicates the political will of the countries to integrate their stock exchanges. Further, harmonisation will facilitate activities such as multiple listings and cross-border trade in securities. However, to bolster such efforts, the supervisory authorities for securities regulation in various COMESA member states must not be divested of their authority. These bodies must be allowed to continue operating as policing institutions on behalf of the state, while collaborating and working closely with other supervisory bodies in neighbouring states. The objective here is to maintain market discipline and win investor confidence. To achieve these goals, the regulatory authorities in the region must comply with regional rules affecting multiple listings. As a fundamental rule, and in an effort to get states to surrender some of their sovereignty to the common good of regional integration, regional rules and regulations relating to multiple listings must take precedence over municipal laws and local decisions.

[65] Indeed, which state would have jurisdiction to try such offenders? Detailed suggestions have been made in Chapter Four on how to deal with insider dealers who are caught up in cross-border transactions.

A possible way to provide for regulations to govern trade on the informal stock market would be to set up an inter-governmental agreement. This agreement might be in the form of a treaty or an amendment to the COMESA Treaty, addressing most of what has been said above. Alternatively, the stock exchanges and the supervisory bodies in the region can workout a multilateral arrangement which binds them to the legal aspects of multiple listings and cross-border trade in securities. Regulation would therefore be done at two levels; the regional and the national levels. As already noted, the recent harmonisation of listing rules in the SADC region by national stock exchanges provides a good base upon which an informal regional market can be founded. While gains such as economies of scale, efficiency, competition and transparency can follow from the promotion of market integration, through multiple listings, the lack of a supra-national institution for policing market players, as noted above, can erode investor confidence. Indeed, a major disadvantage of pursuing the idea of an informal market is that under such an arrangement it might be difficult to police market abusers. This is particularly the case where, in spite of harmonisation of listing requirements, diplomatic relations between two states are no longer favourable.

In Chapter Four of the thesis prospects for setting up a formal regional stock exchange were explored. It was argued that the political and socio-economic context in Eastern and Southern Africa dictated the need to set up a formal regional stock exchange. Given that Eastern and Southern Africa as a region is politically and economically weak, and that civil wars have been witnessed in the region, the fragmentation in the collective will of states entailed that the setting up of a formal stock exchange was a much more attractive idea than that of an informal stock market. The formal stock exchange might have to co-exist with national stock exchanges so as to provide for integration of the markets through multiple listings and cross-border trade in securities. In the case of an informal stock market, the difficulty in setting up an enforcement and policing mechanism at a regional level rendered the idea less attractive. By contrast, the establishment of a formal regional stock exchange, with a centralised approach to regional financial integration, was deemed feasible. However, in spite of these structural and institutional differences, it is expected that some securities listed on the regional stock exchange would be cross-listed on national stock exchanges as well. This feature would thus prompt the need to regulate dual and multiple listings. In a sense, it would be short-sighted to assume that multiple listings are entirely exclusive of the idea of a formal regional stock exchange.[66] While it is theoretically possible to think of a regional stock exchange that does not permit cross-listing of securities, it is practically difficult to implement such an idea. The idea of an

[66] The reverse is, however, not true: multiple listings can be pursued even without the existence of a formal regional stock exchange. Therefore, to argue that trading of securities does not have to take place on an official stock exchange market and that it should instead occur on the basis of a proprietary network is only one window of the argument. In a novel case, where information is not abundantly available, there is often an element of risk-taking involved. To insure against greater risk, we need to acquire more information about possible outcomes. We cannot therefore proceed on the basis of a rigid and preconceived idea about what would work or would not work. In my humble view, the idea of having two or more possible alternatives to the setting up of a regional stock market (as I have argued) provides an objective and better option in terms of how to develop the market. Things tend to change and are never in a state of permanency. Therefore, if we accept this view it becomes easier to appreciate the fact that at various stages of regional integration in Eastern and Southern Africa a new approach to financial integration might be necessary.

isolated regional stock exchange that prohibits cross-listings militates against the concept of market integration. One of the advantages of integrating emerging markets would be for integration to serve as a strategy for capital market development. In this way, not only would economies of scale and competition be developed, but the levels and depths of market liquidity could also be expected to improve. Further, as an advantage of integrating stock markets, greater transparency would be expected from the establishment of a regional stock exchange and the promotion of multiple listings.[67]

There are several arguments that can be advanced to support of the idea of a formal regional stock exchange. It was argued that to regulate activities on a formal stock exchange a regional supervisory authority must be established. The regional supervisory body should be the competent authority for authorising conduct of business on the regional stock exchange. With regard to transactions undertaken exclusively on national stock exchanges the national supervisory bodies should have delegated authority from the

[67] In implementing such an idea, the regulation of securities on the regional market could done at various levels. There could be regulation at the regional and national levels (and multiple-listings might be the main focus in the case of national regulation), and regulation on the various market tiers of both the national and regional stock exchanges. In addition, the national and regional competent authorities could have their own regulatory powers. Although such a multiplicity structure might prove to be too costly, it is important to observe that the political and economic volatility of the region requires the implementation of such multi-faceted measures if investor protection is to be addressed effectively. However, given that the listing of securities on the regional stock market might prove to be costly for some companies, Chapter Four argued that small and thinly capitalised companies, unable to meet listing costs on the regional stock exchange, must list their securities on national stock exchanges, or on the unlisted securities market of the

regional body to authorise conduct of business. Furthermore, to facilitate the establishment of a formal regional stock exchange and a regional supervisory body a common investment code under the auspices of COMESA must be set up. As an inter-state agreement, the common investment code must have provisions which prevail and override municipal laws and regulations of COMESA member states. The code should provide for legal rules to govern matters such as disclosure obligations, dispute settlement, securities advertisements, insider dealing or any other market abuses, and authorisation and regulation of financial intermediaries and collective investment schemes on the regional stock exchange.

As a strategy for establishing an efficient regional framework for public distribution of securities, it would be helpful first, to consider promoting the development of a healthy banking sector in the region.[68] In addition, we may have to harmonise the fiscal and monetary policies of the various states in the region. Also, services relating to telecommunications and information systems may need improvement. The achievement of these objectives will require some strategic institutional changes to the national legal frameworks for public distribution of securities. In Zambia, for example, some changes would be required to harmonise securities laws with some regulations of the regional stock exchange and the laws of neighbouring states. Once again, the notable areas of legal

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regional stock exchange. The regional stock exchange, like most national stock exchanges, must be allowed to have both the listed and unlisted securities markets.

[68] Indeed, banks can be a good source of capital for equity investments. I have explored this issue at length in my forthcoming book, see: K.K. Mwenda, Contemporary Issues In Banking

reform would include disclosure obligations in the companies and securities legislation, tax laws, competition laws, insider dealing laws, and listing requirements. Institutionally, the Securities and Exchange Commission of Zambia and other competent authorities in the region should be affiliated to the regional Securities and Exchange Commission so that these bodies can, through delegated authority, work together to supervise the securities industry. To effect this, the COMESA regional investment code should provide that the national supervisory bodies in the COMESA member states are affiliated to the regional competent authority. Further, it would be helpful to identify areas of potential conflict of interest so that the COMESA code can pro-actively provide for the appropriate level and scope of responsibility for both the national and regional supervisory bodies. In Zambia, another way of effecting this affiliation would be by enacting an amendment to the Securities Act 1993, stating clearly that the Securities and Exchange Commission is affiliated to the regional competent authority. All these developments require some changes to the laws of a country such as Zambia.

8.4. INTRODUCING A REGIONAL STOCK EXCHANGE: LEGAL ISSUES AND ANALYSIS

In this section, it is important to explain some of the main issues arising from the proposal for a regional stock exchange.

Supervision And Systemic Bank Restructuring: Legal And Institutional Perspectives, (*forthcoming*, 2000).

(i) *Lessons of Experience from the European Community Model*

Writing on the operations and governance structures of various stock exchanges, Lee observes:

> "The governance structures of actual exchanges are extremely diverse and complicated... Different governance structures may be appropriate for an exchange at different stages of its development."[69]

What lessons can be drawn from Lee's view? Five major points are reflected here. It could be argued that: (a) the ownership structures of stock exchanges differ;[70] (b) when adopted by a stock exchange, every governance structure imposes different costs on the financial intermediaries trading in the market;[71] (c) all real contracts for public distribution of securities are necessarily incomplete since it is not only costly to provide for fully-contingent contracts, but it is also hard to anticipate all future outcomes;[72] (d) any attempt to explain an exchange's behaviour by seeking to isolate a single parameter which the exchange seeks to maximise is likely to be flawed;[73] and (e) exchanges have never been able to realise the goals of all the various patrons of their markets.[74]

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[69] See R. Lee, What Is An Exchange, (Oxford: Oxford University Press, 1998), pp. 17, 28.

[70] See *Ibid*., p. 18. Lee identifies five broad classes into which the owners of a stock exchange may typically be classified: intermediaries, issuers, investors, management, and the state.

[71] See R. Lee, What Is An Exchange, *Ibid*., p. 12.

[72] *Ibid*., p. 14.

[73] See *Ibid*., p. 20. On that page, Lee observes: "Whether exchanges are seen as firms or as markets, their behaviour is also best viewed as the 'outcome of a complex equilibrium process.' Furthermore, it is not only the contractual relationships at an exchange that determine its governance structure. Both an exchange's constitutional arrangements, and some relationships

Lee provides an international and comparative study of the various efforts to integrate stock exchanges in Europe and America.[75] In Europe, for example, the European Commission made the following pronouncement:

> "Work currently in hand to create a European securities market system, based on Community stock exchanges, is also relevant to the creation of an internal market. This work is designed to break down barriers between stock exchanges and to create a Community-wide trading system for securities of international interest. The aim is to link stock exchanges electronically, so that their members can execute orders on the stock exchange market offering the best conditions to their clients. Such an interlinking would substantially increase the depth and liquidity of Community stock exchange markets, and would permit them to compete more effectively not only with stock exchanges outside the Community but also with unofficial and unsupervised markets within."[76]

The views of the European Community here are closely related to our concept of a regional stock exchange and multiple listings in Eastern and Southern Africa. Proposals were made by the European Community to create a EuroList. As Lee observes, the 'EuroList was a proposal to allow the largest companies to be officially and

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determined by neither contractual nor constitutional factors, can be critical in influencing its nature and behaviour. The very multiplicity of these relationships means that conflict is endemic to exchanges."

[74] See R. Lee, What Is An Exchange, *Ibid*., p. 32.

[75] See generally *Ibid*.

simultaneously listed, and thus traded, on all EC stock exchanges.'[77] One of the objectives behind such a 'List' was that the list was perceived to be advantageous to issuers because they would gain a European status by being showcased on the list.[78] It was also expected that companies would have to pay a listing fee for multiple listings, in addition to their national listing fee.[79] Further, each country was expected to choose the domestic companies that it would quote on the European list.[80]

The case of the EuroList and multiple listings in the European Community was expected to lead to increased liquidity and easier access to international markets by investors.[81] It is such goals that underpin our concept of a regional stock exchange in Eastern and Southern Africa. In the case of the European Community, prices of multiply-listed issues would be quoted in their domestic currency, in the currency of the national exchange on which they were quoted, and possibly also in ECU.[82] However, the EuroList project suffered a major set back. The UK saw the EuroList as an attempt by the French, Belgians, and Italians, in particular, to buttress the positions of their national exchanges.[83] In our case, Chapter Four of the thesis explored a number of such threats to the idea of a regional stock exchange and multiple listings in Eastern and Southern Africa. Differences

[76] See Commission of the European Communities (1985:29), quoted in R. Lee, What Is An Exchange, *Ibid.*, p. 69.

[77] See R. Lee, What Is An Exchange, *Ibid.*, p. 71.

[78] *Ibid.*, p. 71.

[79] *Ibid.*, p. 71.

[80] *Ibid.*, p. 71.

[81] *Ibid.*, p. 71.

[82] *Ibid.*, p. 71.

in ideology (and the self-interest agenda of some states), differences in national currencies, and the various levels of economic growth of COMESA member states were some of the factors that retarded the pace of regional integration in Eastern and Southern Africa. Chapter Four spelt some of the ways in which such obstacles could be overcome. Chief among these solutions was the need to generate the necessary political will among COMESA member states for effective financial and economic integration.

In general, the integration of national stock exchanges through multiple listings and a formal regional market would bring about a number of benefits. These benefits include the giving of investors in both countries (where there is dual listing) an opportunity to obtain the best prices in either country for dually listed securities. Also, dual listings and the regional stock market would not only lead to greater liquidity and cost-effectiveness, but would also facilitate faster executions.

(ii) *The case of Eastern and Southern Africa*

It has been acknowledged above that the governance structures of stock exchanges tend to be different. It was noted that different structures may be appropriate for an exchange at different stages of its development. Against this background, an important point must now be made.

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[83] *Ibid.*, p. 71.

While some lessons of experience may be drawn from models such as that of the European Community stock exchange and the francophone West Africa stock exchange,[84] the model for the Eastern and Southern African market need not necessarily replicate any of these models. However, as a strategy for implementation, COMESA member states must only consider the purposes for which a regional stock exchange is to be established. They must also consider the level and degree of regional integration attained by COMESA. This point is important in spelling out the governance structure of the COMESA stock exchange. Indeed, the strategic issues outlined here can also be extended to the promotion of multiple listings. Two possible ways of establishing a regional stock market in Eastern and Southern Africa have already been examined.[85] Prospects of pursuing multiple listings, as a means of setting up an informal regional stock market, and those of creating a formal regional stock exchange were discussed. There is, however, another way in which a regional stock market could be established.

While conceding that many African stock exchanges are facing constraints such as inadequate liquidity, the Chief Executive and General Manager of the Lusaka Stock Exchange is reluctant to accept that the establishment of a formal regional stock exchange, in addition to the promotion of multiple listings, would contribute towards the development of more competitive stock markets in the region.[86] Mr. Mate argues instead that the notion of setting up a regional stock exchange is less attractive than the idea of

[84] See below for a discussion on the francophone West Africa stock exchange.

[85] See above. See also Chapter Four, *supra*.

[86] Electronic mail from Mr. Charles Mate, Chief Executive and General Manager of the Lusaka Stock Exchange, Lusaka, Zambia, 3rd June, 1999.

introducing a COMESA Equity Fund.[87] According to Mr. Mate, the COMESA Equity Fund must be supported by an evolving process of harmonising listing rules in the region.[88] Although Mr. Mate spells out a tentative proposal on possible financial contributions towards the COMESA Equity Fund, he does not explain how the fund would be structured and how and where it would operate from.

In a note to this author, Mr. Mate argues that the setting up of a regional stock exchange would not necessarily stimulate increased liquidity on the stock markets of Eastern and Southern Africa.[89] By contrast, he believes that liquidity is a function of the institutional structure of the market, the number of players in the market, institutional investment, domestic savings, age and stage of development of the market, spread of shares in public hands, microstructure of the market, and other related factors.[90] Laudable as this view may seem, Mr. Mate does not explain the weaknesses of the regional stock exchange idea. He simply provides an alternative view. Although the alternative put foreward by Mr. Mate is a possible route towards integrating capital markets in Eastern and Southern Africa, most of the issues raised by Mr. Mate, say, on the institutional structure of a stock exchange, have already been explored in Chapter Three. We looked at the fact that potential market players such as commercial banks, insurance companies, venture capital funds, building societies, pension funds, and other collective investment schemes have not been active

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[87] See generally, *Ibid*.

[88] See below for a further analysis.

[89] Electronic mail from Mr. Charles Mate, Chief Executive and General Manager of the Lusaka Stock Exchange, Lusaka, Zambia, 3rd June, 1999.

[90] See generally *Ibid*.

participants on the Lusaka Stock Exchange. Mr. Mate's view can, therefore, be querried: where will the number of players and domestic savings come from, and what risk-spreading mechanism are we going to use to spread share ownership since there are very few collective investment schemes on the market? It is in view of such constraints and on the basis of the primary data presented in Chapter Three that proposals for a regional stock exchange and multiple listings are made. Mr. Mate, however, argues that capital markets tend to have a risk profile spectrum.[91] By this, he means that government bonds are on the low risk end, followed by utility bonds and then equities coming in at the high risk end. According to Mr. Mate, the plausible way forward in developing emerging markets would be to start from the low risk end (i.e. government securities market) and gradually building up towards the high risk end (equities). Mr. Mate provides a helpful view that most of the countries in Africa do not have the basic rudiments of a capital market. Specifically, these countries lack a market in government securities.

However, although Mr. Mate argues that the capital market has a risk profile spectrum with government bonds on the low risk end, closely followed by utility bonds, by 1996 there were no utility bonds listed on the Lusaka Stock Exchange. Further, government bonds were only introduced on the stock market in 1998. Interestingly, however, Mr. Mate argues that the setting up of COMESA Equity Fund could be followed by the harmonisation of listing requirement. He believes that harmonisation of listing rules will come as a natural outcome, and that it should not be government imposed or regulation driven. The difficulties associated with such a view are as follows: first, investors do not

[91] See generally *Ibid*.

always act rationally and therefore the evolution of common standards on regulation is not easy to come by; secondly, information on investor behaviour is not freely available; and thirdly, the micro-economic structure of stock markets in the region are not all the same. There is, therefore, an imperative need to intervene and implement consciously the harmonisation of listing rules and other laws. Mr. Mate, none the less, contends:

"Liquidity will increase leading to better price formation, which in turn will create a virtuous cycle as companies and investors become more attracted to the capital market. In short, a COMESA Regional Fund would almost in one go catapult the whole COMESA region into one huge emerging market bloc. For illustrative purposes the subscription to the fund could be:

COMESA [and its partners - IFC, EU etc]	10 million
COMESA countries - say	10 million
Global institutional investors [including African pension funds] - say	20 million
Total - say	US$ 40 million

There may even be an over subscription!

5.2 Harmonisation of Listings Requirements

The SADC countries, including Zambia, have just completed harmonisation of their listings requirements. I am looking forward to this - though I would have preferred a SADC Regional Fund first and then harmonisation."[92]

[92] See generally *Ibid*.

A number of studies and workshops are now being organised in Eastern and Southern Africa to look at possible ways to stimulate increased liquidity and competition on the stock markets in the region.

(iii) *Implications of pursuing a regional stock exchange in Eastern and Southern Africa*

In pursuing the idea of setting up a formal regional stock exchange and promoting multiple listings, it is important to look at the market and institutional implications involved. Generally, a number of implications relate to the impact of regionalism on municipal laws of COMESA member states. We have already examined a number of these institutional and legal implications.[93] Here, we now turn to look at the market implications.

In Chapter Four, it was argued that the establishment of a formal regional stock exchange in Eastern and Southern Africa would lead to more competitive and efficient markets in the region. The development of a regional stock exchange would in turn lead to economies of scale. Chapter Four explained how a regional investment code under COMESA could provide for matters such as: (a) the establishment and structure of the regional stock exchange; (b) the co-ordination of securities regulation between the national stock exchanges and the regional stock exchanges; (c) listing rules on the regional stock exchange; (d) rules to govern cross-listings on the regional stock exchange and the national stock exchanges (*e.g.* rules on disclosure obligations); (e) the competent authority

[93] See above.

for authorising trade on the regional stock exchange; (f) dispute settlement and regulation of securities advertisements on the regional stock exchange; (g) duties of financial intermediaries [at the regional level]; (h) regulation of financial intermediaries and collective investment schemes [at the regional level]; and (i) control of market abuses taking place either on the regional stock exchange or in cross-listings on the regional and the national stock exchanges.

Matched against the Johannesburg Stock Exchange the COMESA regional stock exchange would provide a second pole of growth for other capital markets in the region. Trade would take place across national borders linking the regional stock exchange to national stock exchanges through multiple listings. The promotion of multiple listings and cross-border trade in securities is, indeed, a way in which stock markets in the region could be integrated. However, the downside of this argument is that the Johannesburg Stock Exchange and the regional stock exchange could pose threats as possible monopolies by attracting all the big investors. To avoid such a scenario, there is need to have efficient anti-trust and competitive laws both at the regional and national levels. Also, to integrate markets in the region effectively and to avoid oligarchy, multiple listings must be encouraged. But this will necessarily require not only an efficient legal framework, but also a vibrant banking and financial sector and efficient telecommunications and information systems. In a sense, it could be argued that the market implications of pursuing a formal stock exchange require more pro-active management than those of an informal market. In an informal market scenario, where no common investment code is in place, regulation is less centralised and there is an implied delegation of authority to the national supervisory bodies. Indeed, authorisation of financial intermediaries and other markets players remains a function of the national competent authority. However, as argued earlier, an informal market is not easy to supervise. The weakness in not having an effective enforcement and policing mechanism remains a major drawback.[94] By contrast, Chapter Four explained how, in the case of a formal regional stock exchange, persons desirous of conducting securities business would require authorisation of the regional competent authority. Also, the regional competent authority would have powers to pursue market offenders such as insider dealers. To put this into practice, the pursuit of market offenders could be done in league with the national competent authorities.

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[94] As, A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," op. cit., p.616, observes: "In addition to an increase in regulatory competition, globalization makes enforcement more difficult. In transnational transactions, both information and assets can be spread around the world. If, for example, regulatory authorities wish to investigate a particular transaction, they must gather relevant information often from the parties to the transaction. If one of those parties is located outside the jurisdiction, it may be difficult to gain access to information held by that party. The inability to use domestic legal structures for the gathering of such information may represent a significant impediment to enforcement. The SEC (U.S.) has pursued various avenues in an attempt to improve the international enforcement of securities laws. These efforts have included, for a example, Memorandum of Understanding in which the regulatory authorities in the United States and another country agree to share certain information. The United

(iv) *An example of a regional stock exchange – the case of francophone West Africa*

In an interview with Ms. Alliali, Counsel at the World Bank, who drafted the legal framework for public distribution of securities on the francophone West Africa regional stock exchange, it was observed as follows:[95]

> "*Question 1.* What were the alternative methods proposed or discussed for facilitating the establishment of the regional stock exchange in West Africa?
>
> *Answer.* Either start listing stocks of companies in the other West African countries on the then sole existing Cote d'Ivoire Stock Exchange, or go the regional route and have a unique system of listing with quotations appearing simultaneously on the screens of all local subsidiaries of the BRVM (the regional stock exchange) and orders entered electronically from those same places."

In francophone West Africa, a formal regional stock exchange – and not an informal regional market - was established. This stock market is located in Abidjan, Cote d'Ivoire. As we shall see below, the regional stock exchange in francophone West Africa has performed well so far. This evidence points to a helpful precedent and some lessons of experience on how a regional stock market could be set up in Eastern and Southern Africa. Other responses provided by Ms. Alliali include the following:

States has also supported IOSCO, the International Organization of Securities Commissions, and international body attempting to increase cooperation among securities agencies."

[95] Full text of interview with Ms. Solange A. Alliali, Counsel, Legal Department, the World Bank, Washington DC, USA, 12th April, 2000. Ms. Alliali drafted the law that governs public distribution of securities on the West Africa regional stock exchange.

"*Question 2.* How does the legal framework governing this regional stock exchange provide for:

(a) a system of cross-listing of securities;

(b) a common stock exchange

Answer. ....(b)

Question 2 continued. A discussion of (a) and (b) should include changes in the national securities or corporate laws of member states, if any, that could have been implemented or considered.

Answer continued. This was facilitated by the fact that most company laws (in the francophone West African region) were French inherited and were very similar. It must be observed that the Uniform Law on corporations (for all 16 francophone countries in Africa, central and western states combined) was in the making and was formally adopted prior to the opening of the BRVM."

As an important lesson of experience, the point made by Ms. Alliali on the similarity of most company laws in the region (*i.e.* in francophone West Africa), supports the view we advanced earlier on the importance of harmonising business laws in Eastern and Southern Africa. The harmonisation of business laws could help to promote and facilitate multiple listings on the regional stock exchange and on various national stock exchanges in the region.

It was further observed that:

"*Question 3.* Also, were there any changes in the supervisory frameworks under national law in case 2(a) to ensure proper supervision of trading in multiple-listed securities;

or in case 2(b) changes in national laws to provide for securities to be listed on the regional stock exchange, and to grant appropriate powers to its supervisor, to deal with cross-border trading?

Answer. In case 2(a), it must be noted that in furtherance of the UEMOA treaty which superseded all national applicable laws (this treaty is based and resembles closely the one establishing the European Economic Community), an ad hoc supervisory committee was created (*Conseil Regional des Marches Financiers*). In the case of 2(b), see OHADA Uniform Laws.

Question 4. What inter-state or inter-governmental agreements were used to implement either case 2(a) or 2(b)?

Answer. The *Union Economique et Monetaire Ouest Africaine* formed the umbrella treaty under which the treaty for the creation of the regional stock exchange (*Convention Portant Creation de Marche Financier*) was established for case 2(a), and the Uniform OHADA laws for case 2(b).

Closely related to the approach proposed in this work, on the setting up of a formal regional stock exchange in Eastern and Southern Africa, Ms. Alliali's response here shows that a common investment code was recommended and provided for in the case of the francophone West African stock exchange. However, unlike the proposal in this work that examines various alternatives of how to set up a regional stock exchange, the case of francophone West Africa shows that there were not many alternatives to consider. An important explanation here is that apart from the national stock exchange in Abidjan there were no other stock exchanges in the region.

"*Question 5.* What are the other alternative ways in which a regional stock exchange could have been set up, and what were/are the market implications for pursuing a regional stock exchange formally, or informally i.e. through multiple listing and cross-border trading?

Answer. None that I can think of at the moment. Except for more liquidity and a broader investor base. Some of the companies that are listed on the BRVM were already listed on the second tier market of the Paris Stock Exchange. As you know equity investment is not the preferred type of investments for Africans, even with middle or upper income.

Question 6. To what extent are national rules governing financial intermediaries affected by the establishment of a regional stock exchange? Are there special regional rules for intermediaries on this exchange?

Answer. Yes... the rules for financial intermediaries dealing with the Exchange have been adopted as part of the regional framework.

Question 7. What are some of the constraints facing the regulatory framework for public distribution of securities on this regional stock market?

Answer. They are many...Broadly speaking, it was about making sure that the companies were 'functioning properly,' were in existence for sometime before going public, had regular mandatory financial auditing, good corporate governance, could deal with increased reporting requirements ,...etc."

Again, this view provides some important lessons on the types of problems that could be faced when regulating securities on a regional stock exchange and in cross-boarder transactions. We have already examined issues such as information disclosure in the case of multiple listings and cross-boarder trade in securities.

"*Question 8.* Would you say this regional stock market has performed as expected at inception? If Yes, explain why. If No, explain why.

Answer. From what I've heard, it has been staffed with people that are not market specialists. Still despite problems among the people there (the Canadian manager- appointee resigned recently after a year there without disclosing the reason behind his resignation, among other things), the market was very active in the beginning, but has now slowed down considerably due to a severe lack of liquidity.

Question 9. Has the regional stock exchange attracted more capital than the national stock exchanges?

Answer. It is hard to tell because only one country (Cote d'Ivoire) had a national Exchange before.

Question 10. Has there been any evidence of insider dealing or other malpractice on the regional stock exchange, and if so what would you attribute this to?

Answer. I do not know.

Question 11. Who drafted the law for the regional stock exchange and where was the model adopted from?

Answer. I did..., as I was under contract from the West African Central Bank which was officially appointed implementing agency and promoter of the project. In view of (i) the existing legal framework already existing in each of these countries, (ii) France being by far the biggest contributor (70% of the financing), and time constraints (due to the approximate year and a half time frame that the Bank thought would be needed to achieve a consensus by all concerned countries regarding the legal changes mentioned earlier) the prevailing model was adopted from the legal framework governing trade on the French Stock Exchange (to my regret) as was then existing (In fact, I argued strongly in favour of creating the African system taking into account the financial directives issued by the EEC which France had not even started implementing and which would have created a modern Exchange from the outset, even well in advance of France). But wisdom is African as they say and they wanted what was there and that they could see with their own eyes. This resulted in; (a) discrimination amongst financial intermediaries on who could deal on the exchange as opposed to the regular commercial banks (although the separation is now extinct in France by virtue of the said directive); and (b) imposing (at least, I heard that it was never in fact implemented) a specific duty on all transactions etc. However, after the skeleton drafts were submitted as per terms of reference for the project, a number of changes were made by the in-house counsels for WACB, in great part to accommodate countries' wishes prior to the signing of the convention establishing the Exchange which had to be ratified by each parliament.

Question 12. Has this regional stock exchange law proved successful?

Answer. So far, and as I have said before, it seems to be functioning quite satisfactorily."

Although Ms. Ailliali points out that, so far, the francophone West African regional stock exchange has performed well, it is not easy to tell - with certainty - the successes or failures of that market since the market is in its early stages of development.

(v) *The propriety of the institutional structure of COMESA in facilitating the establishment of a regional stock exchange in Eastern and Southern Africa*

I have examined elsewhere the objectives and institutional structures of COMESA and SADC.[96] Here, it is argued that COMESA is better suited to facilitating the establishment of a regional stock exchange. Drawing an analogy with the regional stock exchange in francophone West Africa, it is argued that although West Africa as a region has had several regional bodies, including the Economic Community of West African States (ECOWAS), francophone West African states have found comparative advantage in uniting among themselves to form the regional stock exchange. There are various reasons that explain this feature. A notable argument is that most francophone West African states have the same monetary currency and that this makes it easier for them to move towards financial and capital markets integration. Another reason is that francophone West African states have a similar legal and historical background. Indeed, they have borrowed heavily from their colonial master, France. This makes it easier for them to have regional laws on financial dealings. However, while collective investment schemes have played an active role in investing in securities on the BRVM, insurance companies, on the other hand, have continued to draw away potential capital from the stock market due to their attractive insurance policies.[97]

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[96] See Chapter Four of this thesis. See also generally K.K. Mwenda, Legal Aspects of Corporate Capital and Finance, (Washington DC: Penn Press, 1999), pp. 102-156; K.K. Mwenda, "The Law On Regional Integration in Southern and Eastern Africa: Threats and Prospects," SA Public Law Journal, Vol. 12, No. 2, (1997); and K.K. Mwenda, "Legal Aspects of Regional Integration: COMESA and SADC on the Regulation of Foreign Investment in Southern and Eastern Africa," African Journal of Comparative and International Law, Vol.9, Pt.2, (June 1997).

[97] *Interview* with Ms. Solange A. Alliali, Counsel, Legal Department, the World Bank, Washington DC, USA, 15th June, 2000.

Apart from the foregoing, the treaty establishing the *Organisation pour l'Harmonisation en Afrique du Droit des Affaires* (hereinafter referred to as the OHADA Treaty) in October 1993 provides another basis upon which these countries have managed to harmonise their laws. [The OHADA Treaty], as Ofosu-Amaah notes,[98] represents the culmination of a long-standing wish of 16 countries, all of whom belong to the CFA Franc Zone, with the exception of Equatorial Guinea and Guinea Bissau, to promote further economic integration through the adoption of a business law framework. This framework is expected to spur on increased business activities so as to improve the economic fortunes of the OHADA member countries. The central objective of the [treaty] is therefore to harmonise business laws in the region.[99] Indeed, uniform commercial codes are to be prepared and adopted pursuant to the [OHADA Treaty].

By contrast, although anglophone West African states had national stock exchanges even before the francophone West African regional stock exchange was set up, the former states have not taken notable steps towards financial and capital markets integration. National currencies of anglophone African countries are different and so are their general ideological pursuits. By comparison, in Eastern and Southern Africa a number of states have been long standing members of COMESA and SADC. Both COMESA and SADC are relatively stable institutions and this provides the member states of COMESA with an opportunity to engage in synergy through the establishment of a regional stock exchange and the promotion of multiple listings. Besides, COMESA has had in place a regional

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[98] See W.P. Ofosu-Amaah, Reforming Business-Related Laws to Promote Private Sector Development, *op. cit.*, pp. 43-47.

[99] See generally *Ibid*.

monetary instrument known as UAPTA.[100] UAPTA is used mainly as travellers cheques and it was introduced by the then PTA about a decade ago. In addition, a PTA clearing house was set up in Kenya, Nairobi.[101] Overall, there is no doubt that COMESA has better established networks and institutions than SADC. It is this comparative advantage that places COMESA in a favourite position.

Apart from the above reasons, COMESA has had a long standing objective of pursuing trade and market creation in Eastern and Southern Africa. SADC, on the other hand, has historically grown as a development co-ordination organisation. However, although the objectives of SADC and COMESA now overlap, COMESA has a larger number of member states. COMESA has also made significant progress in moving towards removing trade barriers in the region. It has further undertaken feasibility studies on prospects for setting up a regional stock exchange. However, although there is no evidence on efforts being made by COMESA to follow up on these studies, COMESA remains a favourite. Both the treaty establishing COMESA and its predecessor, the PTA Treaty, advocated for the introduction and development of institutions such as the regional stock exchange. By contrast, there is no such provision in the SADC Treaty.

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[100] As time draws closer towards the official commissioning of a free trade area in the COMESA region (scheduled for October 2000), there is also talk of changing the name of the financial instrument 'COMESA UAPTA' to 'COMESA dollar'. See the following web sites, visited on June 10, 2000:
<<http://www.comesa.int/trade/tradftao.htm>>; and << http://www.comesa.int/home1024.asp>>.

[101] See generally materials on the following web site, visited on June 10, 2000:
<<http://www.comesa.int/home1024.asp>>.

8.5. CONCLUSION:

This chapter has provided an overview of the arguments made in the thesis. In the main, the thesis argued that faced with various constraints the legal framework for public distribution of securities in Zambia has not had much success in facilitating the development of a competitive stock exchange. To overcome this problem, it was argued that a regional stock exchange should be established in Eastern and Southern Africa. As the Chairman of the African Stock Exchanges Association observes:

> "African stock markets should integrate if they are to become efficient sources of investment capital...Integration will improve liquidity by providing a larger market from which to tap capital for investments. A workable option would be to combine forces at the regional level before the eventual creation of a single stock market for the continent with the Johannesburg Stock Exchange as the pivot... Pension funds are major players in capital markets. Private sector pension funds will ensure that contributors are free to participate in socio-econo-political reforms."[102]

Indeed, with the exception of the Johannesburg Stock Exchange (JSE), most of the stock exchanges in Africa are relatively small and they lack liquidity.[103] The JSE is Africa's largest and most vibrant stock market accounting for over 90 per cent of the total market capitalisation of sub-Saharan Africa and over 76 per cent for the entire continent.[104]

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[102] See the Daily Nation Newspaper, (Nairobi, Kenya, Wednesday, November 3, 1999), financial news page.

[103] See generally, *Ibid*. See also Chapter Three, *supra*.

In making a case for a regional stock exchange in Eastern and Southern Africa, we looked at other examples of cases dealing with the setting up of a regional stock exchange. We looked at examples from francophone West Africa and the European Union. It was argued that the transplant of models from one region to another should be discouraged. Instead, a pragmatic approach of dealing with cases such as that of the regional stock market in Eastern and Southern Africa, on a case by case basis, would more appropriate. And each case should be dealt with on its own merits.

While some lessons were drawn from cases of the francophone West African regional stock exchange and the attempt by the European Union to introduce a regional stock exchange, COMESA member states should develop a regulatory framework based on their own needs. It is, however, interesting to note that commentators such as Guzman favour the idea of transplanting legal models from one jurisdiction to another, arguing that such models have been tested in other countries and have proved successful. As we shall see below, this is a short-sighted view. Guzman, however, argues:

> "It has taken developed countries many years to develop their capital market regulations and there is little reason to think that a developing country could develop its own rules more quickly or without confusion, uncertainty, and crises."[105]

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[104] See _supra._, (n.103).

[105] A. Guzman, "Capital Market Regulation in Developing Countries: A Proposal," _op. cit._, pp. 621-22. Other arguments advanced by Guzman include the view that corruption in developing countries could prove to be an impediment in the enforcement of legal rules dealing with cross-border transactions. But is there a society that is free of corruption? What Guzman should have

A response to Guzman's assertions can be best undertaken by turning to Ofosu-Amaah's work on legal reform in Africa. In a strikingly instructive note, Ofosu-Amaah, commenting on legal reform in Ethiopia, observes:

> "No review of legal reform in Africa in the past 40 years would be complete without a reference to the legal reforms undertaken in Ethiopia during the 1950s and 1960s... Many studies and law review articles have been written on these new laws (general codes) promulgated in Ethiopia between 1957 and 1965, especially because the methodologies used, the process followed, and the objectives for the law reform exercises, were unique. In each case, a process was designed that was intended to use the law as a tool for social engineering in order to improve the development prospects of the country. In so doing, it was intended that the best out of the external systems of law and practices that appeared to have worked in those societies would be transplanted to Ethiopia. Such laws were, however, supposed to be adapted to the new socio-political milieu in Ethiopia... Although the point of adaptation was stressed and the importance of infusing Ethiopian traditions and culture into the laws was an objective, it was clear that those who were responsible for the new codes were guided by the keen desire of modernisation rather than by attempts to infuse traditional practices and values. Indeed,...'after a general meeting of the Commission established to oversee the civil codification, the expert then retired to the privacy of his workroom, located in Paris, to do the actual drafting'."[106]

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addressed were the various incentives and disincentives that arise under different levels and contexts of corruption.

[106] W. Paatii Ofosu-Amaah, Reforming Business-Related Laws to Promote Private Sector Development, *op. cit.*, pp. 15-16.

It is in view of such human failings that a notorious question comes to the fore now: but, when will they ever listen?[107] As Ofosu-Amaah observes, the case of Ethiopia shows that the Civil Code, drafted in Paris, was not even well known to the judges in Ethiopia. Clearly the 'law of nontransferability of law'[108] was negated and violated. There is need therefore to engage local expertise when undertaking legal reform for often a time the locals have valuable information on the peculiar issues pertaining to a particular environment. However, a trade-off is necessary in order to achieve optimal efficiency; that is, should foreign consultants and experts be seen as the sole stewards of best practices and wisdom on law reform, or should there be a reasonable blend of foreign expertise and local participation? In Africa, a number of so-called 'experts' have emerged from the use of foreign consultants. Most of these consultants have dubious professional backgrounds and their career record is virtually unknown. The unfortunate bit, though, is that Africa remains a testing ground for inferior knowledge from the West. We have seen how some inexperienced foreign consultants have become big sharks on Africa and how they now claim to posses divine knowledge on matters pertaining to the continent. However, although some foreign consultants may possess the requisite expertise, they, too, must re-educate and acquaint themselves with the host country-specific conditions. To do so, they must work jointly with the local experts and be ready to learn about matters that are peculiarly tied to the context of the host environment. Indeed, this underpins the importance of having both foreign and local consultants participate on legal reform

[107] That is, the proponents of legal model transplants.

[108] For an elaborate discussion on this, see generally W. Paatii Ofosu-Amaah, Reforming Business-Related Laws to Promote Private Sector Development, *op. cit*.

projects. In the same vein, the balancing of management skills and technical competencies among team members is vital.

Apart from the proposal to set up a regional stock exchange in Eastern and Southern Africa,[109] the thesis argued in favour of promoting multiple listings and cross-border trade in securities. Multiple listings could provide an alternative window through which to integrate national stock exchanges. The thesis argued that the regional stock exchange could be set up under the auspices of COMESA, and that it would co-exist with the national stock exchanges. It was argued that such a development would lead to economies of scale and to integration of capital markets. In turn, the integration of markets would lead to enhanced liquidity levels and to development of more competitive stock markets in the region.

[109] In particular, the thesis addressed the setting up of a regulatory framework for public distribution of securities on the regional stock market.